Role of the Regulator in Controlling Investments

A Case Study of Experiences in Indiana

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October 18, 2005
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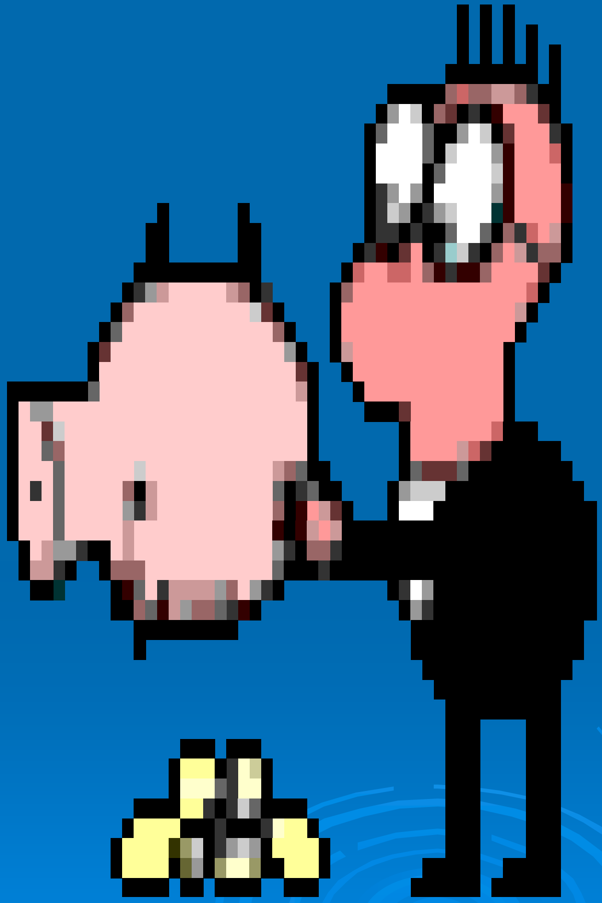
Overview of Two Case Studies

-Restrictions on Utility Actions-

- **Cause No. 42292, Indianapolis Power & Light**
  - Restrictions on passing funds to Corporate Parents.
- **Cause No. 42194, Northern Indiana Public Service Company**
  - Prohibition on planned closing of maintenance hubs that would have resulted in cost savings.



Indianapolis Power & Light
-Financing Case Study-
Background

- ***IPL was acquired by AES in 2001***
  - Following acquisition, IPL encountered service quality problems that resulted in a Commission Investigation.
- ***AES suffered financial distress***
  - The share price of its stock plummeted.
  - Led to concerns regarding the possible impact that AES’ financial difficulties could have on IPL.

Corporate Structure of Indianapolis Power & Light

AES

Parent Corporation

↓

IPALCO

Holding Company

↓

IPL

Local Regulated Electric Utility

Indianapolis Power & Light
-Financing Case Study-

- **Cause No. 42292, filed September 19, 2002**
  - Request for approval of a $380 million Financing Program.
  - $160,000,000 in indebtedness, in the form of Bonds, for an ongoing construction program and to reimburse treasury for funds previously expended;
  - $210,650,000 to retire, refund, or redeem outstanding debt issues;
  - $10,000,000 in Capital Leases.

Statutes Applicable to Commission Review of Utility Investments

- Limitation on Issuance of Stocks and Bonds by Utilities. Ind. Code 8-1-2-76.
- Consideration of Utility Stocks and Bonds- Approval by the Commission. Ind. Code 8-1-2-77.
- Approval of Commission for Issuance of Stocks and Bonds- Limitations. Ind. Code 8-1-2-78.
- Petition for Sale of Securities-Investigations- Penalty for Misrepresentation. Ind. Code 8-1-2-79.
- Authority to Issue Stocks, Bonds, or Notes- Certificate Contents and Conditions. Ind. Code 8-1-2-80.

Indianapolis Power & Light
-Financing Case Study-

- **During the Proceeding the OUCC indicated that:**
  - Financial troubles with IPL's parent companies may lead to cash outflows from IPL (through dividends or loans) that might result in insufficient cash to allow IPL to provide reasonably adequate service or maintain an appropriate debt to equity ratio.
  - The Commission should prohibit IPL from providing loans to AES or IPALCO without prior Commission approval.
  - IPL should not be allowed to pay dividends to its parent companies in an amount greater than its earnings.

Indianapolis Power & Light
-Financing Case Study-

- **IPL Also Recognized AES' Impact on the Utility.**
  - IPL's credit rating had fallen significantly due to AES' financial troubles.
  - There was concern by the investment community that IPL's parent companies might extract cash from IPL in an amount that would jeopardize IPL's current financial position.
  - While IPL agreed that some amount of dividend payment might be excessive it contended that the Utility's management should make this decision and that the Commission should not interfere.

Indianapolis Power & Light
-Financing Case Study-

- **Pursuant to IC 8-1-2-80**
  - "The commission shall have such power to impose such conditions upon a public utility in issuing securities as it may deem reasonable."
- In this case, where the unregulated ultimate parent of a major Indiana utility was in financial distress, the Commission found that it was appropriate to assert its authority under this statute and impose certain restrictions with respect to the requested financing.

Indianapolis Power & Light
-Financing Case Study-

- **Restrictions Imposed by the Commission.**
  - IPL was prohibited from making loans to any corporate parent without prior Commission approval.
  - IPL was required to provide annual reports to the Commission to demonstrate that capital expenditures exceeded its additional long-term borrowings.
  - IPL was required to place proceeds from any new long-term borrowings into a restricted account to only be utilized to pay for its capital expenditures.
  - IPL was prohibited from making dividend payments to its common shareholders that exceeded a predetermined Leveraged Ratio.

Indianapolis Power & Light
-Financing Case Study-

- **The Commission also found that prior to declaring or paying any dividend, IPL should file a report that details:**
  - The amount of the proposed distribution.
  - The amount of dividends distributed during the prior twelve months.
  - An income statement for the same twelve-month period along with IPL's most recent balance sheet, and
  - IPL's capitalization as of the close of the preceding month, as well as a pro forma capitalization giving effect to the proposed dividend, with sufficient detail to indicate the amount of unappropriated retained earnings.

Indianapolis Power & Light
-Financing Case Study-

- **Impact of Decision**.
  - The Commission found that If within twenty (20) calendar days of the filing of IPL's report, it does not initiate a proceeding to further explore the implications of the proposed dividend, the proposed dividend is deemed approved.
  - The approval process will remain in effect during the term of the financing authority, which expires December 31, 2006.
  - IPL has filed reports required by the Order and it has not been necessary for the Commission to take any action in response.

Northern Indiana Public Service Company
-Local Operating Area Case Study-

- **Cause No. 42194, Northern Indiana Public Service Company**
  - In March 2002, Northern Indiana Public Service Company ("NIPSCO") began efforts to close maintenance facilities located in five Local Operating Areas ("LOAs") in Northern Indiana.
  - LOAs contain equipment and supplies used by road crews to repair and maintain NIPSCO's electric and gas utilities.

Northern Indiana Public Service Company
-Local Operating Area Case Study-

- Under its *Consolidation Model* NIPSCO intended to consolidate its 12 maintenance facilities as a money-saving measure. The plan called for closing maintenance hubs in Hammond, Crown Point, LaPorte, Plymouth, and LaGrange and consolidating operations with hubs in Gary, Valparaiso, Angola and Goshen.
- In conjunction with closing these maintenance hubs, in order to maintain customer service, NIPSCO planned to utilize an *Area Service Model* and dispatch repair personnel from their homes.

Northern Indiana Public Service Company
-Local Operating Area Case Study-

- **Chronology of Events**
  - On March 8, 2002, the LaPorte County Board of Commissioners and the City of Michigan City filed an Emergency Petition with the Commission in which they alleged that closing these LOAs would constitute an unsafe practice or act by unnecessarily jeopardizing public safety and customer service.

Northern Indiana Public Service Company
-Local Operating Area Case Study-

- **On March 15, 2002, the Commission issued an Emergency Order.**
  - The Order required NIPSCO to cease taking any actions in furtherance of its planned maintenance office closings and service district expansion until a preliminary review could be completed by the Commission.
  - The Commission conducted a Prehearing Conference and Preliminary Hearing on April 10, 2002 and issued an Order on April 24, 2002. In its April 24, 2002 Order, the Commission determined that the LOAs should remain open pending a full Evidentiary Hearing on the issues.
  - NIPSCO appealed the Commission's Order to the Indiana Court of Appeals which affirmed the Commission's decision.

Northern Indiana Public Service Company
-Service Center Case Study-

- **Concerns of Petitioners at Evidentiary Hearing.**
  - Closing LOAs would increase response times and create public safety issues.
  - NIPSCO did not undertake any study or analysis to evaluate the impact that closing these facilities might have on its service quality.
  - NIPSCO would save $140,000 per week in operating expenses by closing five LOAs, but that fact alone does not support approval of the program.

Northern Indiana Public Service Company
-Service Center Case Study-

- **NIPSCO’s Position Regarding the Complaint**
  - NIPSCO’s LOAs have historically been reconfigured from time to time to respond to changes in the service needs of NIPSCO's customers, consistent with furnishing safe and reliable gas and electric service.
  - The Company's Consolidation Model was a result of the implementation of the Area Service Model which should result in quicker response times.
  - NIPSCO would not have developed, devised or implemented a business structure or practice that jeopardize the health and safety of NIPSCO's employees or customers.
  - This is an issue to be addressed by NIPSCO’s management and the Commission should not interfere.

Northern Indiana Public Service Company
-Service Center Case Study-

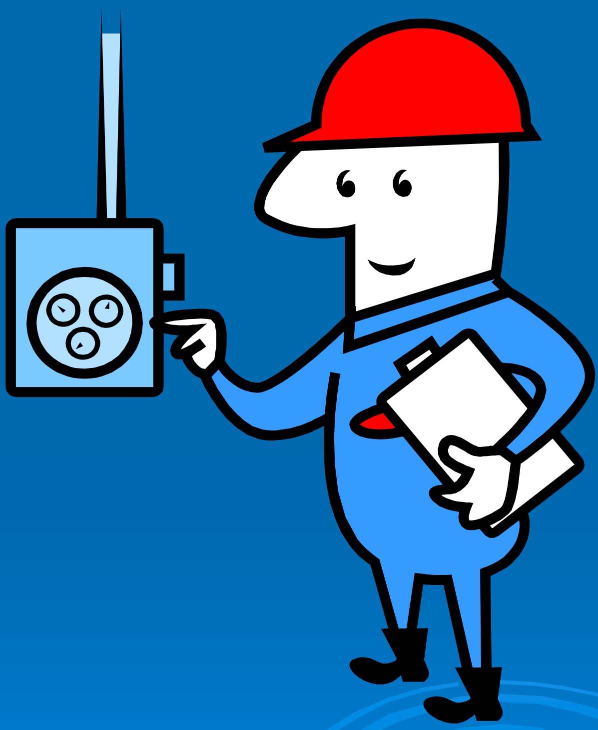
- ***Overview of Issue by the OUCC***
  - "I think NIPSCO has attempted today to present their evidence in support of this as a service enhancement plan where I think it is clear to all of us that this is really a business plan. It is about saving money."
  - The OUCC confirmed that although NIPSCO has a right to save money and make management decisions, it was clear from the evidence that there are "serious reliability issues" and "serious safety issues" involved.

Northern Indiana Public Service Company
-Service Center Case Study-

- ***Statutory Authority to Review Issue***
  - Indiana's Public Utility Act grants this Commission the authority to initiate investigations into a public utility's practices or acts affecting its service that are unreasonable, unsafe, insufficient, discriminatory, or inadequate. Ind. Code § 8-1-2-54.
  - If that investigation reveals that a public utility's practices or acts are unreasonable, unsafe, insufficient, discriminatory, inadequate or otherwise unlawful, this Commission may, by order, fix just and reasonable practices and acts. Ind. Code § 8-1-2-69.

Northern Indiana Public Service Company
-Service Center Case Study-

- ***Overview of Commission Findings***
  - While an area serviceman may be able to promptly respond and address many problems that may arise, more serious problems cannot be addressed by the area serviceman alone.
  - If a serious problem occurs, it is important that area servicemen have the necessary and timely support of additional crews who have the necessary equipment readily available.

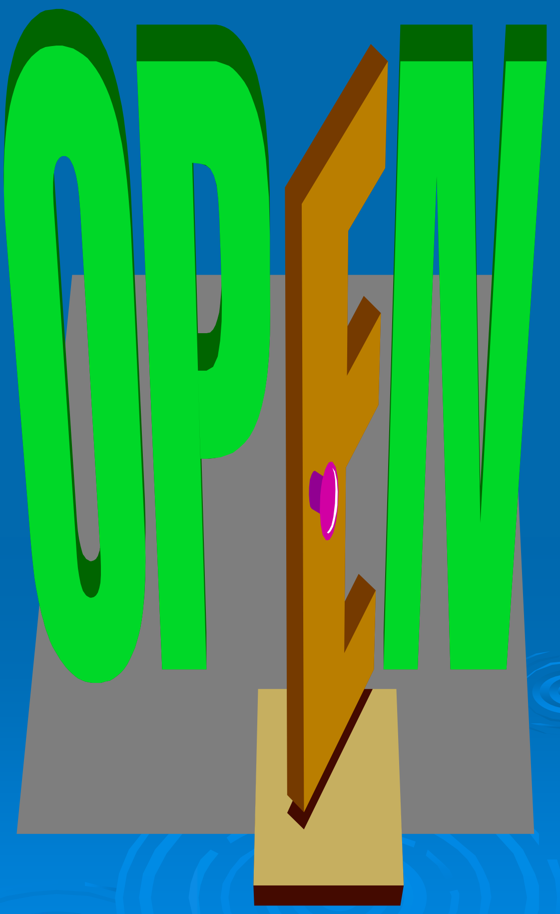


Northern Indiana Public Service Company
-Service Center Case Study-

- ***Overview of Commission Findings***
  - While the Consolidation Model, as originally conceived, was to be based on careful research and analysis prior to its implementation, it seems that NIPSCO ultimately bypassed the research and analysis component in favor of moving directly to anticipated cost savings of $140,000 per week.
  - NIPSCO, as a regulated utility in the state of Indiana is responsible for the day to day management of its operation, and the Commission will not attempt to substitute its judgment for that of a utility subject to our jurisdiction. However, we would expect that an issue as important and potentially far reaching as the planned consolidation of existing facilities and personnel would only occur following careful and thorough review of the numerous and complex issues associated with the proposal.

Northern Indiana Public Service Company
-Service Center Case Study-

- ***Overview of Commission Findings and Appeal by NIPSCO***
  - The Commission found that the Area Service Model should continue to be used in conjunction with appropriate support from the LOAs in order to avoid possible degradation of service quality in NIPSCO's service territory.
  - The Commission determined that NIPSCO should not proceed with the closings of any of the LOAs as a result of the complaint proceeding.
  - NIPSCO has appealed the Commission's decision to the Indiana Court of Appeals.



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