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STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: **INTERSTATE POWER AND LIGHT COMPANY**	**DOCKET NO. RPU-2009-0002** **REPLY BRIEF**

REPLY BRIEF OF
<u>THE IOWA CONSUMERS COALITION</u>

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Pursuant to the Rules of Practice and Procedure of the Iowa Utilities Board ("Board") and the Board's April 13, 2009 "Order Docketing Tariff, Establishing Procedural Schedule, and Scheduling Additional Consumer Comment Hearing," as modified by the Board's September 14, 2009 "Order Modifying Briefing Schedule," the Iowa Consumers Coalition ("ICC") respectfully submits its Reply Brief.

I. Introduction and Summary

Interstate Power & Light Company ("IPL") has failed to justify its proposed revenue requirement. Consequently, adjustments to IPL's proposal are required to make its revenue requirement and the resulting retail electricity rates just and reasonable. In this Reply, ICC addresses several of IPL's arguments set forth in IPL's Initial Brief.

Specifically, with respect to transmission expense, ICC shows that IPL's "Legal Authority" discourse does not address the fundamental question raised by ICC in its Initial Brief – namely, whether IPL should be permitted to collect over a four-year period the $46.9 million true-up for its 2008 transmission expense while simultaneously proposing an adjustment to its 2008 test year transmission expense that recognizes that very same true-up. Allowing IPL's retail revenue requirement to reflect only IPL's 2008 actual transmission expense (the book amount trued-up with the $46.9 million), as proposed by ICC, in no way interferes with the Federal Energy Regulatory Commission's ("FERC") ratemaking authority over ITC-Midwest ("ITCM"). In sum, the "Legal Authority" discourse offered by IPL is a red herring that can safely be ignored by the Board.

Additionally, IPL has still failed to demonstrate any need or basis for calculating its cash working capital needs based on a 24.3-day revenue lag delay. Similarly, IPL has failed to show in its Initial Brief that IPL's proposed inclusion in its revenue requirement of the costs associated with accelerated meter depreciation, future recovery of the cancellation costs of Sutherland Generation Station Unit 4 ("SGS4") and the Variable Pay Plan costs is justified.

ICC also demonstrates that Mr. Gorman's recommended return on common equity ("ROE") remains reasonable, credible, justified, and supported by the evidence. The Board should approve an ROE no higher than 10.0%, as recommended by Mr. Gorman.

Concerning rate design, IPL's arguments for the transmission automatic adjustment clause are wholly unpersuasive. IPL also has offered nothing in its Initial Brief that justifies imposing costs on Standby customers as if they were always on the system at the time of the system peak; IPL's approach in that regard is simply not consistent with how transmission systems are planned and developed.

Finally, ICC emphasizes that a reasonable management penalty should be incorporated into the return on equity as a consequence of the underlying causes of the massive transmission rate increases that IPL seeks to impose in this case. ICC again demonstrates that these increases are the result of IPL management decisions, and that it is appropriate to impose a penalty through an adjustment to ROE to provide an incentive to IPL management and shareholders to better manage transmission expense.

II. Argument

A. Revenue Requirements

1. Transmission Expense

a. IPL's Position

IPL contends that it is claiming the proper level of transmission expenses that should be included in its revenue requirement. IPL explains that there are three adjustments to the 2008 test year booked transmission expense to establish a proper level of transmission expenses: 1) the increase in costs that IPL will incur during 2009; 2) the 2008 true-up amount that will be reflected in ITCM's 2010 rate level; and 3) the increase to ITCM's 2010 rate level.[1]

With respect to the first adjustment (the increase in costs related to the ITCM 2009 tariff rate for network transmission service), IPL contends that ITCM's 2009 tariff rates are "known and measurable" and commenced on January 1, 2009.[2] The 2009 ITCM tariff rates represent a $58.4 million (Iowa retail portion) increase over IPL's 2008 book transmission expense. Similarly, IPL states that the second adjustment (the true-up for 2008 transmission expense) also is currently known and measurable because it is the difference between ITCM's actual costs of providing network transmission service and the revenues it actually collected.[3] The total true-up that IPL is claiming is $46.4 million, which IPL proposes to amortize into four annual sums of $11.6 (as noted in our Initial Brief, the $46.4 million is the revised true-up; the original claimed

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[1] IPL Initial Brief at 31.

[2] *Id.* at 32.

[3] *Id.*

true-up was $46.9 million; for ease of reference, we will continue to refer to the $46.9 million when addressing the true-up for 2008 transmission expense). Alternatively, IPL proposes as its "preferred alternative proposal" to off-set the true-up costs with a portion of the regulatory liability account that was established in the proceeding on IPL's sale of its transmission system to ITCM (Board Docket No. SPU-07-11).[4] Finally, IPL's third claimed adjustment is for the IPL-calculated increase in expenses related to transmission service in 2010. IPL claims that these expenses are known and measureable because ITCM posted its transmission network service rate in Attachment O for 2010 in September, 2009.[5] IPL contends that the Board must allow these amounts in its revenue requirement because they are FERC-approved charges. In support of its arguments, IPL provides a ten-page "Legal Authority" section.[6]

b. LEG's Position

LEG states that it supports IPL's proposal to amortize ITCM's true-up of the 2008 transmission expense, as long as the costs are verified and accurately allocated to IPL's retail customers. LEG does not support IPL's "preferred alternative proposal" to collect those costs from the transmission sale regulatory liability account, because it sees refunds from that account as a separate issue that should not be tied to the true-up recovery.[7]

c. Reply

ICC maintains its position that the 2009 and 2010 costs are uncollectable because they are not known and measurable. ICC similarly disagrees with IPL and LEG with respect to the

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[4] *Id.* at 33.

[5] *Id.*

[6] *Id.* at 50-60.

[7] LEG Initial Brief at 24-25.

amortization proposal because those costs are already reflected in the proposed increase to the 2009 rates, and should be reflected as an adjustment to the test year revenue requirement.[8]

IPL's "Legal Authority" section is interesting, but ultimately it is not dispositive. The focus of the "Legal Authority" discourse is on the filed-rate doctrine and federal preemption of state authorities with respect to FERC-approved rates, the upshot being that states may not interfere with FERC-jurisdictional approved rates. But ICC has not asked the Board to disallow ITCM's costs – indeed, ICC begrudgingly accepts the trued-up 2008 ITCM costs of $133.1 million ($86.2 million in pro forma costs for the 2008 test year plus $46.9 million for the true-up for 2008 actual transmission costs). ICC does, however, object to piling on to that test year amount the speculative amounts for 2009 and 2010, as well as the double-counting resulting from the four-year collection of the $46.9 million. This comes down to an issue of timing, which IPL's multi-page legal discourse simply does not address. In sum, we have not asked the Board to disallow the ITCM rates, nor have we impermissibly challenged them here (even if we do think they are excessive). Rather, we are asking the Board to allow in IPL's revenue requirement only those costs that are known, measurable and verifiable for the 2008 test year. None of the cases cited or discussed by IPL in its "Legal Authority" section prohibits what ICC has asked the Board to do. IPL is correct that the Board gave up its jurisdiction to set wholesale transmission rates for the facilities now owned by ITCM when it approved the sale of those facilities by IPL to ITCM. But the Board did not relinquish its exclusive jurisdiction to determine the revenue requirement for retail electricity service; nothing in the loss of that jurisdiction requires the Board to turn a blind eye toward the proper components of IPL's retail revenue requirement.

[8] *See* ICC Initial Brief at 5-14.

IPL's "Legal Authority" section also includes several pages on the distinction between "final" and "interim" rates, apparently in an attempt to discredit ICC's witness Mr. Brubaker.[9] Specifically, IPL explains that "interim" rates are "final" for purposes of application of the filed-rate doctrine. But as Mr. Brubaker made clear in responses to questioning on redirect, he was using the concept of "interim" rates as meaning rates that are subject to true-up.[10] Nor does the filed-rate doctrine's treatment of "interim" rates address the issue of ***when*** those rates should be included in IPL's revenue requirements, which was (and is) Mr. Brubaker's main contention. As Mr. Brubaker made clear on cross-examination: "I don't think we should be dealing here with rates that aren't actually finally determined as the revenue requirement that's been approved."[11] Mr. Brubaker further elucidated: "It's a function of the timing of your [IPL's] rate proceedings and how successful you are in dealing with ITC-Midwest in terms of their level of expenditures and how that ultimately translates into rates."[12] The issue is thus one of how the Board establishes IPL's retail rates, not interference with FERC-approved rates under the filed-rate doctrine: "And that's not uncommon in a rate case to have pro forma adjustments, and you go forward in time, and some costs go up, some costs go down, revenues grow. All kinds of things change. That's why we have a test year. That's why we try to stick with known and measurable costs."[13] Because the costs beyond the 2008 test year are not fully known, measurable and verifiable, the Board has no obligation to adjust the revenue requirement established for the 2008

[9] IPL Initial Brief at 57 (citing Tr. at 1324-25 (Brubaker), 1327 (Brubaker)).

[10] Tr. at 1343:10-1344:2 (Brubaker).

[11] Tr. at 1325:21-24 (Brubaker).

[12] Tr. at 1328:13-17 (Brubaker).

[13] Tr. at 1329:14-19 (Brubaker).

test year. The trued-up 2008 transmission expense is the amount that should be used to establish IPL's retail revenue requirement in this case.

The use of the trued-up 2008 transmission expense also will help avoid overcharging retail customers should transmission expenses subsequently decrease from the levels that IPL proposes to establish here. If necessary, IPL can file subsequent rate cases to demonstrate increases in its transmission expense from the level established for the 2008 test year (*i.e.*, the trued-up 2008 transmission expense). Such an approach respects the principles established in the filed-rate doctrine. In sum, nothing in ICC's proposal infringes on FERC's exclusive jurisdiction over ITCM's rates or violates the filed-rate doctrine; rather, ICC seeks to have the Board vigorously exercise its exclusive jurisdiction to regulate IPL's retail revenue requirement.

Equally disconcerting is IPL's apparent misunderstanding of its own transmission expense claims. First, as discussed in ICC's Initial Brief, and noted above, IPL's proposal concerning the $46.9 million true-up results in an over-collection since the full actual costs of transmission service for 2008 is reflected in the increase to the 2009 ITCM rates. Now IPL has apparently lost track of additional sums, as revealed by its contention that it "will never be able to" recover approximately $15 million of the increase in IPL's costs from 2008 to 2009 "[s]ince IPL was not able to implement interim rates until the end of the first quarter."[14] This is an unbelievable claim given the fact that this very cost is reflected in IPL's proposed adjustment to the test year revenue requirement.[15] Thus, the Board should not be misled by IPL's assertion that "[i]f the Board accepts the ICC's proposal, the whole amount of this large $50 million under-

[14] IPL Initial Brief at 120 n.58.

[15] *See, e.g.*, Exhibit MEB-4; ICC Initial Brief at 6-7, 13-14.

billing that occurred in 2008 will be reflected in final rates that are established in this case, as compared to IPL's proposal which would amortize the amount."[16] IPL implies that this is an "either / or" proposition, with IPL proposing an approach with a smaller rate impact. But IPL's four-year amortization is hardly the benign approach that it makes it out to be, simply because that "large $50 million under-billing" is also reflected in IPL's proposed adjustment for the 2009 ITCM rates. The sounder, less harmful approach would be, as ICC recommends, to allow the "large $50 million under-billing" as an adjustment to the 2008 test year booked transmission expense, and stop the adjustments there.

2. Revenue Lag Days for Purposes of Calculating Cash Working Capital

a. IPL's Argument

IPL requests an adjustment of approximately $1.48 million to its calculation of cash working capital to account for a 24.3 day collection period. IPL's tariff states that all bills must be paid within 20 days. IPL argues that it is entitled to use a 24.3 day revenue lag period in its calculations because it has a practice of allowing a four-day grace period for the collection of bills to account for possible mail delays. IPL relies upon two statutory provisions to support its argument. First, IPL states that all electric utilities must forgive customers at least one late payment that is made four days or less after the due date.[17] In addition, IPL states that it is required to forgive at least one late payment penalty for each electric service account annually.[18]

[16] IPL Initial Brief at 50.

[17] *Id.* at 62 (citing 199 IAC § 20.4(11)"c"(4)).

[18] *Id.* (citing 199 IAC § 20.4(12)"d").

b. Reply

IPL continues to fail to present any reasonable justification for its approximate $1.48 million adjustment. The adjustment would penalize the majority of IPL's customers who pay their bills on time by inflating IPL's revenue requirement. As ICC pointed out in its Initial Brief, IPL's tariff clearly states that customers must pay their bills within 20 days or they will be penalized.[19]

The regulations are equally unavailing to IPL. In support of its proposed adjustment, IPL cites to 199 IAC § 20.4(11)"c"(4) and 199 IAC § 20.4(12)"d" as requiring periodic late payment forgiveness.[20] These regulations do nothing to advance IPL's argument, however. Even if they can be read in such a manner as to "require periodic late payment forgiveness," they do not require ***routine*** late payment forgiveness. IPL's proposal, by calculating a collection period of 24.3 days, is contemplating that every single customer will be late paying every single bill. This is an implausible result given the express terms of IPL's rules and the apparent lack of common knowledge among customers that this lag period even exists.[21] Therefore, to allow a revenue collection period of 24.3 days would punish the general customer base for the occasional digression of fellow customers (even though tariff rules are in place to address delinquent payments), and would also result in a windfall of revenue to IPL by allowing it to collect on a 24.3 day lag when in fact it will normally receive payment within 20 days. Accordingly, IPL's claimed revenue deficiency in this case should be lowered by $1.48 million.

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[19] ICC Initial Brief at 14.

[20] IPL Initial Brief at 62.

[21] *See* Tr. at 544:7-25 (Hampsher).

3. Salaries and Wages

ICC maintains its original position with respect to salaries and wages.[22]

4. Workforce Reduction

ICC maintains its original position with respect to workforce reduction.[23]

5. Accelerated Meter Depreciation Is Wholly Speculative and Should Be Denied

a. IPL's Position

IPL proposes to accelerate the depreciation of existing electric meters from 23 years to 10 years. It bases its claim for this deprecation on the possible future installation of Advanced Metering Infrastructure ("AMI") technology. IPL argues that it should be allowed to accelerate the depreciation of existing electric meters because it anticipates that it may consider installing AMI at some point in the future. In support of its claim, IPL highlights the benefits of AMI technology and the Smart Grid[24] and points to a provision in the Public Utility Regulatory Policies Act of 1978, as amended ("PURPA") that states that each state should consider authorizing utilities "to deploy a qualified smart grid system to recover in a timely manner the remaining book value costs of any equipment rendered obsolete" by the deployment.[25] IPL states that it has not taken any action to install AMI, but points to Mr. Madsen's commitment to install

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[22] *See* ICC Initial Brief at 15.

[23] *See id.*

[24] IPL Initial Brief at 70.

[25] IPL Initial Brief at 72 (citing PURPA § 111(d)(16)).

AMI within a 10-year period if the accelerated depreciation proposal is granted.[26] IPL concludes that the cost for any future AMI investments will need to be justified in a future rate case.[27]

b. Reply

In its Initial Brief, IPL reiterates its claim for accelerated meter depreciation but continues to fail to provide justification. IPL devotes considerable energy to detailing all of the potential societal benefits of AMI.[28] This is a red herring. Not a single party has stated that AMI or other Smart Grid technology does not have the potential to be beneficial. There very well may be benefits to an enhanced grid that AMI will be able to facilitate in the future. The problem for IPL, however, is the issue is not whether AMI would be beneficial. Rather, the issue is whether there is any reasonable and supported basis for allowing accelerated meter depreciation in this proceeding. The answer to that question is clearly "no". IPL has repeatedly stated it has no specific plans and has not taken any action to deploy AMI.[29] It has even pointed out several barriers to deploying AMI, including a plethora of regulatory and practical challenges in the way of implementing AMI and the rejection of its application for a Department of Energy grant.[30]

Despite these challenges, IPL's witness Mr. Madsen spontaneously, on the stand, committed to move IPL toward AMI / Smart Grid if the accelerated depreciation is granted in this docket. IPL relies on this commitment as a basis for supporting its proposal.[31] ICC has three

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[26] *Id.* at 71, 74.

[27] *Id.* at 75.

[28] *See id.* at 70, 72.

[29] *See id.* at 73; Madsen Rebuttal Testimony at 4:5-6, 5:1-7:23.

[30] IPL Initial Brief at 71 n.36, 73-74.

[31] *Id.* at 74.

significant concerns with this promise: 1) the purpose of this proceeding is not to fund some intangible future project; rather, it is to determine just and reasonable rates based on a reasonable revenue requirement; 2) it is improper to apply pressure to the Board to consider factors other than determining just and reasonable rates in this proceeding; and 3) Mr. Madsen's commitment to move forward with a program that admittedly has numerous flaws without a contingency for proper analysis and testing is reckless and could result in substantial harm to customers.

As IPL states, future AMI investments will need to be justified in future rate cases.[32] Similarly, once concrete and definitive AMI proposals have been carefully prepared, analyzed and submitted to the Board for consideration, then it may also be proper to discuss other rate proposals, such as meter depreciation acceleration. Contrary to IPL's assertion, it is certainly not "good practice"[33] to make customers pay for something that is wholly speculative at this point; nor is it just and reasonable. IPL's proposed accelerated meter depreciation should be rejected.

6. Wholesale Portion of Rate Increase (Decrease)

ICC maintains its original position with respect to the wholesale portion of the rate increase / decrease.[34]

7. Interest Synchronization

ICC maintains its original position with respect to interest synchronization.[35]

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[32] *Id.* at 75.

[33] *Id.* at 71.

[34] *See* ICC Initial Brief at 18.

[35] *See id.*

8. Sutherland Generation Station Unit 4 Cancellation Recovery

a. IPL's Position

IPL proposes that if IPL ultimately becomes responsible for any share of the costs associated with the cancellation of the SGS4 project that were to be paid by IPL's SGS4 partners, it will bring the matter before the Board in another docket.[36]

b. Reply

ICC maintains its original position with respect to any possible future recovery of costs associated with the SGS4 partners' share of the cancellation costs of SGS4. IPL has not put forth any justification for making its retail ratepayers assume the full risk of such cancellation costs, either here or in another, future proceeding.[37] There is no justification to keep IPL's customer's exposed to liability for these other costs. The Board should bar IPL from attempting to recover SGS4 partners' costs in the cost of service to IPL retail customers in any future proceeding.

9. Variable Pay Plan Costs

IPL has failed to introduce any new justifications for its Variable Pay Plan costs. Accordingly, ICC stands by its Initial Brief.[38] Although ICC recognizes and applauds the efforts of IPL's employees during the Flood,[39] the fact remains that no Variable Pay Plan costs were paid or incurred in the test year, and are (by IPL's own admission) speculative going forward. As confirmed by IPL witness Stock, "a utility must prove its variable pay plan program has provided

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[36] IPL Initial Brief at 86-87.

[37] *See* IPL Initial Brief at 86-87 (IPL simply states that issues related to final disbursements for the SGS4 project have yet to be resolved and if IPL is allocated any part of the other SGS4 partners' share of the costs, IPL will bring the matter in another docket).

[38] *See* ICC Initial Brief at 19-21.

[39] ICC certainly never impugned IPL employees' efforts during the flood in anyway, as IPL insinuates. *See* IPL Initial Brief at 69-70.

legitimate cost reductions and/or earnings enhancements in the test year before the variable pay plan costs can be recovered in future years."[40] IPL has failed to provide evidence of those cost reductions and/or earnings enhancements in the test year. Consequently, Variable Pay Plan costs should not be included in the revenue requirement established in this proceeding.

10. Pension Costs

ICC maintains its original position with respect to pension costs.[41]

11. Other Post-Employment Benefit Costs

ICC maintains its original position with respect to other post-employment benefit costs.[42]

12. Capital Structure, Double Leverage, and Debt Issues

ICC maintains its original position with respect to capital structure, double leverage and debt issues.[43]

13. Weighted Average Cost of Capital

ICC maintains its original position with respect to weighted average cost of capital.[44]

14. IPL's Proposed Rate of Return on Common Equity

a. IPL's Position

IPL asserts that its witness, Frank Hanley, is the only witness that submitted a "fair, supportable, and up-to-date" calculation of the appropriate ROE.[45] Mr. Hanley originally put

[40] Tr. at 606:19-24 (Stock); *see also* Tr. at 541:24-542:6 (Hampsher) (generally agreeing with Stock).

[41] *See* ICC Initial Brief at 21.

[42] *See id.*

[43] *See id.*

[44] *See id.* at 22.

forth a recommendation of 11.8% ROE, but subsequently stated that recent declines in capital costs warranted a reduction in the ROE to 11.2%.[46] But IPL has at all times throughout this proceeding requested an 11.4% ROE.

b. Reply

IPL continues to seek an excessive ROE in this proceeding. A more justifiable, reasonable and otherwise appropriate ROE in light of all the market indicators is 10.0%, as recommended by ICC witness Mr. Gorman. That ROE remains justified by the arguments and evidence marshaled in ICC's Initial Brief. Here, we take this opportunity to respond to certain issues raised by IPL in its Initial Brief.

First, ICC objects to IPL's assertion that Mr. Hanley's ROE reflects an up-to-date determination.[47] Mr. Hanley admittedly relied upon outdated materials as inputs for his models and stated that economic conditions have changed since the time he filed his Direct Testimony and related exhibits. When questioned at the hearing, Mr. Hanley admitted that he had not updated his models since that time to incorporate the more accurate, up-to-date data that is available and that he has reviewed.[48] For example, Mr. Hanley conceded that utility bond yields were lower than those that he used in his models in his Direct Testimony, that the market risk premium had decreased from the 7.1% that he had relied upon in his Direct Testimony, and that

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[45] IPL Initial Brief at 96.

[46] IPL Initial Brief at 97 (citing Tr. at 1662 (Hanley), Tr. 1547 (Hanley), IPL Exhibit No. 9).

[47] IPL Initial Brief at 96.

[48] Tr. at 1616:3-5, 1624:16-19 (Hanley).

he had not performed any updated ROE analyses.[49] Accordingly, IPL's assertion that Mr. Hanley's ROE is up-to-date is erroneous.

IPL attempts in its Initial Brief to portray Mr. Hanley's ROE analyses and recommendation as being up-to-date because (IPL asserts) he had had demonstrated in his Rebuttal Testimony and related exhibits that there had been a decline in capital costs.[50] But this is not the same as performing a new study and modifying a recommended ROE, nor is it truly up to date. Mr. Hanley's Rebuttal Testimony (filed August 21, 2009) did not reflect the continued decline in capital market costs (because no new study had been performed),[51] and thus his 11.2% updated recommendation, if not rejected out right, should be further reduced. ICC also offered evidence showing the continuing decline in capital costs, which Mr. Hanley knew about but did not consider in his analyses. For example, ICC Exhibit No. 302, which is an excerpt from Morningstar's 2009 Yearbook, shows that the market risk premium has declined from 7.1% to 6.5%. As Mr. Hanley admitted at the hearing, he was aware of and had reviewed this information.[52] ICC Exhibit No. 301, which is an excerpt from the Mergent Bond Record from September 2009, shows that "A" rated utility bond yields declined to 5.7% from the 6.52% that Mr. Hanley had used in the analysis in his Direct Testimony and related exhibits and the 6.2% yield that he had disclosed in his Rebuttal Testimony (which did not contain an updated ROE

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[49] Tr. at 1616:3-5, 1618:9-1619:17 (Hanley).

[50] IPL Initial Brief at 97.

[51] *See* Tr. at 1616:3-5 (Hanley).

[52] Tr. at 1621:3-1624:19 (Hanley).

recommendation).[53] In these circumstances, Mr. Hanley's ROE analyses and recommendations can hardly be called "up-to-date."

ICC also takes issue with IPL's assertion that ICC witness Mike Gorman's Discounted Cash Flow ("DCF") model is inaccurate because he compared IPL's "senior secured credit rating" to the senior secured credit rating of the proxy group.[54] This attempt to invalidate Mr. Gorman's model is a red herring. Regardless of whether IPL holds unsecured debt or has a senior secured debt rating, the fact of the matter remains that both Mr. Gorman and Mr. Hanley relied upon the same proxy group. Importantly, and more to the point, the proxy group is risk comparable to IPL. Mr. Gorman compared the proxy group senior secured credit rating to IPL's senior secured credit rating to prove that IPL and the proxy group are comparable in risk (which would make it appropriate to rely upon the proxy group in the models used to estimate a market-based ROE for IPL). IPL argues that it was improper for Mr. Gorman to "utilize IPL's prior secured debt ratings and/or provisional shelf debt ratings";[55] according to IPL, Mr. Gorman erred because IPL's senior secured credit rating from S&P and Moody's were removed around September 2008 when IPL retired its senior secured debt issuance authority (the "shelf" rating referred to by Mr. Bacalao at the hearing).[56] That IPL no longer has a senior secured credit rating is true enough.[57] But the remaining question is whether any of this changes Mr. Gorman's conclusion that IPL is comparable in risk to the proxy group. The answer is "no": IPL is still

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[53] *See* Tr. at 1619:23-1621:2 (Hanley).

[54] IPL Initial Brief at 99.

[55] *Id.* at 100.

[56] Tr. at 1932:6-20 (Bacalao).

[57] *See* Tr. at 1931:19-23 (Bacalao).

comparable in risk to the proxy group, and the evidence supporting this conclusion is taken from both Mr. Gorman and IPL's witness Mr. Bacalao.

Mr. Gorman explained at the hearing that senior secured credit is normally rated at least one "notch" above the utility's unsecured credit rating.[58] Importantly, in response to questions on cross-examination, IPL's Mr. Bacalao agreed that senior secured debt is normally rated about one "notch" above the unsecured rating.[59] With this as the factual background, it is clear that IPL and the proxy group are comparable in risk. Mr. Gorman testified that the senior secured credit rating of the proxy group is the same as IPL's recent senior secured credit rating.[60] Mr. Gorman also explained that IPL's unsecured credit rating was one notch lower than the senior secured credit of the rating proxy group, which is a normal credit rating spread between senior secured and unsecured credit rating.[61] The comparison of IPL's recent senior secured and its current unsecured credit rating to the proxy group senior secured credit rating support Mr. Gorman's conclusion that the proxy group is comparable in risk to IPL. As Mr. Gorman testified at the hearing:

> So no matter how you weigh this issue, this proxy group is a reasonable proxy for the investment risk of IP&L. Whether you compare it on a senior secured bond rating to a senior secured bond rating standpoint or whether or not you compare it on a senior secured bond rating for the

[58] Tr. at 1911:20-23, 1913:5-13 (Gorman).

[59] Tr. at 1942:25-1944:18 (Bacalao).

[60] Tr. at 1913:14-21 (Gorman). To be clear, the recent senior secured credit rating of IPL was no mistake by the credit rating agencies. As explained by IPL's Mr. Bacalao in referring to that rating: "It is correct. It's not a mistake." Tr. at 1940:10-11 (Bacalao).

[61] Tr. at 1911:20-23, 1913:5-13 (Gorman).

> proxy group and IP&L's corporate bond rating, it is a reasonable risk proxy group.[62]

IPL also attempts to discredit Mr. Gorman's analysis and conclusions concerning IPL's and the proxy group's level of risk by asserting that IPL does not have a senior secured credit rating and that its unsecured debt rating is by default a senior secured credit rating.[63] Thus, according to IPL, the proxy group is less risky than IPL (presumably warranting an ROE for IPL that is higher than that for the proxy group companies). But as noted above, IPL's recent senior secured and its current unsecured credit rating are comparable to the proxy group senior secured credit rating, and the debt covenants place the unsecured debt on the same level as secured debt,[64] making the risk relative to the proxy group the same. Despite all of the attention given at the hearing to the issue of IPL's credit rating, whether it has secured debt, and whether its unsecured debt has the equivalent of a secured debt rating, there does not appear to be any fundamental disagreement with Mr. Gorman's conclusion that the proxy group is a "reasonable risk proxy group" for determining a market-based ROE for IPL. IPL's assertion that the proxy group and IPL are not comparable in risk is not supported by competent evidence, is not credible and should be rejected. IPL's eleventh-hour attempt to discredit Mr. Gorman and his recommended ROE fall flat.

IPL also chastises Mr. Gorman for his decision to exclude his constant growth DCF analysis from consideration because it produced a long-term growth rate that significantly

[62] Tr. at 1913:14-21 (Gorman).

[63] Tr. at 1934:23-1935:2 (Bacalao).

[64] Tr. at 1934:23-1935:10 (Bacalao) ("Plain English, if we issue secured debt later, the holders of unsecured debt will become secured holders, so that all issues – excuse me – all investors will be ranked ratable and equal, technically known as pari passu standing. . . . [s]hould we issue secured, all our debt would be converted to secured. Everybody would stand equal.").

exceeded the GDP growth rate. IPL disputed this position, but markedly failed to produce any evidence to the contrary that would tend to show the long-term growth rate of a company ***can*** exceed overall GDP in the long run. To be sure, IPL cited to a 2007 publication that states that "dividends for mature firms are often expected to grow in the future at about the same rate" as the GDP and that "one might expect" that dividends of an "average" or "normal" company to grow at a rate of 5 to 8 percent a year.[65] But of course, there is an elementary distinction between the ***same*** growth rate and a growth rate that ***exceeds*** GDP. None of the studies cited by IPL definitively state that a utility company can exceed overall GDP over the long term. In contrast, Mr. Gorman provided relevant citations and analysis as to why GDP remains a cap on long-term growth rates for individual companies,[66] and he fully explained at the hearing why the passages quoted by IPL are best viewed in the historical context, rather than as proof that individual companies' growth rates can exceed GDP over the long term.[67] Simply put, IPL has not presented a persuasive case for discrediting Mr. Gorman's conclusions.

Finally, IPL faults Mr. Gorman for excluding the ROE resulting from Mr. Gorman's constant growth DCF model. IPL argues that Mr. Gorman excluded that ROE from consideration simply because it was a high "outlier"; in IPL's view, the lowest return in Mr. Gorman's DCF analyses was the "true outlier" because it was further from the mid-range figure than the higher,

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[65] IPL Initial Brief at 100 (quoting Eugene Brigham and Joel Houston, *The Fundamentals of Financial Management* (2007)).

[66] *See, e.g.*, Gorman Direct Testimony at 20:10-21:26; Gorman Rebuttal Testimony at 5:12-6:9.

[67] Tr. at 1924:16-1925:10 (Gorman).

constant growth DCF return.[68] What IPL fails to recognize, however, is that Mr. Gorman excluded the constant growth DCF return not because it was mathematically the highest "outlier," but rather because it was based on faulty growth rate inputs (*i.e.*, it assumed a growth rate in excess of the GDP growth rate).[69] The exclusion was entirely appropriate and the averaging of the two remaining DCF ROE results was proper.

For the foregoing reasons, Mr. Gorman's recommended ROE remains reasonable, credible, justified, and supported by the evidence. The Board should approve an ROE no higher than 10.0%, as recommended by Mr. Gorman.

B. Rate Design Issues

1. Automatic Adjustment Clause of Transmission Costs (Issue #15)

a. IPL's Position

IPL has proposed an automatic adjustment for transmission-related costs, including ITCM costs. For support, IPL states that transmission costs are expected to vary widely and that an automatic adjustment clause will help minimize the number of rate cases.[70] IPL argues that these costs meet the Board's criteria for an automatic adjustment clause.[71] Specifically, IPL states that the costs are "1) [i]ncurred in the supplying of energy; 2) [b]eyond direct control of management; 3) [s]ubject to sudden important change in level; 4) [a]n important factor in determining the total cost to serve; and 5) [r]eadily, precisely, and continuously segregated in the

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[68] IPL Initial Brief at 101. Of course, IPL's questioning of Mr. Gorman on this point was "just for the sake of argument" and "a bit more curiosity." Tr. at 1916:21, 1917:8 (IPL counsel). This reflects the weight that should be given to IPL's argument on this point.

[69] *See* Gorman Direct Testimony at 17:1-22; Tr. at 1915:21-23, 1917:19-23 (Gorman).

[70] IPL Initial Brief at 109, 113.

[71] *Id*. at 114 (citing Iowa Code § 476.6(8) and 199 IAC 20.9(1)).

accounts of the utility."[72] IPL concludes that an automatic adjustment for these costs will not affect management's incentive to be diligent about managing these costs.[73]

b. LEG's Position

LEG vigorously opposes IPL's proposed automatic adjustment mechanism for transmission-related costs, stating that the proposal is "unreasonable, unjustified, and unsupported by the evidence in the record."[74] LEG supports its position by summarizing a recent Board order in which the Board explained the principles and standards to be applied in determining whether to approve an automatic adjustment mechanism.[75] LEG explains that the proposed automatic adjustment clause that IPL is proposing in this proceeding mirrors the automatic adjustment clause that the Board rejected in that case. For example, LEG states that there is no "extraordinary need" for this kind of adjustment, that the costs can be projected fairly accurately and will be fairly stable, and that IPL has a significant degree of control over these costs.[76]

c. Reply

ICC stands on its Initial Brief and concurs with the arguments and analysis of LEG set forth in its Initial Brief. ICC adds here that IPL's attempt to distinguish distribution and generation services from ITCM costs because the former are Board-regulated and the latter are

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[72] IPL Initial Brief at 115.

[73] *Id*. at 119.

[74] LEG Initial Brief at 6, 10.

[75] *Id*. (citing *In re Black Hills/Iowa Gas Utility Company, LLC d/b/a Black Hills Energy (f/k/a Aquila, Inc. d/b/a Aquila Networks*), Docket No. RPU-08-3, "Order Rejecting Revenue Requirement and Capital Additional Tracker Settlement and Approving Small Volume Transmission Service Settlement Agreement" (May 7, 2009)).

[76] LEG Initial Brief at 8-9.

FERC-regulated is a distinction without a difference.[77] The manner in which those two sets of costs are regulated does not tell us why only one should be characterized as "incurred in the supplying of energy" (thereby satisfying the Board's first criterion for an automatic adjustment clause) but not the other.

ICC also replies to IPL's concluding section on the proposed transmission automatic adjustment clause. There, IPL states that "it will ultimately have to justify [the ITCM costs] to its customers, so therefore IPL has considerable incentive to manage these [costs]."[78] But the Board should treat this statement with skepticism. With an automatic adjustment clause, IPL will be able to collect the ITCM costs without any review or oversight by the Board. IPL's assertion also appears to contradict IPL's lengthy legal analysis that those costs must be passed through pursuant to the filed-rate doctrine. In light of IPL's substantial reliance on that doctrine, its claimed incentive to manage the costs rings hollow.

2. Revenue Allocation on a Uniform Percentage Basis (Issue # 16)

ICC stands on its Initial Brief on this issue. Only LEG is pursuing the issue of using a class cost of service study for revenue allocation purposes, rather than using a uniform percentage increase. The use of a class cost of service study should be deferred until after rate equalization is complete.

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[77] IPL Initial Brief at 115.

[78] *Id*. at 119.

3. Rate Design Proposals for the LGS and Bulk Power Classes (Issue #17)

a. IPL's Position

IPL contends that the transmission-related demand charge for Standby Service must be based on 100% of the full costs for the demand component that is charged to the full-requirements supplementary service customers. This proposal would result in an increase to the transmission-related demand charge for Standby customers from $2.14/kW-mo. to $3.95/kW-mo., a substantial and unjustified increase of 85%.

b. Reply

IPL has failed to justify the 85% increase in transmission service demand charges for Standby customers. In its Initial Brief, IPL argues that the demand charges for generation service should be determined on a basis different than those for transmission service "given there is a liquid market to purchase generation."[79] But this argument fails to recognize and account for the fact that the development of Standby charges (for both generation and transmission components, which historically were bundled) long pre-dates the development of a "liquid market" in which to purchase generation.[80] The emergence of MISO and organized wholesale generation markets for day-ahead and real-time energy do not adequately reflect the reliability of Standby customer-owned generation and the probability that Standby customers will make use of the transmission system at peak times.[81] Nothing in the record demonstrates that ITCM's investment costs will include 100% of the Standby customers' load, as IPL suggests.[82] IPL claims that it provides to

[79] *Id.* at 128.

[80] Brubaker Rebuttal Testimony at 8:10-13.

[81] *Id.* at 8:18-21.

[82] IPL Initial Brief at 128.

ITCM the contract demand levels of its Standby customers, and makes the unrealistic assertion that ITCM plans the transmission system as if the full level of that contract demand will be on at the time of the system peak. But the testimony offered by IPL in support of those claims does not support the claim that ITCM invests and incurs costs on that basis. In fact, utilities factor in the reliability of customer-owned generation and the probability of standby customers being on the grid at the time of the system peak.[83] Mr. Brubaker's testimony in response to questioning by Board Member Tanner on this issue is worth quoting at length:

> But if you have diversity, and you have a very small use of the system by those customers, very small use of the generation system and a very small use of the transmission system.
>
> And to me, the same principles apply. We always have – you know, we don't build generation to meet exactly our expected peak. ***We don't build transmission to meet exactly our expected peak.***
>
> ***There is reserve capacity in both systems*** and that's – you know, that's why.
>
> We don't – we don't reserve generation a hundred percent. We reserve it 10 percent, 15 percent, whatever the planning criteria is. And it's just no different in the case of standby customers for generation, which there isn't any disagreement about apparently, and I think also ***no difference with respect to transmission***.[84]

IPL witnesses Vognsen and Bauer offer no credible testimony to contradict Mr. Brubaker's testimony on this issue.[85] Instead, IPL ignores this reality and makes an unsupported leap in

[83] Tr. at 1342:10-1343:3 (Brubaker).

[84] Tr. at 1341:13-1342:4 (Brubaker) (emphasis added).

[85] Mr. Bauer asserted on the stand that the reliability of customer-owned generation is not relevant, Tr. at 835:17-836:5 (Bauer), and that "[i]f you have a 00.1 percent probability it's going to happen, it still has a potential to happen, and you have to provide service for that hour." Tr. at 836:13-15 (Bauer). Mr. Bauer apparently does not give any consideration to transmission reserves or the looped or networked nature of the transmission system serving larger, Standby

continued . . .

concluding that costs are incurred based on the full Standby contract demand levels.[86] IPL's position should be rejected by the Board so that Standby customers pay a demand charge related to transmission reservation that is consistent with the costs that they impose on the system.

C. Management Efficiency

1. A Management Efficiency Penalty Is Warranted (Issue # 18)

a. IPL's Position

IPL questions whether the ICC has proposed a management efficiency penalty.[87] IPL also raises a number of arguments as to why the management efficiency penalties proposed by ICC and OCA are not warranted. Specifically, IPL argues that a management efficiency penalty is not warranted under the Iowa Code's standard of measuring management inefficiency because 1) the utility is not operating in an inefficient manner, 2) ordinary, prudent management is being exercised, and 3) it is not operating in a manner less beneficial than other utilities.[88]

b. OCA's Position

OCA argues that the Board should penalize IPL by reducing its revenue requirement by $50 million because IPL is performing in a manner less beneficial than other Iowa utilities (specifically, MidAmerican). OCA also states the penalty will provide an incentive to IPL's management to correct its inefficiencies.[89]

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customers. *See* Tr. at 1345:14-16, 1346:7-15 (Brubaker) (explaining that transmission system has reserves and looping provides for multiple paths to reach customers).

[86] *See* IPL Initial Brief at 131.

[87] *See id.* at 6 n.5.

[88] *Id.* at 8 (citing Iowa Code § 476.52).

[89] OCA Initial Brief at 14.

c. Reply

In case any doubt remains, ICC does believe a management efficiency penalty is warranted in this case. As we stated in our Initial Brief, OCA's arguments and the supporting evidence concerning IPL's performance merit serious consideration by the Board. Although IPL management's failure to adequately manage its transmission expense – resulting in IPL's claiming a doubling of transmission-related expense in its proposed revenue requirement – is sufficient to justify a management efficiency penalty in this case, the arguments and supporting evidence offered by OCA also justify ICC's proposed 30-baisis point penalty downward adjustment to the return on equity otherwise approved by the Board. The 30-basis point penalty proposed by IPL would result in a decrease in IPL's revenue requirement of $3.7 million – sufficient to get the attention of IPL management and shareholders, but not so large as to impair IPL's ability to attract capital on reasonable terms.[90]

The increases in IPL's transmission expense make crystal clear why a management efficiency penalty is warranted. IPL itself has admitted that its transmission costs are too high; so high, in fact, that IPL has filed a complaint with FERC to initiate an investigation as to whether the rates are just and reasonable.[91] But IPL's filing of a FERC complaint does not absolve it of responsibility for the high costs. In fact, the precise reason IPL, and consequently IPL's customers, are subject to ITCM's excessive transmission costs is because of management decisions that led to the sale of IPL's transmission assets to ITCM. As elaborated in ICC's Initial Brief, IPL's customers opposed the sale and pointed out all of the potential complications (principally the potential for higher costs and rates). At the time, IPL's management ignored

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[90] *See* Gorman Direct Testimony at 2:16-19; ICC Initial Brief at 68-69.

[91] IPL Initial Brief at 25-26.

IPL's customers – indeed, IPL's Mr. Aller admitted that IPL never considered whether ITCM's rates could double and never presented that possibility to IPL's customers[92] – and made the decision to move forward with the transaction. It is wholly unjust for IPL's customers to be penalized with substantially higher rates for the failure of IPL's management to accurately gauge the level of costs that would result from IPL's sale of its transmission system. Contrary to IPL's assertion, the fact that FERC approved ITCM's rates does not address the fact that the reason IPL is facing such large transmission costs is because of IPL's voluntary decision to sell its transmission system.

IPL argues that a management efficiency penalty is unwarranted here because the principal management failures cited by ICC and OCA (the failed AER unregulated investments, the unwise sale of DAEC, and the foolhardy sale of the transmission system to ITCM) all occurred in the past and therefore cannot influence future decisions and actions of IPL management. But this argument ignores reality. All facts used in the management efficiency penalty analysis will be historical, which means that it is entirely appropriate for the Board to examine past decisions to determine if a penalty is warranted. Under IPL's approach, so long as a decision is in the past, IPL's management gets a free pass; all IPL has to do to evade a financial penalty for management inefficiency is paint a rosy picture of the future. But it is precisely the rosy picture painted by IPL in seeking Board approval of its sale of its transmission system that has led to the massive transmission expense increases that IPL seeks to recover in this case. Surely that is not the intent of the management efficiency penalty statute and regulations. The Board should decline IPL's invitation to ignore the past, find that a penalty is warranted, and

[92] Tr. at 136:12-137:22 (Aller).

impose an appropriate penalty – a 30-basis point downward adjustment to IPL's ROE, as recommended by ICC.

III. Conclusion

Wherefore, the Iowa Consumers Coalition urges the Board to grant the relief that ICC requests herein and in its Initial Brief, along with all other appropriate relief, including (a) allowing a transmission expense limited to actual 2008 expenses with no adjustments for speculative transmission rates for 2009 and beyond or for double collecting on ITCM charges, (b) rejecting IPL's claimed revenue deficiency of $1.48 million resulting from its overstatement of its cash working capital needs due to the use of a revenue collection period of 24.3 days (instead, only a 20-day period should be used for that purpose), (c) rejecting the expenses associated with IPL's proposed accelerated meter depreciation (without prejudice to IPL filing a new proposal that is properly supported), (d) disallowing IPL's recovery of its SGS4 partners' cancellation expenses (which IPL concedes should not be recovered by IPL), (e) rejecting the recovery of any variable pay plan expenses, (f) allowing a reasonable ROE of no more than 10.0% (subject to downward adjustment for the management inefficiency penalty), (g) crediting the Bulk Power class with the $5 million in interruptible credits, (h) requiring the use of a reasonable and rational method for the development of the transmission reservation charge for Standby service, and (i) imposing a management inefficiency penalty of 30 basis points off the otherwise approved ROE.

Respectfully submitted,

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