

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF NORTHERN INDIANA PUBLIC SERVICE )  
 COMPANY FOR AUTHORITY TO MODIFY ITS RATES )  
 AND CHARGES FOR ELECTRIC UTILITY SERVICE )  
 AND FOR APPROVAL OF: (1) CHANGES TO ITS )  
 ELECTRIC SERVICE TARIFF INCLUDING A NEW )  
 SCHEUDLE OF RATES AND CHARGES AND CHANGES )  
 TO THE GENERAL RULES AND REGULATIONS AND )  
 CERTAIN RIDERS; (2) REVISED DEPRECIATION )  
 ACCRUAL RATES; (3) INCLUSION IN ITS BASIC )  
 RATES AND CHARGES OF THE COSTS ASSOCIATED )  
 WITH CERTAIN PREVIOUSLY APPROVED )  
 QUALIFIED POLLUTION CONTROL PROPERTY, )  
 CLEAN COAL TECHNOLOGY, CLEAN ENERGY )  
 PROJECTS AND FEDERALLY MANDATED )  
 COMPLIANCE PROJECTS; AND (4) ACCOUNTING )  
 RELIEF TO ALLOW NIPSCO TO DEFER, AS A )  
 REGULATORY ASSET OR LIABILITY, CERTAIN )  
 COSTS FOR RECOVERY IN A FUTURE PROCEEDING. )

CAUSE NO. 44688

DIRECT TESTIMONY OF KARL R. RÁBAGO  
 ON BEHALF OF CITIZENS ACTION COALITION AND  
 THE ENVIRONMENTAL LAW & POLICY CENTER

January 22, 2016

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**I. INTRODUCTION AND OVERVIEW**

**Q. Please state your name, position, and business address.**

**A.** My name is Karl R. Rábago. I am the principal and sole member of Rábago Energy Limited Liability Company, a New York limited liability company with an office at 62 Prospect Street, White Plains, New York.

**Q. On whose behalf are you appearing in this case?**

**A.** I am appearing on behalf of the Citizens Action Coalition and the Environmental Law & Policy Center (collectively, Joint Intervenors).

**Q. What is your relevant background and experience in the field of electric utility regulation?**

**A.** I have more than 25 years' experience in the electric utility industry, including as a Public Utility Commissioner for the State of Texas, as a Deputy Assistant Secretary with the U.S. Department of Energy, as a utility executive and director of regulatory affairs, as an academic, and as an advocate. Through my position as Executive Director of the Pace Energy and Climate Center, I am active in all aspects of the groundbreaking New York Reforming the Energy Vision process, which seeks to develop and implement a blueprint for electric utility transformation. I am an attorney with degrees from Texas A&M University and the University of Texas School of Law, and post-doctorate degrees in military and environmental law from the U.S. Army Judge Advocate General's School and

1 Pace School of Law, respectively. A detailed resume is attached as Exhibit KRR-  
2 1.

3 **Q. Have you previously testified before this or any other Commission?**

4 **A.** I have not previously testified before the Indiana Utility Regulatory Commission  
5 (the Commission). In the past three years, I have submitted testimony, comments,  
6 or presentations in Commission proceedings in Ohio, New York, Rhode Island,  
7 Virginia, Georgia, Minnesota, Michigan, Missouri, Louisiana, North Carolina,  
8 Kentucky, Arizona, Florida, Wisconsin, and the District of Columbia. A listing of  
9 my recent testimony is attached as Exhibit KRR-2.

10 **Q. What is the purpose of your testimony?**

11 **A.** The purpose of my testimony is to review the proposals by the Northern Indiana  
12 Public Service Commission (NIPSCO, or the Company) to increase fixed  
13 customer charges for residential and small business customers in this case.

14 **Q. What information did you review in preparing this testimony?**

15 **A.** I reviewed relevant materials in this case, including pre-filed testimony of the  
16 Company's witnesses, responses to information requests, statutes and regulations,  
17 and documents relating to other, relevant Commission proceedings.

18 **Q. Do you have any financial relationship with the Company?**

19 **A.** No. I do sit as the chair of the board of directors for the Center for Resource  
20 Solutions, a California not-for-profit organization that provides certifications for  
21 green power products under the Green-e® program. The Company offers such a

1 product through its Green Power Rider. I do not participate in product-specific  
2 certification decisions at the Center for Resource Solutions, and would not  
3 participate in any matter relating to the Company’s product certification where  
4 there existed a real or perceived conflict of interest.

5

6 **II. SUMMARY OF FINDINGS AND RECOMMENDATIONS**

7 **Q. What legal and regulatory principles guide your review and testimony in this**  
8 **Cause?**

9 **A.** I am guided by two important elements of law and regulation in this testimony.  
10 First, Indiana Code § 8-1-2-4 provides that “The charge made by any public  
11 utility for any service rendered or to be rendered either directly or in connection  
12 therewith shall be reasonable and just, and every unjust or unreasonable charge  
13 for such service is prohibited and declared unlawful.” Second, pursuant to  
14 General Administrative Order (GAO) of the Indiana Utility Regulatory  
15 Commission 2013-5, “a utility petitioning for a change in its rates and charges  
16 bears the burden of proof and must submit sufficient evidence as part of its case in  
17 chief to satisfy its burden of proof.”

18 **Q. Do the Company’s fixed customer charge proposals square with this**  
19 **guidance?**

20 **A.** No. First, the Company has a burden to produce evidence and prove that its  
21 proposals are just and reasonable. In this regard, the foundation for the



1 Company's proposals lies in its Allocated Cost of Service Study (ACOSS). As  
2 Company Witness Gaske explains, development of the ACOSS involves three  
3 important and somewhat subjective steps—cost functionalization, cost  
4 classification, and cost allocation. While I did not review every unique decision  
5 involved in the functionalization, classification, and allocation of the Company's  
6 costs, it is important to note that reasonable people could differ on many of the  
7 imbedded decisions that purport to show the high levels of customer and fixed  
8 costs that the Company purports to assign to small customers. I address some of  
9 those decisions later in my testimony.

10 Second, the Company uses its ACOSS results to then make the  
11 unsupported argument that the broader interests of "fixed-variable alignment"  
12 require that the Commission support the proposals to increase fixed customer  
13 charges based solely on the Company's conclusion that a high percentage of the  
14 Company's costs are fixed. At their core, the Company proposals regarding  
15 "fixed-variable alignment" are based upon nothing more than the argument that  
16 there is greater certainty of revenue recovery for fixed costs that are collected  
17 through fixed charges than for fixed costs collected through volumetric or  
18 variable rates. It is impossible to agree with the Company unless one also believes  
19 several other impossible things first, including that the Company: (1) cannot set a  
20 volumetric rate adequate to ensure full recovery of justifiable fixed costs, (2)  
21 cannot improve its forecasting to better take account of variations in consumption

1 levels against forecasts, (3) has no access to lost revenue adjustments associated  
2 with reductions in sales due to energy efficiency measures and programs, (4) has  
3 no right to request a rate case adjustment, (5) has no right to use a future test year  
4 forecast to address future sales volatility, (6) cannot petition the Commission for  
5 relief any time that it faces a real and measurable threat to its financial integrity  
6 due to revenue recovery shortfalls, and (7) will not, in fact, be motivated by  
7 guaranteed revenue recovery through fixed charges to overbuild its system,  
8 creating additional costs and problems. Guaranteed revenue recovery is not and  
9 never has been a goal of ratemaking. The Company has failed to demonstrate that  
10 it faces any financial harm due to current fixed cost recovery mechanisms that  
11 would justify its earnings guarantee proposals.

12 Finally, the Company's proposed fixed customer charges would create  
13 significant barriers and impediments to energy efficiency, conservation, and  
14 renewables that would result in improper discrimination against customers  
15 investing in these options. Again, the Company offers no evidence that customers  
16 who have or who are likely to invest in these options have created any harm that  
17 can best be remedied through the Company's fixed charge proposals.

18 **Q. What are your findings based on your review of this case?**

19 **A.** Based on my review of the Company's filings, I find that the Company proposals  
20 to increase the fixed customer charge for residential customers from \$11/month to  
21 \$20/month in proposed Rate 711, and to increase the fixed customer charge for

1 small non-demand commercial customers from \$20/month to \$30/month in  
2 proposed Rate 721, are premised on flawed ratemaking and economic theory, will  
3 create serious adverse consequences for ratepayers, and will create improper  
4 incentives for the Company to manage costs and improve service.

5 **Q. What conclusion do you reach in your testimony?**

6 **A.** I conclude that the proposals to increase fixed customer charges in proposed Rates  
7 711 and 721 are unjustified and would be unjust and unreasonable.

8 **Q. What are your recommendations to the Commission?**

9 **A.** I recommend that the Commission deny the increases reflected in the fixed  
10 customer charges in Rates 711 and 721. Any additional revenue requirement that  
11 is ultimately approved for these rates should be collected through the variable  
12 energy charges in those rates.

13

14 **III. CUSTOMER CHARGES**

15 **Q. What does the Company propose regarding fixed customer charges for**  
16 **residential customers taking service from the Company?**

17 **A.** NIPSCO proposes an increase of approximately 82% in non-bypassable customer  
18 charges for its residential customers.

19 **Q. Does the Company also propose a customer charge increase for small**  
20 **business customers?**

- 1    **A.**    Yes. The Company proposes a 50% increase in the customer charge for small  
2           business customers. My testimony focuses on the impacts of the Company’s  
3           proposal for residential customers, under proposed Rate 711. Though I do not  
4           further address the proposed small business customer charge rate increase in  
5           proposed Rate 721 in this testimony, I would note that:
- 6           •    Increased customer charges have the same disincentive effect on commercial  
7               customers considering energy efficiency and distributed energy resource  
8               (DER) investments as they do on residential customers.
  - 9           •    Increased customer charges have the same devaluation impact on prior energy  
10            efficiency and DER investments for commercial customers as for residential  
11            customers.
  - 12          •    Increased customer charges have a similarly regressive economic impact on  
13            small businesses that are low users of energy as they do on low use residential  
14            customers.
  - 15          •    The Company’s efforts to guarantee revenue collections through increased  
16            customer charges are antithetical to the goals and policy objectives of Senate  
17            Enrolled Act 412<sup>1</sup> to advance cost-effective energy efficiency programs and  
18            measures. Revenue collection intentionally tilted toward non-bypassable  
19            charges is economically what it appears to be—an effort to use rate design to  
20            extract monopoly rents and immunize the Company from the impacts of

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<sup>1</sup> Ind. Code § 8-1-8.5-10 (2015).



1           efficient use of energy and the exercise of customer choice in meeting the  
2           need for electric service.

3           As with the residential customer charge proposals, I recommend that the  
4           Commission disapprove the fixed small business customer charge proposal in  
5           Rate 721 in favor of volumetric recovery of any underlying and prudent revenue  
6           requirement.

7   **Q.   Does the Company provide any distinguishing analysis or policy justification**  
8           **for the imposition of increased fixed customer charges for small business**  
9           **commercial customers, as opposed to residential customers?**

10 **A.**   No. The Company does not distinguish between customer classes in its attempt to  
11       justify its fixed charge proposals. I find that justification deficient as to both  
12       residential and small business customers.

13 **Q.   How does the Company justify its residential customer charge proposals?**

14 **A.**   The Company points to its cost of service analysis, which allocates fixed costs to  
15       residential customers. The cost of service classification and allocation  
16       methodologies chosen have the effect of assigning \$22.51 per customer per month  
17       to the customer charge classification, and \$83.95 per customer per month as fixed  
18       costs for residential customers. (Shambo, p. 36, lines 5-7.) Company Witness  
19       Shambo states that increasing fixed charges for customers “simply improves  
20       recovery of the fixed costs.” (Shambo, p. 36, lines 2-3.) The Company cites a self-  
21       imposed limit of an aggregate increase resulting from all the proposals in this

1 proceeding of not greater than 25.72% for residential customers, citing “the spirit  
2 of gradualism.” (Shambo, p. 36, lines 9-10.)

3 **Q. Does the Company cite any economic, ratemaking, or other justifications for  
4 its efforts to collect fixed costs through fixed charges?**

5 **A.** Witness Shambo offers the Company’s only arguments for increasing fixed  
6 charges. He states that the Company’s policy objectives in this case are to achieve  
7 rates that “will better align the recovery of costs from the customers that drive  
8 those costs.” (Shambo, p. 18, lines 15-16.) He further states that the Company  
9 seeks to “improve alignment of cost recovery with cost causation.” Witness  
10 Shambo states that in addition to recovering costs from customers that cause the  
11 costs and properly aligning pricing signals and incentives, the goal of improving  
12 alignment of cost recovery to cost causation implies “fixed cost recovery through  
13 fixed charges.” (Shambo, p. 20, lines 4-7.)

14 **Q. What does the Company offer as evidence to support the idea that fixed cost  
15 recovery through fixed charges will improve alignment of cost recovery to  
16 cost causation?**

17 **A.** The Company offers no evidence to support the concept that the nature of a cost,  
18 as either fixed or variable, should dictate the form of the charge used to recover  
19 such a cost. Citizens Action Coalition submitted Data Request 4-10, asking the  
20 Company to “provide all studies, reports, orders, or decisions relied upon by the

1 Company in pursuing “fixed-variable alignment” as cited by Witness Shambo at  
2 page 35 of Petitioner's Exhibit 2.” The Company responded that:

3 NIPSCO’s proposal to take a relatively small step towards further fixed-  
4 variable alignment for residential rate design, as discussed by Frank A.  
5 Shambo at page 35, is based upon, in part, economic principles,  
6 experience, education, and various treatises, reports, studies, orders or  
7 decisions that are publicly available. NIPSCO would suggest that CAC  
8 review the Commission’s Orders in Cause Nos. 42943, 42767, 43046,  
9 44062, 44063, and 43180. While these cases all involve gas utilities, it is  
10 worth noting that the gas business is a fixed cost business and that  
11 volumetric pricing makes it difficult for a utility to recover its approved  
12 revenue requirements in the face of declining usage, and also promotes a  
13 utility’s willingness to promote energy efficiency measures. See Cause  
14 No. 44124. In addition to Commission Orders, over the years, Mr. Shambo  
15 has reviewed materials from the National Association of Regulatory  
16 Utility Commissioners, National Resources Defense Council, other state  
17 public utility commission orders, previous orders of the Federal Energy  
18 Regulatory Commission, and reference material available from industry-  
19 based authors.

20  
21 NIPSCO’s Response to CAC Data Request 4-10 is attached as Exhibit KRR-3.

22 **Q. Did you review the Commission orders in the Causes cited by Mr. Shambo?**

23 **A.** Yes. Those Causes primarily addressed: (1) gas utilities, identified by the  
24 Commission to be pure fixed cost businesses, (2) the impact of reduced sales  
25 volumes resulting from efficiency programs and measures, and (3) the setting of  
26 the Sales Reconciliation Component as a mechanism for decoupling revenues  
27 from sales volume.

28 **Q. Does the Company offer any explanation about how or why the cited gas**  
29 **utility cases inform the setting of rates for an electric utility on the issue of**  
30 **fixed customer charges?**



1 A. No. Given the adverse policy and fairness consequences of increased fixed  
2 customer charges, the gas utility cases cited by Witness Shambo should be  
3 afforded no weight in this proceeding. It is important to note that the Company  
4 proposal suffers from the fact that NIPSCO is a late arrival to the fixed charge  
5 proposal campaign—so late in fact, that the trend has already reversed in many  
6 places.<sup>2</sup>

7 **Q. Does the Company offer any specific citations to the publicly available**  
8 **materials that Mr. Shambo has reviewed “over the years?”**

9 A. No.

10 **Q. What impact would the proposed increases in fixed customer charges have**  
11 **on the Company’s residential customers?**

12 A. The proposed change would increase the fixed customer charge by 82% for  
13 residential customers. As demonstrated in the Company’s Exhibit 17, Attachment  
14 17-J, the impacts of these proposed changes are heavily allocated to low energy  
15 users. The Company estimates monthly bill increases of greater than 10% for any  
16 customer using fewer than 900 kWh per month, and less than 5% monthly bill  
17 increases for customers using 2,500 kWh or more per month. These impacts  
18 factor in fuel and tracker charges.

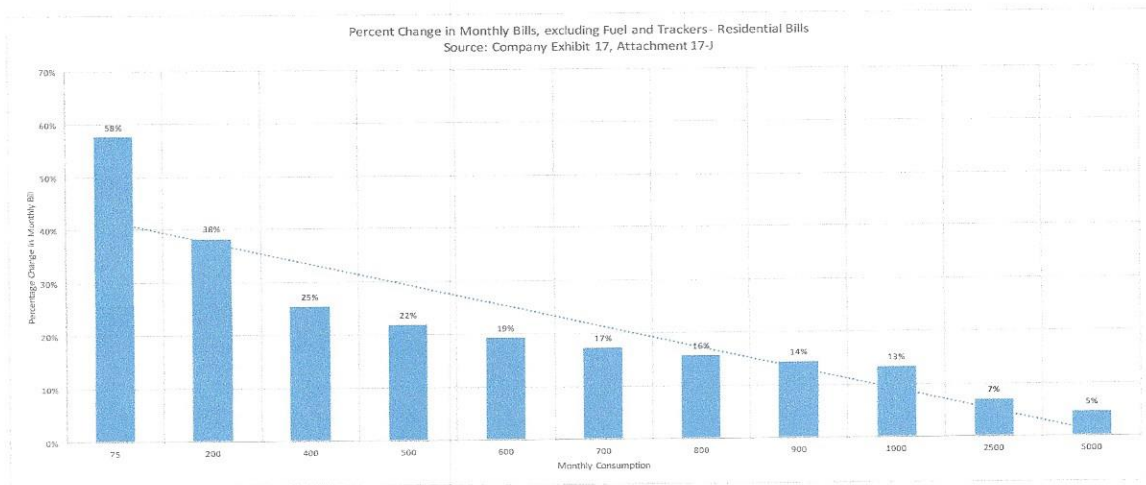
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<sup>2</sup> See Kind, P., “Pathway to a 21<sup>st</sup> Century Electric Utility,” CERES (Nov. 2015); available at: <https://www.ceres.org/resources/reports/pathway-to-a-21st-century-electric-utility/view> (attached as Exhibit KRR-4). See also Bade, G., “The future of rate design: Why the utility industry may shift away from fixed charges,” UtilityDive.com (Nov. 19, 2015); available at: <http://www.utilitydive.com/news/the-future-of-rate-design-why-the-utility-industry-may-shift-away-from-fix/409504/> (attached as Exhibit KRR-5).



1 Q. Does the fixed customer charge proposal impact some customers more than  
2 others?

3 A. Yes. Like the declining block rates of old, the fixed customer charge increases  
4 proposed by the Company impose their greatest burden on low use customers  
5 without regard for why they are low users, and minimize impacts on high use  
6 customers. While the residential class-wide increase proposed by the Company is  
7 a 12.47% increase in average monthly bills, the average monthly residential bill,  
8 not including trackers or fuel, increases by 17.24% under the Company proposal.  
9 This bill impact of these proposed changes differ dramatically with the level of  
10 residential consumption. The following NIPSCO chart depicts the impacts at  
11 various consumption levels selected by the Company, and demonstrates how  
12 heavily the impacts of the proposed fixed customer charge increase are skewed to  
13 low users:



1   **Q.    Does the Company propose future fixed customer charge increases in**  
2           **subsequent rate cases?**

3   **A.**    The Company implies that this case is only a first step, and that it will seek further  
4           and dramatic fixed charge increases in the future. Company Witness Gaske asserts  
5           that because of the way the Company performed its Allocated Cost of Service  
6           Study (ACOSS), it finds that customer and fixed costs for the residential and  
7           small business classes would be \$83/month and \$218/month, respectively.  
8           (Gaske, p. 48, lines 9-11.) Company Witness Shambo explains that as a “gradual  
9           approach” it is proposing to “mitigate” the impacts of its proposal in this case by  
10          limiting class rate changes at this time. (Shambo, p. 31, lines 3-5.) Nothing in the  
11          Company’s case indicates that it will not seek further increases in the future.

12   **Q.    Are you familiar with what the Company calls “fixed-variable alignment”?**

13   **A.**    Company Witness Shambo identifies taking a step toward “fixed-variable  
14          alignment” as a Company objective in this case. (Shambo, p. 35, lines 17-18.) In  
15          my experience, I can find no authority in economic literature or regulatory  
16          practice, outside of utility proposals to increase fixed customer charges, for any  
17          principle that all fixed costs should always be recovered in fixed rates.

18   **Q.    Is Witness Shambo correct in stating that “aligning” fixed costs and fixed**  
19          **charges will help “align” cost recovery with cost causation?**

20   **A.**    No. This would create an appealing symmetry in nomenclature, but whether a cost  
21          is labeled as fixed or as variable tells us nothing about the most economic, just,

1 and reasonable way to collect the cost from the customer class that caused it.  
2 Aligning cost recovery with cost causation is about trying to ensure that the  
3 quantity of the costs caused by the class is recovered from the class. Company  
4 Witness Gaske cites Bonbright's objectives for rate structures in his testimony.  
5 (Gaske, p. 40-41.) None of these principles bears any resemblance to the concept  
6 of "fixed-variable alignment."

7 **Q. What would advancing the Company's "fixed-variable alignment" agenda**  
8 **accomplish then?**

9 **A.** It would provide guaranteed revenues to the Company unrelated to usage and  
10 would impose the kind of non-bypassable charges that only a monopolist could  
11 get away with charging. It would encourage the Company to make wasteful and  
12 unnecessary investments in gold-plating their distribution system. It would  
13 encourage gaming in the ACOSS process in an effort to characterize more and  
14 more costs as "fixed." It would erect barriers to energy efficiency investments and  
15 impose increased burdens on low users of energy, who are often the poor, the  
16 elderly, students, and others on fixed incomes. It would create a barrier to growth  
17 in markets for energy efficiency and distributed generation. It would violate most  
18 of Bonbright's objectives for rate charges. This is hardly the path for a utility that  
19 seeks, in the words of Company Witness Sistovaris, "to be the premier utility in  
20 Indiana in every aspect of its performance, including interaction with its  
21 customers." (Sistovaris, p. 20, lines 12-13.)

1 Q. What do mean by “gold-plating,” and why is it a concern?

2 A. I use the term “gold-plating” to describe behavior by the utility to spend more  
3 than is economically efficient—to make wasteful and unnecessary investments.  
4 Gold-plating means buying, upgrading, modifying, enhancing, or otherwise  
5 spending on things that are not necessary to efficiently and cost-effectively  
6 provide electric service. In the vertically-integrated electric utility system, this  
7 issue appeared as building too many and too expensive generation plants, and has  
8 been described as the Averch-Johnson effect.<sup>3</sup> Gold-plating can also be  
9 implemented through manipulation of cost of service studies to drive more costs  
10 into fixed cost categories to increase guaranteed recovery of those costs. In this  
11 case, I am making the point that the price signals in rate design go both ways.  
12 High fixed charges send a price signal to customers that it matters less how they  
13 change their level of consumption, because they can never avoid or reduce fixed  
14 charges. These charges also send a signal to utilities. The signal sent by high fixed  
15 charge rates is that wherever they can get away with it, utilities should try: (1) to  
16 functionalize everything possible as fixed costs, and (2) to over-build, or gold-  
17 plate, their distribution systems with wasteful and unnecessary fixed cost  
18 spending—because these costs will flow directly to fixed charges. A competitive  
19 market would not tolerate such behavior, and so it is a priority issue for regulators

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<sup>3</sup> Averch, Harvey; Johnson, Leland L. (1962). "Behavior of the Firm Under Regulatory Constraint". *American Economic Review* 52 (5): 1052–1069. [JSTOR 1812181](#).



1 to not allow this rent seeking behavior, because regulators must act as a substitute  
2 for the forces of competition.

3 **Q. Cannot the gold-plating problem be avoided through careful and detailed**  
4 **oversight of utility growth in fixed cost spending?**

5 **A.** In theory, yes, but given the much greater administrative and regulatory burdens  
6 associated with detailed oversight of all the ways fixed costs are incurred in the  
7 distribution system, there are better approaches. In particular, regulators should  
8 look for rate structures that send powerful rate signals to utilities to ensure that  
9 investments are economically efficient, and not just a pathway to greater profits.  
10 Volumetric rate recovery of fixed costs for residential and small business  
11 customers accomplishes this result and properly aligns rate design with sound  
12 policy objectives.

13 **Q. Would increasing fixed charges decrease revenue risk for the utility?**

14 **A.** Yes. As such, any proposal to increase fixed charges should be offset by an equal  
15 proposal to reduce rate of return.

16 **Q. Does not increased energy efficiency and reduced usage of energy create**  
17 **revenue problems for the utility?**

18 **A.** Yes. Declining revenues are a problem for a utility that does not properly forecast  
19 its sales or properly account for trends in electricity consumption. Revenue  
20 shortfalls caused by declining sales can be remedied by non-bypassable fixed  
21 charges, but an increasing number of utilities and experts recognize that

1 increasing fixed charges is a blunt and counterproductive tool for addressing the  
2 revenue issue. The Company could instead improve its forecasting skills, file  
3 more frequent rate cases, or use a future test year in rate cases, for example.  
4 Rather than focus on the embedded or sunk fixed costs only, the Company could  
5 improve its understanding of how reduced sales can help defer or avoid future  
6 fixed costs, and adjust its construction and equipment replacement budgets  
7 accordingly. Among all its choices, increasing fixed customer charges to stabilize  
8 revenues is the most regressive, most punitive, and most uneconomic option  
9 available.

10 **Q. Is there any merit in increasing fixed customer charges “just a little”?**

11 **A.** No. Proper cost allocation ensures that customers who cause the costs bear those  
12 costs. Increasing fixed customer charges does not improve cost allocation, only  
13 the collection of monopoly rents. Even small customer charge increases can have  
14 profound impacts on the household budgets of the poor, and actually subsidize  
15 customers who are high users and high cost causers.

16 **Q. Are there any costs that should be collected through fixed charges?**

17 **A.** Yes. Only those costs that strictly vary only according to the number of customers  
18 should be recovered through fixed charges. In this case, the Company has  
19 allocated a wide range of costs to customer charges—including a general category  
20 of customer services, transformers, AMR meter reading, and customer  
21 information and advertising—that do not strictly vary only with the number of

1 customers. (Company Exhibit 17, Attachment 17-E, p. 4 of 9.) As a result, the  
2 Company has allocated \$22.51 to customer charges. The fixed customer charge  
3 should be limited to the costs of the service drop, the cost of the meter attributable  
4 to billing, billing and collection costs, and other costs that vary exclusively with  
5 customer count. For most utilities in the United States, these customer costs do  
6 not exceed \$10 per month.<sup>4</sup>

7 **Q. Are there benefits to using volumetric charges, instead of fixed charges, to**  
8 **recover fixed costs?**

9 **A.** Volumetric charges can be used to recover fixed costs associated with distribution  
10 infrastructure while also sending a price signal to customers to decrease usage and  
11 lower their bills. The use of volumetric charges instead of increasing fixed  
12 charges also lessens the disproportionate impact on low use and low-income  
13 consumers.

14 Furthermore, to advance the adoption of cost-effective energy efficiency  
15 and to reduce the cost of energy efficiency programs provided by utilities, it is  
16 important to provide incentives to reduce usage – such as shifting costs *away*  
17 from fixed customer charges to volumetric delivery charges instead. As a result,  
18 the Commission should take a hard look at any request to increase fixed customer  
19 charges, and to the costs that are actually allocated to customer charges.

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<sup>4</sup> See Lazar, J. & Gonzalez, W., “Smart Rate Design for a Smart Future,” Regulatory Assistance Project (Jul. 2015), at 36; available at: <http://www.raponline.org/document/download/id/7680>.

1                   **A. IMPACTS ON LOW USE AND LOW INCOME CUSTOMERS OF**  
2                   **INCREASING CUSTOMER CHARGES**

3   **Q.    Do increases in fixed charges pose potential problems for low-income and**  
4           **low usage customers?**

5   **A.**    Yes. Increasing fixed charges can have disproportionate impacts on low usage  
6           customers (who are often low-income customers), customers on fixed incomes  
7           (frequently seniors), students, and customers who have aggressively pursued  
8           green building and energy efficiency. This is an area where the Company needs to  
9           demonstrate definitively that low-income customers will not be unfairly affected,  
10          but the Company fails to address the issue adequately in testimony.

11 **Q.    How does a change to higher fixed charges impact low- and moderate-income**  
12          **customers and other low use customers?**

13 **A.**    Allocation of costs to fixed, non-bypassable charges imposes a significant burden  
14          on low energy users who are low- and moderate-income customers, or customers  
15          on fixed incomes, many of whom are the elderly. The higher fixed charge is  
16          economically regressive. This “reverse Robin Hood” proposal likely subsidizes  
17          the well-to-do at the expense of the low use, often low-income, users.

18 **Q.    What is the Company’s position on the impact of increased fixed customer**  
19          **charges on low-income customers?**

20 **A.**    The Company’s testimony demonstrates that increases in customer charges will  
21          disproportionately affect low *use* customers, which could indicate that there will



1           likely be a disproportionate effect on low-income customers. (Company Exhibit  
2           17, Attachment 17-J.) Company Witness Shambo asserts that they reviewed the  
3           usage levels for low-income customers and found them higher than those for the  
4           “normal” population. (Shambo, p. 36, lines 14-16.)

5   **Q.   Does this information address your concern about low-income, low use**  
6           **customers?**

7   **A.**   No. The chart provided by Witness Shambo in Attachment 2-C does not prove the  
8           argument asserted. The Company does not indicate that the sample selected for  
9           review is representative of low-income customers in general. The Company does  
10          not indicate whether the relatively large number of “normal” residential customers  
11          in the 25 kwh/month, 100 kWh/month, and 200 kWh/month bins includes  
12          vacation or second home bills. (NIPSCO Response to CAC Request 4-005,  
13          attached as Exhibit KRR-6.) The chart appears to include only customers with 12  
14          monthly bills, which may not be inclusive of all low-income customers. There is  
15          no way to tell whether the data selected for the chart fairly addresses the issue of  
16          whether low-income customers tend to be lower or higher user than other  
17          residential customers. It is important to note that the National Association of State  
18          Utility Consumer Advocates (“NASUCA”) has looked at the fixed customer  
19          charge issues and recently adopted a resolution opposing and urging utility  
20          commissions to reject increased delivery service customer charges because of

1 their tendency to adversely impact the poor, the elderly, racial minorities, and  
2 customers on fixed incomes.<sup>5</sup>

3 **Q. Do you have other concerns about the impacts of customer charge increases**  
4 **on low-income customers?**

5 **A.** Yes. The Company fails to address the important issue of household energy  
6 burden. The Company admits that it has no data on low-income household  
7 income or energy burdens. (NIPSCO Responses to CAC Requests 4-006, 4-007,  
8 attached as Exhibit KRR-8.)

9 **Q. What do you mean by household energy burden?**

10 **A.** Household energy burden refers to the share of household expenses reflected by  
11 energy costs. A more comprehensive analysis of the impacts of the fixed customer  
12 charge proposals would account for household income levels in low-income and  
13 low use households.

14 **Q. Does the Company propose any measures to mitigate the impact or potential**  
15 **impact of the increased fixed customer charges on low-income or low use**  
16 **customers?**

17 **A.** Yes. The Company proposes a single bill credit of \$50 to be applied to the June  
18 bills of customers who receive LIHEAP funding. (Shambo, p. 38, lines 3-10.)

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<sup>5</sup> National Association of State Utility Consumer Advocates, “Resolution 2015-1: Opposing Gas and Electric Utility Efforts to Increase Delivery Service Customer Charges,” (Jun. 9. 2015); available at: <http://nasuca.org/customer-charge-resolution-2015-1/> (attached as Exhibit KRR-7.)

1    **Q.    Do you find this to be a meaningful measure to address the needs of low-**  
2           **income customers or the problems created by the proposal to increase fixed**  
3           **customer charges?**

4    **A.**    No. The annual impact of the proposed fixed customer charge occurs in all twelve  
5           months, and totals \$108 for the year. A one-time \$50 credit offsets less than one-  
6           half of the proposed fixed customer charge increase. Moreover, the credit will not  
7           encourage energy efficiency, and will not address high bills in other months.  
8           Finally, the Company submits no evidence that receipt of LIHEAP funding is the  
9           best or even a good basis for characterizing the universe of customers who would  
10          be adversely impacted by the Company’s fixed charge proposal.

11

12                    **B. IMPACTS ON ENERGY EFFICIENCY AND OTHER**  
13                    **DISTRIBUTED ENERGY RESOURCES OF INCREASING**  
14                    **CUSTOMER CHARGES**

15   **Q.    How does increasing fixed customer charges specifically impact customer**  
16           **investment in energy efficiency, conservation, and other distributed energy**  
17           **resources (DER)?**

18   **A.**    Increases in non-bypassable fixed customer charges create powerful price signals  
19           *against* investment in energy efficiency, distributed generation, and other DER  
20           products and services, which would frustrate attainment of energy efficiency  
21           goals established pursuant to Senate Enrolled Act 412.

1   **Q.    Did the Company consider the impact of their proposed increase in the fixed**  
2       **customer charge on energy efficiency, conservation, and DER?**

3   **A.**    I found no information in the record that the Company considered or analyzed the  
4       impacts of their proposals on demand for DER. I find this omission striking. The  
5       Company confirmed in response to CAC Request 6-007 that it has done no  
6       analysis of the potential impact of its fixed customer charge proposal on energy  
7       efficiency uptake and adoption by its customers (attached as Exhibit KRR-9).

8   **Q.    Why should the Commission be concerned about approving a rate design**  
9       **that is detrimental to DER?**

10  **A.**    Advancing the increased reliance on DER supports achieving goals of energy  
11       service affordability, environmental improvement, and market development. The  
12       benefits of increased DER markets include resource diversification, future cost  
13       reductions associated with increased volume of deployment (economies of scale),  
14       job creation, system-wide cost reductions, and leveraging of non-utility  
15       investment dollars, among others.

16  **Q.    How do energy efficiency and conservation in particular produce these**  
17       **benefits?**

18  **A.**    Energy efficiency and conservation generate benefits to the utility, ratepayers, and  
19       society in many ways, including lower cost than traditional generation and  
20       infrastructure investments, downward pressure on rates over the mid- and long-  
21       term, persistent and consistent savings, nearly endless resource potential due to



1 economies of manufacturing scale and technological innovation, broad  
2 availability to all classes of customers, and significant externalized benefits often  
3 not accounted for in ratemaking.

4 **Q. Can affected customers avoid customer charges with more efficient energy**  
5 **use or deployment of other DER?**

6 **A.** No. The higher customer charge cannot be avoided by customer reductions in  
7 energy use through efficiency, conservation, or other DER measures. The  
8 proposed monthly customer charge increase for NIPSCO is the equivalent of  
9 about 82 kWh of volumetric delivery charges each month.

10 **Q. What do these changes mean to the energy savings opportunity for**  
11 **residential customers?**

12 **A.** The Company's proposal means that low use customers (using 500 kWh or fewer  
13 per month) will have to first reduce or offset consumption by at least 15% (based  
14 on the Company's bill impact assessments) to offset the bill impact of the  
15 proposed customer charge increase before they can even start thinking about  
16 reducing their overall bill through energy efficiency or other DER investments.  
17 Fixed customer charges are "unavoidable" and reduce the marginal value and the  
18 ultimate bill value to those customers who have taken action to reduce their  
19 energy consumption. These proposed changes will also have a chilling impact on  
20 customers who are contemplating such energy efficiency investments, especially  
21 in light of the Company's implied intentions to further increase customer charges

1 to further its pursuit of guaranteed revenues through what it calls “fixed-variable  
2 alignment.” The higher customer charge is a non-bypassable connection tax that  
3 makes serious investment in energy efficiency less cost-effective and potentially  
4 futile.

5 **Q. How does a change to higher customer charges impact prior customer**  
6 **investments in energy efficiency?**

7 **A.** Allocation of costs to fixed, non-bypassable charges adversely affects customers  
8 who have already invested in energy efficiency and other DER options, and also  
9 has a chilling impact on customers who are contemplating such energy efficiency  
10 and DER investments, especially in light of the Company’s apparent intentions to  
11 further increase fixed customer charges up to implied by their cost allocation and  
12 assignment methodologies. Increased fixed customer charges also impose an  
13 extraordinary burden and destroy investment-backed savings expectations on low  
14 energy users who have made significant prior investments in order to lower their  
15 bills. Customers—including residential, small commercial, and other customer  
16 classes—and communities that invest in weatherization, equipment  
17 improvements, distributed generation, and building remodeling do so with  
18 payback expectations in mind. An increased fixed charge is like a regulatory  
19 taking from customers who have made good faith investments in greater  
20 efficiency and self-reliance. As explained above, the Company proposal is like  
21 taking almost 1,000 kWh per year out of the planned savings stream for those

1 customers, extending the payback period they had planned upon, and frustrating  
2 their investment economics. This is irreversible damage to the customers that  
3 could be avoided without harm to the Company by simply allocating the revenues  
4 associated with the fixed charge increase proposal to volumetric rates instead.

5 **Q. What is the likely long-term impact of reduced energy efficiency,**  
6 **conservation, and development of renewable energy?**

7 **A.** Inefficient use means uneconomically high levels of energy consumption. This  
8 excess use, in turn, leads to demand for more expensive power plants and  
9 infrastructure. The costs of those investments are levied on consumers and raise  
10 their rates. Following the Company's logic in this rate application means that in  
11 the long term, more costs would be allocated to demand and fixed charges,  
12 creating higher non-bypassable charges irrespective of electrical usage. And so  
13 on. The Company's proposal seems likely to start a death spiral of electric service  
14 unaffordability.

15 **Q. Does the Company address the issue of increasing customer interest in**  
16 **distributed generation and energy efficiency and the potential impacts of**  
17 **increased fixed charges on those customers?**

18 **A.** Company Witness Shambo testifies that customers who invest in distributed  
19 generation and energy efficiency could impact the Company's ability to recover  
20 its expenses and its cost of capital by causing it to under-recover its fixed costs  
21 and eventually shift those costs to other customers. (Shambo, p. 22, lines 11-17.)

1 This argument lacks merit. First, as previously explained, under-recovery due to  
 2 reductions in sales is primarily a problem of poor forecasting, and is limited to the  
 3 period between rate cases. The Company offers no evidence that such under-  
 4 recovery exists or has significant financial impact on the Company’s earnings.

5 This is not surprising given the tiny number of NIPSCO customers who are  
 6 customer generators.

7 **Q. How many residential customers are customer generators in the Company’s**  
 8 **service territory?**

9 **A.** According to the Company response to CAC Request 6-001, Attachment B  
 10 (attached as Exhibit KRR-10), the numbers are very, very small. The Company  
 11 has about 410,000 residential customers, and about 51,000 small commercial  
 12 customers. The number of customer generators, according to the Company, is as  
 13 follows:

CAC Request 6-001 b.								
Total Number of Customers <sup>a</sup> with Distributed Generation by Rate								
	Customer Class	2010	2011	2012	2013	2014		
		611	34	46	46	53		67
		621	0	3	7	9		13

17 What this means is that customer generators represent about 0.016% of residential  
 18 customers, and about 0.025% of small commercial customers.

19 **Q. How do these customers impact their bills with self-generation, and how do**  
 20 **customer-generators impact Company revenues, now and in the future?**



1    **A.**    We don't know. In response to CAC Request 6-001 (attached as Exhibit KRR-  
2           11), the Company does not know how distributed generation from residential and  
3           small business distributed generation impacts revenues. In response to CAC  
4           Request 6-002 (attached as Exhibit KRR-12), the Company reports that it has no  
5           idea how many distributed generation systems will be installed by residential and  
6           small business customers over the next five years. In response to CAC Request 6-  
7           003 (attached as Exhibit KRR-13), the Company reports that it has conducted no  
8           analysis to confirm the existence or magnitude of actual under-recovery due to  
9           customer generators. In response to CAC Request 6-004 (attached as Exhibit  
10          KRR-14), the Company reports that distributed generation reduces sales, but it  
11          cannot account for the specific impacts per customer.

12    **Q.**    **Does the Company address whether distributed generation customers impact**  
13          **distribution system costs due to changes in their energy use?**

14    **A.**    No. Customers who use less energy make less use of the system, reducing wear  
15          and tear and offsetting future fixed costs. The wholesale imposition of fixed  
16          customer charge increases to address speculative earnings issues associated with  
17          the tiny fraction of customers who invest in distributed generation or energy  
18          efficiency is a disproportionate and unfair imposition of burden on all residential  
19          and small business customers. In the interests of administrative efficiency and  
20          fairness, the Commission should not approve any action to address this tiny issue

1           until the Company meets its burden of proof by demonstrating the nature of the  
2           problem and a reasonable response.

3

4                           **C. THE MERITS OF RECOVERING REVENUES THROUGH**

5   **VOLUMETRIC RATES INSTEAD OF FIXED**

6   **CUSTOMER CHARGES**

7   **Q.   Does the Company have alternatives to allocating increased costs to fixed**  
8       **customer charges?**

9   **A.**   Yes. A fixed customer charge is not the only mechanism for recovering fixed  
10       costs. Precisely because of the concerns that I summarized above, utilities and  
11       regulators have often allocated a large proportion of fixed costs to volumetric rate  
12       elements for residential and small commercial customers. The Company uses a  
13       volumetric delivery charge that could help carry whatever revenue requirement is  
14       ultimately and properly allocated to residential customers. Volumetric charges can  
15       be used for the small commercial Rate 721 as well. Even assuming the full  
16       revenue requirement sought by the Company in this Cause, I estimate that  
17       collecting the proposed fixed customer charge increases through volumetric rates  
18       would increase the rate by \$0.0129/kWh for Rate 711, and \$.0040/kWh for Rate  
19       721.

1 **Q. Does the use of volumetric rates to carry fixed costs present a financial**  
2 **integrity risk to the utilities that could be remedied with higher customer**  
3 **charges?**

4 **A.** No. First, the rate making principle is that rates should reflect costs, not that they  
5 be perfectly aligned with cost structure. As I previously stated, properly reflecting  
6 costs means that the costs caused by a class of customers are charged to those  
7 customers. It does not mean that economic efficiency or sound policy is advanced  
8 by seeking guaranteed recovery of fixed costs through fixed charges. Second, the  
9 Company could use a future test year and take more frequent opportunities to  
10 adjust rates in periodic rate cases. There is no statistical likelihood of any real risk  
11 to the Company's financial integrity due to some customers using less energy than  
12 if the utility had forecast in the interval between reasonably timed rate cases. The  
13 adverse impact on low use, low-income, and fixed income elderly customers, as  
14 well as the economics of efficient use of energy, outweighs any speculative short-  
15 term risk to the Company's earnings.

16 **Q. Does the Company address any other opportunities to reduce the adverse**  
17 **impacts of its proposed customer charge proposals?**

18 **A.** No. In particular, the Company does not assess the respective impact of allocating  
19 its proposed revenue requirements to volumetric distribution charges. Assigning  
20 the revenue requirement to the volumetric delivery charge would spread the  
21 increase across all energy use, and result in a more gradual increase.

1    **Q.**     **Company Witness Shambo asserts that “designing rates to favor low usage**  
2           **customers in an effort to help [low-income] customers” is not appropriate.**  
3           **(Shambo, p. 37, lines 7-8.) Is that what you are arguing for?**

4    **A.**     Not at all. Costs increase with use, so rates that encourage lower use help reduce  
5           costs for all customers. Assigning revenues to volumetric rates instead of fixed  
6           customer charges would have the additional beneficial policy outcome of being  
7           less burdensome to low-income customers.

8    **Q.**     **Why is it appropriate to consider recovering fixed costs through volumetric**  
9           **rates?**

10   **A.**     It is appropriate because of the price signal function of properly designed rates.  
11           Properly designed rates *reflect* properly allocated costs *and* send signals for  
12           efficient consumption in the future. Sunk fixed costs, the focus of the Company’s  
13           concern in their customer charge proposals, can be reflected in *either* the fixed  
14           charge or a volumetric charge. A customer’s demand, especially for low-income  
15           and low use customers, is largely a function of the energy performance of their  
16           home, which is often rented; their major appliances, which are often expensive to  
17           replace or upgrade; and the weather. Imposing high fixed costs on these  
18           customers is the economic regulation equivalent of suggesting that we “let them  
19           eat cake.” An efficient price signal (that is, one that customers can respond to  
20           without disconnecting from all service) relating to future fixed costs can *only* be  
21           communicated with a volumetric charge. To meet sound public policy and



1           ratemaking objectives, it is very important to send price signals that can motivate  
2           and reward economically efficient consumption decisions. That is why a  
3           volumetric charge is the optimal rate design in this case for any merited revenue  
4           requirement increases.

5   **Q.   Does volumetric charge recovery of fixed customer costs violate principles of**  
6   **ratemaking or sub-optimize the economic efficiency of rates?**

7   **A.**   No. Sound ratemaking is based on ensuring that costs are properly allocated to  
8           customer classes based on cost causation. I know of no ratemaking or economic  
9           principle that finds that cost *structure* must be exactly replicated in rate *design*,  
10          especially when significant negative policy impacts are attendant to that approach.  
11          As I previously testified, traditional ratemaking limits customer charges to certain  
12          basic customer connection costs—the meter, billing services, and other similar  
13          general and administrative costs. These are fixed costs that vary by customer  
14          count and typically form the basis and limit for fixed customer charges. Even so,  
15          when the policy impacts discussed above are considered, some of these costs are  
16          best collected through variable charges.

17   **Q.   When costs associated with distribution systems are classified as fixed,**  
18   **should they be collected through the non-bypassable customer charge?**

19   **A.**   Not necessarily, and not if the result is that low usage customers are  
20          disproportionately impacted or that adverse impacts on energy efficiency,  
21          conservation, and DER also result. Recently in other states, some utilities have

1 argued that increased fixed customer charges secure revenue recovery in a world  
2 where customers have more options to reduce their level of usage. I am not aware  
3 of any evidence or analysis, and see none in this record, that increasing fixed  
4 customer charges improves system-wide economic efficiency, the efficiency of  
5 *customer* decisions, or the ability of the Company to meet its objectives as laid  
6 out by Company Witness Sistovaris to be a premier utility in its interactions with  
7 its customers. (Sistovaris, p. 20, lines 12-13.) Absent evidence of system-wide or  
8 customer efficiency benefits, and proof that this type of rate structure will  
9 advance policy and regulatory objectives, fixed customer charges should not be  
10 increased and costs should instead be allocated to variable charges. Again, the  
11 differences in costs that lead to labeling them as fixed or variable does not,  
12 standing alone, tell us anything about the rate design that should be used to  
13 recover them.

14 **Q. How do customers exercise control over their variable and fixed costs?**

15 **A.** The benefit of using volumetric rates to recover both fixed and variable costs is  
16 that class costs are still properly reflected in rates, and that customers have  
17 meaningful, practical, and realistic opportunities to exercise control over their  
18 energy bills and costs. Reductions in use—through efficiency, conservation, or  
19 self-generation—all contribute to reductions in variable energy costs. Moreover,  
20 these behaviors also reduce high peak demand, and by doing so, customers  
21 directly contribute to reduced fixed costs going forward. Efficiency, demand

1 response, west-facing solar, and other options allow customers to contribute to  
2 fixed cost reduction, and all of these are frustrated by shifting cost recovery from  
3 volumetric to fixed charges, as proposed by the Company. There is no evidence in  
4 the record that the Company considered these or other benefits associated with  
5 distributed energy resources.

6 **Q. Do increased fixed charges impact volumetric charges?**

7 **A.** Yes. All other things being equal, increased fixed charges result in lower  
8 volumetric charges. Lower volumetric charges weaken the short- and mid-term  
9 price signal customers receive relating to their consumption. In this way,  
10 increased fixed charges are economically equivalent to and exacerbate the  
11 uneconomic behavior encouraged by declining block electric rates.

12

13 **IV. FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS**

14 **Q. What are your findings based on your review of this case?**

15 **A.** Based on my review of the Company's filings, I find that the Company proposals  
16 to increase the fixed customer charge for residential customers from \$11/month to  
17 \$20/month in proposed Rate 711, and to increase the fixed customer charge for  
18 small non-demand commercial customers from \$20/month to \$30/month in  
19 proposed Rate 721, are premised on flawed ratemaking and economic theory, will  
20 create serious adverse consequences for ratepayers, and will create improper  
21 incentives for the Company to manage costs and improve service.

1    **Q.    What problems does the Company identify in its current rates to justify its**  
2           **efforts to increase “fixed-variable alignment?”**

3    **A.**    None. Other than to say that its Allocated Cost of Service Study (“ACOSS”)  
4           shows that not all of what it classifies as fixed costs are recovered in its fixed  
5           charges, the Company witnesses produced no studies, surveys, analysis, or other  
6           data to demonstrate the actual existence of any actual problems manifest in faulty  
7           rate design. Company Witnesses Shambo and Gaske (1) fail to quantify with any  
8           numbers or analysis any economic inefficiency that attends to current rate  
9           structures, (2) fail to quantify the purported under-recovery of revenues associated  
10          with fixed customer charges or facilities charges that they argue are currently too  
11          low, (3) fail to provide evidence that customers are under-using electric energy  
12          because they improperly consider it too valuable, (4) fail to demonstrate that  
13          current energy efficiency programs and participation rates are excessive or not  
14          cost-effective as a result of incorrectly set customer fixed charges, (5) fail to  
15          demonstrate that the utility has suffered chronic under-recovery problems as a  
16          result of incorrectly set customer fixed charges, and (6) fail to demonstrate with  
17          evidence that the Company has suffered any adverse cost-of-financing or other  
18          threats to its financial integrity as a result of incorrectly set customer fixed  
19          charges.

20   **Q.    Why are these failures significant?**



1    **A.**    These failures are significant because under generally held principles of  
2            regulatory practice, the utility has both the burden of production and persuasion in  
3            seeking to establish and modify rates. And in failing to meet those burdens, the  
4            Company's proposed fixed customer charges cannot be found to be just and  
5            reasonable.

6    **Q.**    **What ultimate conclusion do you reach in your testimony?**

7    **A.**    I conclude that the proposals to increase fixed customer charges in proposed Rates  
8            711 and 721 are unjustified and would be unjust and unreasonable.

9    **Q.**    **What are your recommendations to the Commission?**

10   **A.**    I recommend that the Commission deny the increases reflected in the fixed  
11           customer charges in Rates 711 and 721. Any additional revenue requirement that  
12           is ultimately approved for these rates should be collected through the variable  
13           energy charges in those rates.

14   **Q.**    **Does this conclude your testimony?**

15   **A.**    Yes.