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Sen. Thomas Wyss, Co-Chairperson
Sen. James Merritt
Sen. Vaneta Becker
Sen. Michael Delph
Sen. Beverly Gard
Sen. Victor Heinold
Sen. Brandt Hershman
Sen. Allie Craycraft
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Rep. Matt Whetstone
Rep. Carlene Bottorff
Rep. David Crooks
Rep. Ryan Dvorak
Rep. Win Moses
Rep. Dan Stevenson



REGULATORY FLEXIBILITY COMMITTEE

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Authority: IC 8-1-2.5-9

MEETING MINUTES¹

Meeting Date: September 20, 2006
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington St., Senate Chambers
Meeting City: Indianapolis, Indiana
Meeting Number: 1

Members Present: Sen. Thomas Wyss, Co-Chairperson; Sen. James Merritt; Sen. Vaneta Becker; Sen. Michael Delph; Sen. Victor Heinold; Sen. Brandt Hershman; Sen. Larry Lutz; Rep. Jack Lutz, Co-Chairperson; Rep. David Frizzell; Rep. Robert Behning; Rep. James Buck; Rep. William Ruppel; Rep. Matt Whetstone; Rep. Carlene Bottorff; Rep. Ryan Dvorak; Rep. Dan Stevenson.

Members Absent: Sen. Beverly Gard; Sen. Allie Craycraft; Sen. Earline Rogers; Sen. Connie Sipes; Rep. Timothy Neese; Rep. David Crooks; Rep. Win Moses.

¹ Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.in.gov/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Senator Tom Wyss and Representative Jack Lutz, Co-Chairmen of the Regulatory Flexibility Committee, convened the meeting at 10:05 a.m. Senator Wyss announced that the meeting's agenda would include: (1) a presentation of the Indiana Utility Regulatory Commission's (IURC's) annual reports on the energy and telecommunications industries; and (2) an update on the telecommunications industry's response to HEA 1279-2006.

Annual Reports from the IURC

(1) Report on the Electric Industry²

After setting forth the agenda, Senator Wyss asked Chairman David Lott Hardy of the IURC to present the IURC's annual reports on the energy and telecommunications industries. Chairman Hardy began by acknowledging the work of both his predecessor, Chairman William McCarty, and his fellow Commissioners. He also acknowledged the dedication of the IURC's existing staff and noted the IURC's need to hire additional staff in certain areas, such as in the Pipeline Safety Division. Chairman Hardy further suggested that, although not required by the statutes governing the IURC's reports to the Committee, it would be appropriate for future reports to include updates on water and sewer utilities.

Chairman Hardy thanked legislators for enacting SEA 72-2006, which allows the IURC to deliberate in executive session when taking final action on proposed orders. He noted that this new procedural authority has made the Commissioners' deliberations more efficient. While acknowledging the usefulness of executive sessions, Chairman Hardy also committed the IURC to communicating openly with legislators and other persons interested in its proceedings, whenever such communication is permitted by the IURC's rules. He explained that the IURC would assume responsibility for knowing its own rules governing ex parte and other communications. Given the IURC's commitment to knowing and observing these rules, Chairman Hardy told legislators they should feel comfortable asking questions when they arise. Chairman Hardy described the IURC's increased efforts to serve as a source of information for legislators, consumers, and regulated utilities. Accordingly, the IURC plans to conduct workshops on various utility issues as they arise. These workshops, for which public notice will be given, will allow the IURC to both share and receive information as it formulates its policies.

After updating the Committee on the IURC's accomplishments and goals, Chairman Hardy presented the IURC's annual report on the electric industry. He began by noting that Indiana's regulatory climate has been consistently considered favorable by Wall Street ratings agencies, such as Standard & Poor's. In addition, a Harvard University study cited Indiana as the basis for a model regulation for approving new electric generation facilities. According to Chairman Hardy, the state's favorable regulatory structures improve Indiana's economic competitiveness, reduce uncertainty and mitigate risks for utilities, provide fair returns for investors, and maintain Indiana's reputation as a low-cost energy state. Because of the state's favorable status among ratings agencies, the cost of capital is lower for utilities investing in Indiana, which translates into lower electric rates for Indiana consumers.

Having noted the relatively favorable regulatory climate in Indiana, Chairman Hardy reported that utilities across the nation face regulatory changes due to Congress' enactment of the Energy Policy Act of 2005 (EPAAct 2005). As the first significant energy policy legislation in thirteen years, the EPAAct 2005 included the following major provisions: (1) repeal of the Public Utility Holding Company Act of 1935; (2) establishment of an

²See Exhibit 1.

Electric Reliability Organization under federal jurisdiction; (3) incentives for the construction of new transmission facilities; (4) federal backstop siting for interstate transmission facilities; and (5) amendments to the Public Utility Regulatory Policies Act of 1978. The EAct 2005 also required state regulatory authorities to consider enacting rules concerning net metering, interconnection, fuel diversity, the efficiency of fossil fuel generation, and smart metering to enable time-based rate designs. Chairman Hardy reported that the IURC has already adopted rules with respect to net metering (170 IAC 4-4.2) and interconnection (170 IAC 4-4.3). The IURC's consideration of rulemakings in the areas of fuel diversity and fossil fuel efficiency was initiated by a data request to regulated utilities. Given the EAct's timeline for the consideration of each topic, the IURC has directed its current focus on metering that supports time-differentiated pricing of electric services. Accordingly, the IURC initiated an investigation on July 21, 2006, to consider this topic.

Turning to an area in which there has been a decrease in activity, Chairman Hardy reported that from March 2001 through May 2006, the IURC received no new petitions for the construction of merchant power plants.³ From November 1998 through March 2001, the IURC had received and approved 26 petitions for merchant plant projects. Of the 26 plants that were approved, fifteen of the applications were rescinded, one plant remains inactive, and 10 plants are currently operating. Chairman Hardy attributed investors' waning interest in merchant plants to several factors, including adequate existing generation capacity, high natural gas prices,⁴ and low wholesale market prices. While there has been a lack of interest in gas-fired merchant plants, Chairman Hardy reported that on June 8, 2006, Benton County Wind Farm, LLC, filed a petition to construct 130 MW of wind generation in Benton County. A hearing on the petition is scheduled for October 5, 2006.

As another example of a project that would increase Indiana's generation capacity, Chairman Hardy pointed to a petition by Duke Energy Indiana and Southern Indiana Gas and Electric Company to construct a 630 MW Integrated Gasification Combined Cycle (IGCC) generating facility⁵ in Indiana. Chairman Hardy noted that the petition cited IC 8-1-8.8, which allows utilities to recover construction and operating costs for certain clean coal and energy projects, including coal gasification projects.

³Merchant power plants are generating facilities constructed to sell electricity into the competitive wholesale generation market. Unlike traditional retail utilities that build generating facilities with IURC approval and then recover the costs through a regulated rate structure, companies that construct merchant plants assume the full risk of capital and operating costs. INDIANA UTILITY REGULATORY COMMISSION, 2006 ELECTRIC REPORT TO THE REGULATORY FLEXIBILITY COMMITTEE OF THE INDIANA GENERAL ASSEMBLY 47 (2006).

⁴Many merchant power plants, and all ten of the plants operating in Indiana, use natural gas as a fuel source in generating electricity.

⁵An IGCC facility uses coal gasification to convert coal to a synthetic gas ("syngas") and produces steam as a part of the process. After certain pollutants are removed, the syngas is then used to fuel a combustion gas turbine generator. The heat from the combustion turbine's exhaust is recovered to generate additional steam. The steam from both processes then drives a steam turbine generator to produce electricity. INDIANA UTILITY REGULATORY COMMISSION, 2006 GAS REPORT TO THE REGULATORY FLEXIBILITY COMMITTEE OF THE INDIANA GENERAL ASSEMBLY 36 (2006).

Chairman Hardy next reported on how Indiana's retail electric prices compare to those in other states. According to statistics from the U.S. Energy Information Administration (EIA), Indiana electric utilities reported the eleventh lowest revenues per kilowatt hour for all customers in 2006. The 2006 ranking represents an increase in prices for Indiana customers since both 2005, when Indiana utilities had the tenth lowest revenues, and 2004, when Indiana utilities had the eighth lowest revenues. The increase in revenues to Indiana utilities is the result of increased environmental compliance costs having been passed through to customers. For example, since 2001, Indiana electric utilities have spent \$1.3 billion to reduce nitrogen oxide emissions. As allowed by law, the utilities have recovered this spending through their rate structures. The Indiana Department of Environmental Management has estimated that Indiana electric utilities will spend an additional \$1.6 billion through 2015 to comply with the federal Clean Air Interstate Rule.

Just as utilities have confronted higher environmental compliance costs, they have also faced higher fuel costs. According to Chairman Hardy, from 2004 to 2005, the average fuel cost per MW for Indiana's five investor-owned electric utilities increased 30%, from \$13.08/MW to \$16.98/MW. Because coal fuels over 90% of electric generation in Indiana, the EIA's projection of an 8.4% increase in coal prices from 2005 to 2007 means that Indiana electric utilities are likely to contend with still higher prices in the near future.

In concluding his report on the electric industry, Chairman Hardy examined what the future holds for both the industry and Indiana consumers. As reported by the State Utility Forecasting Group (SUFG), Indiana currently has 22,261 MW of existing generating capacity. The SUFG has predicted that by 2012, Indiana will need an additional 4,120 MW over the 2003 capacity of 19,839 MW. By 2023, the cumulative additional need over the 2003 capacity will grow to 12,220 MW. Chairman Hardy suggested that this increased demand for electricity will require significant new investment by utilities in transmission and distribution equipment. Increased spending by utilities for this equipment will, in turn, increase the likelihood of new rate cases being filed with the IURC. Given the likelihood of more docketed rate cases, Chairman Hardy reiterated the IURC's need to retain and add skilled employees to its ranks.

(2) Report on the Natural Gas Industry⁶

Following his discussion of the electric industry, Chairman Hardy focused on the natural gas industry. He reminded Committee members that the natural gas industry has been largely deregulated over the past decade. He explained that local distribution companies (LDCs) buy natural gas as a commodity in the open market. The prices paid for this gas are not subject to regulation. Typically, LDCs also contract with interstate pipeline companies to purchase transportation rights, the prices for which are regulated by the Federal Energy Regulatory Commission. The IURC, in turn, regulates the price for delivery to the end user. According to Chairman Hardy, the commodity costs that an LDC pays for natural gas represent 70% of a customer's bill, while an LDC's distribution costs account for 30% of a customer's bill. Thus, only 30% of a customer's bill can be attributed to regulated costs of the LDC.

Next, Chairman Hardy displayed graphs showing both historic⁷ and recent⁸ prices for

⁶See Exhibit 2.

⁷See Exhibit 3.

⁸See Exhibit 4.

natural gas in the United States. The graph depicting historic wellhead prices from 1955 through 2005 revealed relatively level prices that remained below \$1.00/Mcf through 1975. Prices then began to rise until the mid 1980s, when they began to level off again. Chairman Hardy noted that prices hovered around \$2.00/Mcf until they began spiking around the year 2000. As demonstrated by the graph showing recent natural gas prices, the NYMEX natural gas settlement price has fluctuated between \$5.00/MBtu and \$6.00/MBtu from May 29, 2006, through September 11, 2006.

Chairman Hardy then reviewed the IURC's recent activities with respect to the natural gas industry. He reported that the IURC has continued to monitor gas prices and the purchasing practices of LDCs through Gas Cost Adjustment (CGA)⁹ proceedings. Due to the volatility in natural gas prices, the scrutiny within these proceedings by both the IURC and the Office of Utility Consumer Counselor (OUCC) has increased dramatically since 2000.

The IURC's Pipeline Safety Division has also assumed increased responsibilities. Chairman Hardy explained that the Division is responsible for enforcing state and federal safety regulations for Indiana's intrastate pipelines. Before 2006, the Division's jurisdiction extended only to gas pipeline facilities. However, with the enactment of HEA 22-2006, the Division now has jurisdiction over pipelines that transport hazardous liquids and carbon dioxide fluids. The Division also has been active in monitoring Indiana's underground plant protection laws and damage prevention programs. Chairman Hardy reported that in 2005, the Federal Communications Commission (FCC) designated "811" as the nationwide three-digit telephone number for contractors and others to call before conducting excavation activities. On August 23, 2006, the IURC issued an order designating the Indiana Underground Plant Protection Service as the administrator of the 811 dialing code in Indiana.

Chairman Hardy then recognized the work of Commissioner Greg Server in implementing HEA 1006-2006, which allows schools to pool their purchasing power for natural gas and to choose their own natural gas marketer. Chairman Hardy reported that Vectren's two LDCs are the only Indiana companies to have applied for changes to their tariffs in order to implement this law.

Finally, Chairman Hardy indicated that the IURC will continue to work with utilities and the Governor's Winter Heating Task Force to meet the needs of low income households for home energy assistance during the 2006-2007 winter heating season.

(3) Report on the Telecommunications Industry¹⁰

Having concluded his reports on energy sector, Chairman Hardy updated the Committee on the many changes that have occurred in the regulation of telecommunications service. Chairman Hardy reported that the IURC's recent activities have focused on the implementation of HEA 1279-2006, which gradually deregulates basic telecommunications service and establishes the IURC as the sole authority for granting statewide video franchises. Upon passage of the bill, the IURC formed an implementation team to focus

⁹Governed by the procedures set forth in IC 8-1-2-42, a gas cost adjustment (GCA) is an adjustment to an LDC's rates to reflect the fluctuating cost of purchased gas. An LDC may pass through the cost of purchased gas to its customers, but it is not allowed to profit from the pass-through.

¹⁰See Exhibit 5.

on five major components of the legislation: (1) streamlining the issuance of certificates of territorial authority (CTAs); (2) video franchising; (3) the creation of the Indiana Lifeline Assistance Program; (4) monitoring broadband service deployment in connection with the "rate transition period" for basic service; and (5) additional reporting requirements for communications service providers.

Upon the enactment of HEA 1279, one of the IURC's first actions was to create a streamlined process for communications service providers to apply for a CTA. Although the legislation does not require the IURC to implement this process until 2009, the IURC decided that doing so immediately would provide more certainty for providers. Accordingly, the IURC issued an emergency order on March 29, 2006, establishing an expedited review process and adopting a new application form. Chairman Hardy noted that the new process does not require an applicant to be represented by an attorney. All applications pending under the former process were immediately identified and directed to be reviewed under the new procedures. According to Chairman Hardy, the IURC has issued 11 CTAs under the streamlined process.

In addition to implementing a new process for CTA applications, the IURC has developed the forms and procedures necessary to carry out its new responsibility as the sole franchising authority for the provision of video service in Indiana. On June 14, 2006, the IURC issued a General Administrative Order (GAO) adopting a Video Franchise Authority Application Form, a Notice of Change Form, and instructions for filing the forms. In addition to the authority to grant franchises, other responsibilities of the IURC with respect to video service include resolving disputes over franchise fees, adopting rules concerning customer notification requirements, reporting to the legislature on the video industry, and establishing certain requirements concerning PEG¹¹ channel capacity and support. Chairman Hardy reported that on August 30, 2006, the IURC issued an order granting AT&T Indiana the first statewide certificate of franchise authority. On August 14, 2006, Daviess-Martin Rural Telephone Corporation filed the second application for a statewide franchise. As of September 6, 2006, the IURC had determined that the Daviess-Martin application was complete, but had not yet issued an order granting the franchise.

HEA 1279 also requires the IURC to establish the Indiana Lifeline Assistance Program to offer reduced charges for basic telecommunications service to low income Indiana customers.¹² The IURC must adopt rules establishing the program by July 1, 2008, and the rules must take effect by July 1, 2009. Additionally, the IURC must determine a funding mechanism for the program based on comparable funding mechanisms for the federal Lifeline program. Accordingly, on July 6, 2006, the IURC opened an official proceeding to address the program's funding mechanism. Chairman Hardy noted that as part of this proceeding, the IURC will conduct a series of workshops with industry personnel to determine the appropriate scope of the IURC's oversight of the fund.

HEA 1279 also gave the IURC new authority with respect to "providers of last resort." As explained by Chairman Hardy, a provider of last resort is required to offer local telephone service throughout a defined geographic area. HEA 1279 specifies that within a given

¹¹As used in IC 8-1-34 (Video Service Franchises), a "PEG channel" refers to a channel made available by a provider on the provider's video service system for public, educational, and governmental programming. (IC 8-1-34-25(b)).

¹²Under IC 8-1-36-9, a customer is eligible for the program if: (1) the customer's income does not exceed 150% of the federal poverty guidelines; or (2) any person in the customer's household receives specified forms of public assistance.

service area, the incumbent local exchange carrier (ILEC) has the obligations of the provider of last resort. However, HEA 1279 allows these obligations to be met "using any available technology."¹³ HEA 1279 additionally requires a provider that seeks to relinquish its obligations as the provider of last resort to provide notice to its customers and the IURC, and allows the IURC to appoint a successor provider of last resort. On June 14, 2006, the IURC issued a GAO adopting a notice form for use by a company that requests a change in its status as a provider of last resort. Chairman Hardy reported that no providers of last resort have yet requested a change in their status.

Addressing the IURC's duties with respect to the deregulation of basic telecommunications service, Chairman Hardy indicated that the IURC had developed a procedure for receiving notices of rate increases during the "rate transition period" from March 28, 2006, through June 30, 2009. The IURC has likewise devised a procedure for monitoring a provider's deployment of broadband service within the service area of the rate increase, and for tracking the 18-month timeframe in which the required deployment must occur. Finally, the IURC has established an internal review team to periodically review and identify any obsolete telecommunications rules that may be eliminated, as required by IC 8-1-2.6-4.1.

Aside from performing the new duties assigned to it under HEA 1279, the IURC has continued to perform its existing duties, to the extent they were preserved by the legislation. For example, HEA 1279 does not affect any alternative regulatory plan (ARP) approved by the IURC before July 29, 2004. Accordingly, the IURC continues to monitor the compliance of ATT&T, Verizon, and Embarq (formerly Sprint) with their respective ARPs. Chairman Hardy noted that the IURC's duties with respect to these plans will end on January 1, 2009, when Embarq's agreement is set to expire.

Chairman Hardy reported that the IURC's Division of Telecommunications has been closely following proposed changes in federal telecommunications policy. For example, a segment of the telecommunications industry has filed a plan with the FCC to reform intercarrier compensation regulations. Known as the "Missoula Plan," the proposed policy would change the method of calculating intercarrier compensation rates, or the payments between carriers for the exchange of traffic over their networks. According to Chairman Hardy, these payments cost carriers between \$5 billion and \$10 billion annually. Because these costs are ultimately passed through to customers, any change in the cost structure will impact consumers. Chairman Hardy assured Committee members that the IURC is carefully monitoring the proposals in order to protect the interests of Indiana consumers. Similarly, the IURC is also tracking comprehensive telecommunications reform legislation that is moving through both houses of Congress.¹⁴ Chairman Hardy reported that the IURC is working with other state commissions to prevent the federal preemption of state video franchising legislation. The IURC also seeks to preserve its existing authority with respect to universal service.

Chairman Hardy concluded his report on the telecommunications industry by highlighting the activities of the Consumer Affairs Division. In 2005, the Division carried out its traditional role of registering and resolving consumer complaints. With the passage of HEA 1279, the Division has continued to receive complaints, but now directs customers to the company involved to resolve most issues. However, Chairman Hardy noted that HEA

¹³IC 8-1-32.4-11.

¹⁴On June 8, 2006, the U.S. House of Representatives passed H.R. 5252 (Rep. Joe Barton, R-TX) by a vote of 321-101. On June 28, 2006, the bill was amended and passed by the Senate Commerce, Science and Transportation Committee by a vote of 15-7.

1279 preserves the IURC's authority to resolve complaints concerning basic telecommunications service (until July 1, 2009) and slamming and cramming.¹⁵ In 2005, billing disputes comprised 30% of the all telecommunications complaints received by the Division, followed by cramming complaints, which made up 14% of the total. Chairman Hardy further noted that after July 1, 2006, the Division began to register video service complaints, which it handles by directing customers to the appropriate video service provider for resolution.

Industry Response to HEA 1279

Following Chairman Hardy's presentation, Senator Wyss invited industry representatives to discuss their efforts to deploy broadband and video services since the enactment of HEA 1279. He asked George Fleetwood, President of AT&T Indiana, to address the Committee.

(1) AT&T¹⁶

Mr. Fleetwood began by thanking legislators for enacting HEA 1279. He described the bill as one of the most progressive telecommunications laws in the nation, and suggested that it would result in more providers entering the market to deliver communications services to customers. He then presented a video featuring local news coverage of AT&T's announcement of its new Internet Protocol television service (IPTV), known as "U-verse." After the video, Mr. Fleetwood reported that AT&T will invest \$250 million to deploy IPTV, along with highspeed Internet access, to customers across Indiana. He stated that digital subscriber line (DSL) broadband service would be deployed to all 160 of AT&T's central offices by early 2007. He explained that 127 of these offices are currently equipped to provide DSL, and that the remaining 33 offices would have this capability by the end of next year's first quarter. Mr. Fleetwood noted that this capability would help AT&T meet its goal of offering high speed Internet access to 50% of the homes it serves by the end of 2008.

In addition to its efforts to deliver broadband and IPTV, AT&T has established a partnership with DISH Network to provide AT&T Homezone, a service that will integrate satellite TV and broadband service. According to Mr. Fleetwood, Homezone will feature a set-top box that will give customers access to satellite TV, a digital video recorder, caller ID on TV, movies on demand, photo sharing, and music. Mr. Fleetwood then presented a second video illustrating the various features of this product.

(2) Verizon

Senator Wyss then invited remarks from Gale Given, President of Verizon's Great Lakes Region. Ms. Given also thanked legislators for encouraging competition and investment in Indiana's communications infrastructure by enacting HEA 1279. She then announced that Verizon will introduce its all-digital, fiber-based FiOS TV service in Fort Wayne in 2007.

¹⁵"Slamming" is a practice in which a customer is switched from one telecommunications provider to another without the customer's consent. "Cramming" involves the adding of telecommunications services to a customer's bill without the customer's authorization. Under IC 8-1-29, the IURC has the authority to investigate complaints, hold hearings, and impose civil penalties for violations of state statutes and rules prohibiting slamming and cramming.

¹⁶See Exhibit 6.

Ms. Given noted that Verizon had already introduced its FiOS Internet service in Fort Wayne and New Haven last year. She explained that both the FiOS TV and FiOS Internet services are delivered over an all-fiber network that extends all the way into customers' homes, apartments, and offices. When FiOS TV is offered in Fort Wayne next year, the city will join 80 cities in parts of seven other states where Verizon already offers the service.

(3) Embarq

Rich Higgins, Manager of Government Relations for Embarq (formerly Sprint), provided the final update from the industry. Like the other industry representatives, he commended the General Assembly for enacting HEA 1279. He explained that when HEA 1279 was enacted, Embarq did not yet exist as a business entity. Rather, after emerging from Sprint's local phone business in Indiana, the company began doing business under its current name in May 2006. He reported that Embarq's 250,000 access lines provide service in 50 counties in Indiana. While predicting that the incentives offered by HEA 1279 would encourage Embarq to invest in even more broadband deployment in the future, Mr. Higgins noted that the company has already committed to deploying broadband service to 70% of its exchange areas by December 2008, as part of its existing ARP. Mr. Higgins reported that Embarq has made significant progress in meeting that commitment, pointing out that 91 of Embarq's 93 exchanges currently have DSL capability.

After thanking the industry representatives and Chairman Hardy for their testimony, Senator Wyss adjourned the meeting at 11:55 a.m.