STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 831

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Application of Duke Energy Carolinas, LLC for Approval of Save-a-Watt Approach, Energy Efficiency Rider and Portfolio of Energy Efficiency Programs	)	ORDER APPROVING AGREEMENT AND JOINT STIPULATION OF SETTLEMENT SUBJECT TO CERTAIN COMMISSION-REQUIRED MODIFICATIONS AND DECISIONS ON CONTESTED ISSUES

HEARD IN: Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina on August 19, 2009

BEFORE: Chairman Edward S. Finley, Jr., Presiding; and Commissioners Robert V. Owens, Jr., Lorinzo L. Joyner, and William T. Culpepper, III

APPEARANCES:

For Duke Energy Carolinas, LLC:

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For the Using and Consuming Public:

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For N.C. Waste Awareness & Reduction Network (NC WARN):

John D. Runkle, Attorney at Law, P.O. Box 3793, Chapel Hill, North Carolina 27515

For North Carolina Justice Center (NCJC), AARP, North Carolina Council of Churches (NCCC), and Legal Aid of North Carolina (LANC):

Jack Holtzman, North Carolina Justice Center, 224 South Dawson Street, Raleigh, North Carolina 27601

For the Carolina Industrial Group for Fair Utility Rates (CIGFUR III) and Air Products and Chemicals, Inc.:

Ralph McDonald, Bailey & Dixon, LLP, P.O. Box 1351, Raleigh, North Carolina 27602

For the Carolina Utility Customers Association, Inc. (CUCA):

Robert F. Page, Crisp, Page, & Currin, LLP, Suite 205, 4010 Barrett Drive, Raleigh, North Carolina 27603

For Environmental Defense Fund, Natural Resources Defense Council, Southern Alliance for Clean Energy and Southern Environmental Law Center:

Gudrun Thompson, Southern Environmental Law Center, 200 West Franklin Street, Suite 330, Chapel Hill, North Carolina 27516

For North Carolina Sustainable Energy Association:

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BY THE COMMISSION: On May 7, 2007, Duke Energy Carolinas, LLC (Duke, Company) filed an application in this docket for approval of its save-a-watt approach, energy efficiency rider, and portfolio of energy efficiency.

The following parties have been allowed to intervene in this matter: the North Carolina Attorney General; the Public Staff – North Carolina Utilities Commission (Public Staff); the Carolina Utility Customers Association, Inc. (CUCA); the Carolina Industrial Group for Fair Utility Rates (CIGFUR III); Piedmont Natural Gas Company, Inc. (Piedmont); the Southern Alliance for Clean Energy (SACE); the North Carolina Waste Awareness & Reduction Network, Inc. (NC WARN); Virginia Electric and Power Company d/b/a Dominion North Carolina Power (Dominion); Progress Energy Carolinas, Inc. (PEC); the North Carolina Sustainable Energy Association (NCSEA); Public Service Company of North Carolina, Inc. (PSNC); the City of Durham; Wal-Mart Stores East, LP (Wal-Mart); Environmental Defense (ED); the Southern Environmental Law Center (SELC); Air Products and Chemicals, Inc. (Air Products); the North Carolina Justice Center (NCJC), AARP, North Carolina Council of Churches (NCCC) and Legal Aid of North Carolina (LANC) (collectively, the Public Interest Intervenors); and the Natural Resources Defense Council (NRDC).

On May 24, 2007, Piedmont filed a motion for establishment of a generic proceeding. On May 31, 2007, the Commission entered an order requesting comments regarding the statutory authority for the relief requested by Duke and the appropriateness of converting this docket into a generic investigation as requested by Piedmont. PEC and Dominion filed comments on June 20, 2007; Duke, the Attorney General, the Public Staff, CUCA, CIGFUR III, SACE, NCSEA, and PSNC filed comments on June 22, 2007; NC WARN filed comments on June 25, 2007; Dominion filed further comments on June 29, 2007; and the City of Durham filed initial comments on July 3, 2007. Reply comments were filed by Duke, PEC, PSNC, SACE, the Public Staff, NCSEA, CIGFUR III, and Piedmont on July 13, 2007; and the City of Durham filed reply comments on July 16, 2007. The Henderson County Chamber of Commerce filed notice of its support of Duke's proposed energy efficiency plan on July 12, 2007 and August 3, 2007.

On August 2, 2007, the Commission issued an order denying Piedmont's petition for establishment of a generic proceeding and consolidating Duke's application in this docket with Docket Nos. E-7, Subs 828 and 829 and E-100, Sub 112, dockets which the Commission had consolidated earlier for purposes of hearing. Docket No. E-7, Sub 828 was Duke's then-pending general rate case proceeding. At that time, the Commission acknowledged that pending legislation (Senate Bill 3) would address the Commission's authority to examine energy efficiency programs and cost recovery for such programs outside of general rate cases. However, because Senate Bill 3 had not yet been enacted and the Commission was concerned with losing its opportunity to consolidate the energy efficiency docket with the general rate case, the Commission consolidated the dockets, reserving the right for reconsideration.

On August 14, 2007, Duke moved for reconsideration and requested to deconsolidate the energy efficiency docket on the grounds that Senate Bill 3, ratified by the General Assembly on August 2, 2007, includes G.S 62-133.8[1] which provides the Commission with express authority to consider and grant the relief requested by Duke's energy efficiency application, obviating the need to combine the energy efficiency docket with Duke's general rate case proceeding. In this motion, Duke also proposed a procedural schedule. On August 15, 2007, the Commission entered an order requesting comments on Duke's motion. Comments were filed on August 21, 2007, by CIGFUR III, CUCA, PSNC, Wal-Mart, the Public Staff and the Attorney General. On August 29, 2007, Duke, the Public Staff and the Attorney General filed reply comments.

On August 31, 2007, the Commission issued an order bifurcating this docket from Duke's pending general rate case investigation. The Commission concluded that Senate Bill 3, signed by the Governor August 20, 2007, authorized the Commission to hear the energy efficiency docket separate from general rate case proceedings, and that Duke's save-a-watt application should not be heard and decided until after the Commission completed its rulemaking to implement Senate Bill 3. On

[1] Renumbered G.S. 62-133.9 at the direction of the Revisor of Statutes.

February 29, 2008, the Commission issued its Order Adopting Final Rules in Docket No. E-100, Sub 113 adopting new rules and amendments to implement Senate Bill 3; that same day the Commission also issued its Order Scheduling Hearing in this docket.

On March 11, 2008, the Alliance to Save Energy, the American Council for an Energy-Efficient Economy, and the Energy Future Coalition filed notice of their agreement with Duke to support Duke's save-a-watt plan. These groups asked the Commission to include the first four elements of this agreement[2] in its ruling on this docket.

On April 4, 2008, Duke filed the direct testimony and exhibits of James E. Rogers, Chairman, President and Chief Executive Officer of Duke Energy Corporation (Duke Energy); Ellen T. Ruff, President of Duke; Judah Rose, Managing Director of ICF International; Jane Sadowsky, Senior Managing Director of Evercore Partners; Charles J. Cicchetti, co-founder and member in Pacific Economic Group, L.L.C.; Theodore E. Schultz, Vice President – Energy Efficiency, Duke Energy; Janice D. Hager, Managing Director of Integrated Resource Planning and Environmental Strategy, Duke; Richard G. Stevie, Managing Director of Customer Market Analytics for Duke Energy Shared Services, Inc.; Nick Hall, President and owner of TecMarket Works; Stephen M. Farmer, an independent contractor who provides rate and regulatory consulting services; and J. Danny Wiles, Vice President – Franchised Electric & Gas Accounting, Duke.

Duke filed an Agreement and Stipulation of Settlement with PSNC (PSNC Settlement Agreement) on June 24, 2008. An Agreement and Stipulation of Settlement between Duke and Piedmont (Piedmont Settlement Agreement) was filed on June 26, 2008.

The Public Interest Intervenors filed the direct testimony and exhibits of Roger D. Colton on June 24, 2008. On or about June 26, 2008, ED, NRDC, SACE and SELC (collectively, the Environmental Intervenors) filed the direct testimony and exhibits of Donald Gilligan, Brian M. Henderson and J. Richard Hornby; Air Products filed the direct testimony of James Butz; CIGFUR III filed the direct testimony and exhibits of Nicholas Phillips, Jr.; Wal-Mart filed the direct testimony and exhibits of James T. Selecky; CUCA filed the direct testimony of Kevin W. O'Donnell; and the Public Staff filed the direct testimony and exhibits of Jack Floyd, Michael C. Maness and Richard F. Spellman. NC WARN filed the direct testimony and exhibit of John O. Blackburn on June 27, 2008.

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[2] (1) Identify and pursue every cost-effective energy efficiency program. Duke will not impose any predetermined cap on Duke's total energy efficiency investment.
(2) An overall energy efficiency target for save-a-watt to achieve on-going annual electricity savings of at least 1% of its 2009 retail sales by 2015 (i.e., 1% savings in 2015, an additional 1% to total 2% in 2016, etc.), with savings each year over the 2009-2014 period ramping up to this 1% per year target.
(3) The use of accepted best practices in program evaluation, measurement and verification (EM&V). Duke is committed to allocate 5% of energy efficiency expenditures to EM&V.
(4) Make evaluation results available to all interested parties, to establish a broad-based peer review and advisory process, and to use evaluation results as feedback to continuously improve Duke's programs.

On July 21, 2008, Duke filed the rebuttal testimony and exhibits of Richard A. Morgan, President of the consulting firm Morgan Marketing Partners, and witnesses Cicchetti, Stevie, Rose, Hager, Wiles, Farmer and Schultz. The case came on for hearing as ordered on July 28, 2008. On August 1, 2008, the Public Staff filed two late-filed exhibits requested by the Commission regarding data on the top twenty electric energy efficiency utilities in the United States for the years 2004 and 2006. On August 7, 2008, the Attorney General filed Attorney General's Office Stevie Cross-Examination Exhibit No. 3, a reproduction of the information placed on the blackboard by the Attorney General's counsel and used during the cross-examination of Duke witness Stevie, which was requested by the Commission. On August 13, 2008, Duke filed the supplemental testimony and exhibits of witness Schultz in response to questions by the Commission during the hearing; the Public Staff filed the affidavit of witness Maness in response to this supplemental testimony on August 25, 2008. Duke filed one late-filed exhibit on August 18, 2008, and two more on August 27, 2008.

The parties submitted proposed orders and/or briefs on October 7, 2008. Proposed orders were submitted by Duke, the Public Staff, and the Public Interest Intervenors. Briefs were filed by Duke, the Public Interest Intervenors, the Environmental Intervenors, CUCA, NC WARN, the Attorney General, and jointly by CIGFUR III and Air Products.

On February 26, 2009, the Commission issued its Order Resolving Certain Issues, Requesting Information on Unsettled Matters, and Allowing Proposed Rider to Become Effective Subject to Refund in this docket (February 26, 2009 Order). Also on February 26, 2009, an errata order was issued replacing the supplemental information section of the February 26, 2009 Order beginning on page 60 and ending on page 63. On March 20, 2009, Air Products petitioned the Commission to reconsider the February 26, 2009 Order. On March 31, 2009, Duke filed the supplemental information requested in the February 26, 2009 Order and errata order.

The February 26, 2009 Order required Duke to work with the Public Staff to prepare a Notice to Customers giving notice of its proposed Rider EE. Duke and the Public Staff developed a Notice to Customers, which Duke filed on May 1, 2009. Duke filed Revised Tariffs and Riders on May 7, 2009. On May 8, 2009, the Commission approved the Revised Tariffs and Riders and the Notice to Customers and required Duke to publish the Notice.

On May 22, 2009, the Public Interest Intervenors filed comments regarding the supplemental information Duke filed in response to the February 26, 2009 Order. NC WARN filed comments on May 26, 2009. On June 12, 2009, the Public Staff and CUCA filed comments.

Also on June 12, 2009, Duke, the Environmental Intervenors and the Public Staff (collectively, the Stipulating Parties) filed an Agreement and Joint Stipulation of Settlement (Settlement Agreement or Agreement). On June 19, 2009, the Public Staff

filed the settlement testimony of James S. McLawhorn; the Environmental Intervenors filed the settlement testimony and exhibits of John D. Wilson; and Duke filed the settlement testimony and exhibits of witnesses Wiles, Schultz, and Farmer.

On June 18, 2009, the Commission issued an order requiring both Duke and the Public Staff to file (a) Modified Internal Rate of Return (MIRR) analyses consistent with the Settlement Agreement, given their respective positions on the appropriate inputs to the MIRR calculations, and (b) testimony regarding the outstanding issue between the Stipulating Parties of the appropriate jurisdictional allocation method to use in determining the North Carolina retail Demand-Side Management/Energy Efficiency (DSM/EE) Rider.[3] The June 18, 2009 Order also scheduled a hearing on August 12, 2009, to consider the Settlement Agreement filed by the Stipulating Parties. In accordance with this order, on June 26, 2009, Duke filed the MIRR testimony and exhibit of Raiford L. Smith, the Director of Strategy and Collaboration for Duke Energy Business Services, LLC. On July 2, 2009, the Public Staff filed the supplemental testimony and exhibits of witness Maness. Also on July 2, 2009, the Commission issued an Order rescheduling the hearing, to consider the Settlement Agreement, to August 19, 2009.

On July 22, 2009, Air Products moved for the Commission to enter an order requesting comments on its petition to reconsider the February 26, 2009 Order, and if deemed necessary, scheduling an oral argument. On August 17, 2009, the Commission issued an order denying Air Products' petition to reconsider and its motion.

On July 27, 2009, the Public Interest Intervenors filed the supplemental testimony of witness Colton. On August 10, 2009, Duke filed the rebuttal testimony of witness Smith in response.

On July 30, 2009, the Commission entered a pre-hearing order requesting verified information from the Stipulating Parties, which Duke responded to on August 10, 2009. The Commission entered a second pre-hearing order requesting verified information from the Environmental Intervenors and the Public Staff on August 14, 2009, which both responded to on August 18, 2009.

The case came on for hearing as ordered on August 19, 2009. On August 28, 2009, Duke filed late-filed exhibits in response to questions posed by the Commission during the hearing. The Public Staff filed late-filed exhibits on September 1, 2009. The deadline for parties to file proposed orders and/or briefs was October 7, 2009.

On December 14, 2009, the Commission entered a Notice of Decision in this docket. The Notice of Decision stated that the Commission was approving the Settlement Agreement subject to certain specified modifications and decisions on contested issues and that the Commission would thereafter enter an Order Approving

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[3] In this same order, the Commission decided to hold in abeyance any further consideration of the supplemental information filed by Duke on March 31, 2009.

Agreement and Joint Stipulation of Settlement Subject to Certain Commission-Required Modifications and Decisions on Contested Issues. Duke was authorized to submit revised save-a-watt rates and tariffs for implementation for service rendered on and after January 1, 2010. Duke was requested to consult with the Public Staff prior to filing any revised tariffs and a proposed customer notice to ensure that the Public Staff was in agreement therewith.

On December 23, 2009, the Commission approved Duke's proposed customer notice and on December 28, 2009, the Commission approved Duke's proposed compliance rate schedules.

Based upon consideration of the pleadings, testimony, and exhibits received into evidence at the hearing, and the record as a whole, the Commission now makes the following

FINDINGS OF FACT

1. Duke is a public utility with a public service obligation to provide electric utility service to customers in its service area in North Carolina and is subject to the jurisdiction of the Commission.

2. The Commission has jurisdiction over this application and the Settlement Agreement pursuant to the Public Utilities Act. A utility must submit cost-effective DSM and EE options that require incentives to the Commission for approval and may petition the Commission for approval of an annual rider to recover all reasonable and prudent costs incurred for the adoption and implementation of new DSM and EE measures pursuant to G.S. 62-133.9 and Commission Rules R8-68 and R8-69. The Commission concludes that it has the authority to consider and approve the relief Duke is seeking in this docket.

3. On May 7, 2007, Duke filed its application for approval of the save-a-watt approach (the original save-a-watt proposal), EE rider (Rider EE) and portfolio of EE and DSM programs (collectively, the EE plan) with the Commission. After the filing of testimony and exhibits and a fully litigated hearing, the Commission issued the February 26, 2009 Order, in which it resolved certain issues, requested information on unsettled matters, and allowed the proposed Rider EE to become effective subject to refund.

4. On June 12, 2009, the Stipulating Parties filed the Settlement Agreement, which resolves all issues between the Stipulating Parties associated with Docket No. E-7, Sub 831, including Duke's EE plan and Duke's proposed compensation model; except for certain cost allocation issues, which the Stipulating Parties requested that the Commission decide in this proceeding, and the issue of the interest rate to be applied to refunds to customers resulting from overcollection, which the Stipulating Parties requested that the Commission decide in the first annual true-up proceeding in which an overcollection occurs.

5. The Settlement Agreement proposed a "Modified Save-a-Watt Approach" whereby Duke would be compensated based on predetermined percentages of Duke's capacity- and energy-related "avoided costs," which would represent an estimate of the cost of supplying electricity. These percentages include 75% of avoided capacity costs for DSM programs, and 50% of the net present value (NPV) of the avoided energy costs plus 50% of the NPV of avoided capacity costs for EE programs. The Commission concludes that the level of avoided cost recovery proposed in the Settlement Agreement is reasonable and in the public interest.

6. The modified save-a-watt approach has a term of four years, and it is a pilot program.

7. The Settlement Agreement provides for increased energy savings targets as compared to the original save-a-watt proposal.

8. The Settlement Agreement includes a performance target of avoided cost savings based on projected EE and DSM results. Duke's avoided cost target, based on 100% participation, is $754 million[4] (nominal system dollars) and is tied to target capacity and cumulative energy savings for the life of the EE measures. The Commission concludes that Duke's performance targets under the Settlement Agreement are appropriate.

9. The earnings to Duke that result from the incentive compensation will be capped at a percentage of incurred program costs not to exceed 15%. The specific percentage applied to program costs to determine the earnings cap will be based on the percentage of the target avoided cost savings actually achieved. The earnings cap based on Duke's performance helps ensure that customers receive fair value and that their rates remain reasonable.

10. The Settlement Agreement and supporting testimony provide for the separate recovery of 36 months of net lost revenues, as defined by Commission Rule R8-68, resulting from EE measures only. The Commission authorizes Duke to recover net lost revenues for 36 months for each installation of an EE measure during a given vintage year,[5] except that the recovery of net lost revenues will end upon Commission approval of an alternative recovery mechanism, or the implementation of new rates in a general rate case or comparable proceeding to the extent that rates set in a rate case or comparable proceeding are set to explicitly or implicitly recover those net lost revenues. Recovery of net lost revenues for vintage year installations not covered by the new rates will continue, subject to the 36 month limitation.

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[4] As shown in Duke's Late-Filed Exhibits, the avoided cost target for North Carolina only is $547 million.

[5] A vintage year is the twelve month period in which a specific DSM or EE measure is installed for an individual participant or a group of participants.

11. The cumulative jurisdictional revenue requirement for the four-year term of the Settlement Agreement is significantly less under the Settlement Agreement than under the original save-a-watt proposal. The rate impacts under the Agreement are reasonable in light of Duke's increased energy and capacity savings targets, and Duke's revised Rider EE reflecting these rate impacts is in the public interest and should be approved.

12. After the conclusion of the four-year term of the Settlement Agreement, actual measured and verified avoided cost savings will be compared to the target avoided cost savings in a final true-up proceeding. The true-up process provides a reasonable means of ensuring that Duke does not collect revenues for its DSM and EE programs in excess of what is allowed under the Agreement.

13. The costs of Duke's DSM and EE programs should be allocated to the North and South Carolina retail jurisdictions, and such costs should be recovered from only the class or classes of retail customers to which the programs are targeted. No costs of any approved DSM or EE program should be allocated to the wholesale jurisdiction. The reduced energy consumption resulting from the implementation of EE measures, or EE Renewable Energy Certificates (RECs), thus paid for by Duke's retail customers should be used solely for Duke's Renewable Energy Portfolio Standard (REPS) compliance obligation.

14. The Settlement Agreement provides for the creation of a Regional Efficiency Advisory Group (the Advisory Group) to review the measurement and verification process, collaborate on new program ideas, and review changes to existing programs. The Commission concludes that the establishment of this Advisory Group is in the public interest.

15. Pursuant to Commission Rule R8-27(a)(2), the Commission authorizes Duke, for North Carolina jurisdictional regulatory accounting purposes, to utilize Account 182.3 – Other Regulatory Assets to record the difference between the level of revenues estimated to be ultimately recoverable under the Settlement Agreement and the level of revenues then currently billed under Rider EE when it is probable that such ultimately recoverable revenues will be greater than the currently billed revenues, and Account 254 – Other Regulatory Liabilities to record the difference between the level of revenues then currently billed customers and the level of revenues that is estimated to be ultimately recoverable when it is probable that such currently billed revenues are in excess of the revenues ultimately recoverable.

16. The methods and criteria to be utilized in determining the interim and ultimate rates charged for the term of the Settlement Agreement, including the true-up processes discussed herein, are sufficient to support deferral accounting for North Carolina jurisdictional regulatory purposes.

17. With regard to save-a-watt, Duke should be required (1) to include all actual program revenues (estimated, if not known) and only actual program costs

(estimated, if not known) for purposes of calculating and presenting its regulated earnings to the Commission for NCUC ES-1 purposes; (2) to provide supplementary schedules setting forth the Company's jurisdictional earnings excluding the effects of EE and DSM programs; and (3) to provide schedules separately stating the earnings impact of its DSM and EE programs on a combined basis as well as on a stand-alone, program-class basis, that is, with earnings from DSM programs, collectively, and earnings from EE programs, collectively, shown separately. Detailed calculations of the foregoing should also be provided. Such schedules and/or calculations should show, at a minimum, actual revenues; expenses; taxes; operating income; investment base, including major components where applicable; and applicable capitalization ratios and cost rates, including overall rate of return and return on common equity. Net lost revenues realized (estimated, if not known) for each reporting period should be clearly disclosed as supplemental information.

18. The Commission concludes that the Public Interest Intervenors have not presented any new evidence justifying revision of Duke's EE and DSM programs that were approved in the February 26, 2009 Order. The Public Interest Intervenors' request for rejection and/or modification of the Settlement Agreement should be denied.

19. The Settlement Agreement is reasonable and appropriate and in the public interest. The incentives proposed by the Stipulating Parties, including net lost revenues and the modified save-a-watt approach, are reasonable and appropriate and in the public interest.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1 AND 2

The evidence in support of these findings of fact can be found in the application, Settlement Agreement, pleadings, testimony and exhibits in this docket, and the statutes, case law, and rules governing the authority and jurisdiction of this Commission. These findings are informational, procedural, and jurisdictional in nature.

Prior to the passage of Senate Bill 3, the Commission's authority to authorize cost recovery pursuant to a rider for DSM and EE programs was unclear. The Commission requested comments on its authority to consider Duke's application and eventually consolidated Docket No. E-7, Sub 831 with Duke's general rate case proceeding. Although the Commission acknowledged that the pending Senate Bill 3 would expressly address whether the Commission possessed this authority, because enactment was possibly several weeks away, the Commission consolidated the dockets, reserving the right to reconsider its decision. Duke requested reconsideration of consolidation shortly after the General Assembly ratified Senate Bill 3. Senate Bill 3 became law soon thereafter, and the Commission accordingly granted Duke's request and bifurcated Docket No. E-7, Sub 831 from Duke's general rate case.

Among other things, Senate Bill 3 contains the new G.S. 62-133.9, which concerns cost recovery for DSM and EE programs. This specific statute grants the Commission the authority to approve an annual rider, outside of a general rate case, for recovery of reasonable and prudent costs incurred in the adoption and implementation

of new DSM and EE measures. G.S. 62-133.9(c) specifically provides that utilities shall submit DSM and EE programs that require incentives to the Commission for approval.

Commission Rule R8-68 establishes guidelines for the application of G.S. 62-133.9. Under this Rule, a utility must obtain Commission approval before implementing any new or modified DSM or EE measure. Rule R8-68 sets forth detailed filing requirements and outlines what the Commission may consider in deciding whether to approve a new measure or program. The Rule also provides that reasonable and prudent costs of new DSM or EE programs approved by the Commission shall be recovered through the annual rider described in G.S. 62-133.9 and Rule R8-69. The Commission may also consider in the annual rider proceeding whether to approve any utility incentive pursuant to G.S. 62-133.9(d)(2)a-c.

Commission Rule R8-69 outlines the procedure whereby a utility applies for and the Commission establishes an annual DSM/EE rider. The Rule defines a DSM/EE rider as "a charge or rate established by the Commission annually pursuant to G.S. 62-133.9(d) to allow the electric public utility to recover all reasonable and prudent costs incurred in adopting and implementing new demand-side management and energy efficiency measures after August 20, 2007, as well as, if appropriate, utility incentives, including net lost revenues." Rule R8-69(a)(2). Rule R8-69(c) allows a utility to apply for recovery of incentives for which the Commission will determine the appropriate ratemaking treatment.

G.S. 62-133.9, Rule R8-68, and Rule R8-69 establish a procedure whereby an electric public utility files an application in a unique docket for the Commission's approval of an annual rider for recovery of reasonable and prudent costs of EE and DSM programs as well as appropriate utility incentives, including specifically "[a]ppropriate rewards based on capitalization of a percentage of avoided costs achieved by demand-side management and energy efficiency measures." The incentives Duke seeks under the modified save-a-watt approach are based upon paying Duke a percentage of the avoided capacity costs achieved by DSM measures, and a separate percentage of the NPV of avoided capacity costs and avoided energy costs achieved by EE measures. In addition, the Settlement Agreement provides for a limited period of recovery of Duke's net lost revenues resulting from implementation of its EE measures. The Commission concludes that it has the authority to consider and approve the relief Duke is seeking in this docket.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

The evidence in support of this finding can be found in the application, the proposed order and brief Duke submitted on October 7, 2008, and the Order issued by the Commission on February 26, 2009, in this docket.

On May 7, 2007, Duke filed its application in this docket proposing its EE plan. By this filing, Duke requested approval of its original save-a-watt proposal, a portfolio of EE programs, and Rider EE to compensate and reward it for verified DSM and

EE results and to recover the amortization of, and a return on, 90% of the costs avoided by the EE plan. More specifically, Duke requested that the Commission, after hearing, issue an order approving (1) the implementation of the original save-a-watt proposal; (2) the portfolio of proposed EE programs; (3) the implementation of the proposed Rider EE, including the proposed initial charges for customers; (4) the deferral of program costs and amortization of such costs over the life of the applicable program, with an acknowledgement that the revenues established in Rider EE based on avoided costs specifically include the recovery of incurred program costs; (5) the closing of designated existing programs; and (6) the proposed manner of accounting for the impacts of the original save-a-watt proposal in Duke's Quarterly Surveillance Reports (NCUC Form ES-1 Reports) to the Commission.

The Commission held hearings on Duke's application in July and August 2008.

On February 26, 2009, the Commission entered an Order granting Duke's request for approval of its portfolio of proposed EE programs. The Commission also approved Duke's DSM program Power Manager, and provided that current customers on Rider LC be given the option to discontinue participation before being transferred automatically to Power Manager. Similarly, the Commission approved the PowerShare DSM program, and provided that existing current customers on Rider IS and Rider SG be allowed to continue to participate in those programs at their current contract levels. The Commission granted Duke's request to close certain existing programs. In addition, Duke's proposed measurement and verification plan was approved by the Commission, as were its settlement agreements with Piedmont and PSNC. The Commission also ordered that certain types of program changes would require Commission approval. The Commission rejected Duke's proposed accounting and reporting procedures, and specified a different approach in the February 26, 2009 Order. Finally, the Commission allowed Duke's proposed Rider EE to become effective subject to refund.

The Commission determined that the record was not adequate to allow it to reach a decision regarding certain issues concerning the appropriateness of Duke's save-a-watt, avoided cost-based compensation mechanism. Accordingly, the Commission required Duke to provide certain supplemental information and data, and deferred ruling on the proposed compensation mechanism. Duke filed this supplemental information, and several intervenors submitted their comments thereto, but the Commission decided to hold in abeyance its consideration of this supplemental information pending consideration of the Settlement Agreement.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

The evidence in support of this finding can be found in the Settlement Agreement and the testimony of Duke witness Stephen Farmer.

On June 12, 2009, the Stipulating Parties filed the Settlement Agreement, which resolved all issues between the Stipulating Parties associated with

Docket No. E-7, Sub 831, including Duke's proposed compensation model, except for certain cost allocation issues which the Stipulating Parties requested that the Commission decide in this proceeding and the issue of the interest rate to be applied to refunds to customers resulting from overcollection, which the Stipulating Parties requested that the Commission decide in the first annual true-up proceeding in which an overcollection occurs.

The Settlement Agreement retains many features of Duke's original save-a-watt proposal. For example, the Agreement provides for compensation to Duke for successful implementation of DSM and EE programs on the basis of a discount to the "avoided costs" of a power plant rather than on the basis of what Duke spends on DSM and EE programs. This compensation is based upon actual DSM and EE savings achieved, measured and verified by an independent third party as described in the testimony of Duke witnesses Dr. Richard D. Stevie and Nick Hall, filed in this docket on April 4, 2008.[6] As in the original save-a-watt proposal, Duke bears the risk, based upon its actual performance, for recovery of its DSM and EE program costs, as well as any management incentive.

The Settlement Agreement incorporates a number of provisions that are important to the Environmental Intervenors. For example, the Agreement contains performance targets pursuant to which Duke is eligible to receive a higher level of incentive based upon its performance in achieving actual demand and energy reductions that result in bill savings for customers, as well as environmental benefits. The performance targets reflect a significant increase in energy savings when compared to the original save-a-watt proposal. To protect consumers and encourage strong performance, Duke's earnings opportunity is tied to Duke's performance in achieving its targets, and is capped at preset percentages of return on investment on program costs, ranging from 5% to 15%.

Along with certain of the provisions listed above, the Settlement Agreement also incorporates additional provisions that are important to Duke, the Public Staff, and the Environmental Intervenors. First, Duke proposed the modified save-a-watt model as a four year limited term pilot, which limits the exposure of the parties to unintended consequences that can occur with a new regulatory approach. Second, Duke's revenues recovered on the basis of percentages of avoided costs are limited to the amount necessary to produce an after-tax return on program costs between 5% and 15%, depending on Duke's success in reaching the target aggregate DSM and EE avoided cost savings level. Third, the amount of net lost revenues that Duke may recover is limited to those incurred within 36 months of implementation of a particular measure. The Settlement Agreement and supporting testimony provide for the separate

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[6] The Commission approved Duke's proposed Measurement & Verification Plan in Order Resolving Certain Issues, Requesting Information on Unsettled Matters, and Allowing Proposed Rider to Become Effective Subject to Refund, at p. 64 (February 26, 2009).

recovery of these net lost revenues resulting from EE programs only.[7] The Settlement Agreement defines net lost revenues consistently with Commission Rule R8-68, which results in greater transparency. Fourth, unlike the original save-a-watt proposal, which tied revenue recovery for DSM and EE programs to variable supply-side costs, the Agreement locks in the per megawatt hour (MWh) and per MW-year avoided costs. Finally, the Settlement Agreement provides for the return, with interest, to ratepayers of any revenues collected in excess of what is allowed under the Settlement Agreement. Under the Settlement Agreement, any overcollection will be returned to the customers with interest, at an interest rate to be determined by the Commission in the first true-up proceeding in which an overcollection occurs.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 5 AND 6

The evidence in support of these findings is found in the Settlement Agreement, as well as the testimony and exhibits of Public Staff witness McLawhorn and Duke witnesses Schultz and Farmer.

Theodore E. Schultz, Vice President of EE for Duke Energy Business Services, testified that Duke initially proposed that revenue requirements reflect 90% of the avoided capacity and energy costs produced by both DSM and EE programs – as compensation for program costs, lost revenues, and a management incentive. He explained that three primary changes were made in the Settlement Agreement to the avoided cost percentage contained in the original save-a-watt proposal. First, witness Schultz stated that separate avoided cost percentages were developed for DSM and EE programs to ensure that Duke would be indifferent to implementation of either kind of program relative to the portfolio's overall profitability. Second, the recovery of lost revenues was carved out of the avoided cost compensation and treated as a direct recovery cost. And third, the percentages were lowered from 90% to 75% of the avoided capacity costs for DSM achievements and to 50% of the NPV of avoided lifetime capacity and energy costs for EE programs. Witness Schultz explained why Duke believed it was appropriate to capture the NPV of EE savings in the year in which Duke spends money on the EE measure:

> [W]e spend the money up front on energy efficiency. All the costs are actually incurred in the first year. There's a stream of [future] benefits, and it's appropriate from our point of view to bring those benefits back to present value . . . in the year in which the program was installed.

Duke does not use NPV for its DSM percentage because, according to witness Schultz, DSM programs do not create future benefits:

> Demand-side management programs are a benefit for the year in which they occur. So, in other words, they're equivalent to a peaking station. So

[7] The June 19, 2009 testimony of Duke witness Farmer and Duke's August 10, 2009 Responses to the Commission's Pre-Hearing Order Requiring Verified Information clarify that recovery of net lost revenues under the Settlement Agreement is limited to EE programs only.

every year you can look at those and they're either there or they're not. And if they're there, they have benefit for the year that they're there.[8]

Chairman Finley asked witness Schultz why Duke uses a higher avoided cost recovery percentage for DSM programs than for EE programs. Witness Schultz explained that the different percentages were designed to put EE and DSM on a "level playing field" so that they both earn a similar return. He testified that "if you look at the 75 percent applied to the portfolio for demand-side management resources, you're going to get a [maximum] return per the Settlement Agreement . . . of 15% after tax for program cost." He went on to say that while EE appears lower at 50%, "[y]ou've got to remember it's the present value of all those benefits coming back and lost margins are separated out. So lost margins occur with energy efficiency programs. They're treated separately, which would lower the avoided cost percentage. And then that 50 percent again will return about a 15 percent after tax return on the program cost."

Witness Schultz testified that avoided capacity costs will be based on Duke's filed avoided cost rate, as Duke initially proposed, with one modification. He explained that instead of updating the avoided costs with the bi-annual filed avoided cost rates, the avoided capacity costs under the Settlement Agreement will remain fixed using the 2007 approved avoided costs in Docket No. E-100, Sub 106. James S. McLawhorn, Director of the Electric Division of the Public Staff, explained that in the original save-a-watt proposal, Duke proposed to tie its revenue recovery for implementing DSM and EE programs to its avoided supply-side costs, which can vary over time. The Public Staff was concerned that, if avoided supply-side costs increased from one year to the next, ratepayers would pay for that increase, even if they were not receiving any additional energy or demand reduction savings. Witness McLawhorn testified that the Settlement Agreement shields ratepayers from this risk by "locking in" the avoided cost rate for the term of the Agreement.

Witness Schultz testified that the calculation of the avoided energy costs will be the same as initially proposed by Duke and will be based on the avoided energy costs per Duke's Integrated Resource Plan. He added that the avoided cost rates will not be otherwise updated during the term of the Settlement Agreement unless the filed biennial avoided capacity and energy cost rates change by more than 25%.

Witness McLawhorn testified that the Public Staff believed that Duke's initial proposal to recover 90% of avoided costs achieved by its proposed EE and DSM programs would have resulted in excessive earnings by Duke and insufficient savings on energy by ratepayers. He explained that the Settlement Agreement addresses these concerns by providing that Duke's revenues are now to be recovered on the basis of separate percentages of avoided costs for DSM and EE programs. Witness McLawhorn noted that the recovery of these percentages of avoided costs is

[8] In Comments filed in this docket on June 12, 2009, the Public Staff indicated that it disagreed with Duke's position that DSM programs do not create future benefits beyond one year. This disagreement, however, did not prevent the Public Staff from entering into the Settlement Agreement.

intended by Duke to cover its costs for adopting and implementing DSM and EE programs, along with providing a financial incentive for doing so.

Witness McLawhorn testified that the Settlement Agreement also addresses the Public Staff's concerns by limiting the cost recovery period for the modified save-a-watt approach. Specifically, the Settlement Agreement has a term of four years, and it is a pilot program. Witness McLawhorn testified that, at the conclusion of this four-year period, actual measured and verified avoided cost savings will be compared to the target avoided cost savings in a final true-up proceeding.

The Settlement Agreement preserves Duke's concept that compensation for implementation of EE and DSM programs should be based on a discount to the avoided costs of a power plant, but modifies the compensation mechanism to provide for a more reasonable level of avoided cost recovery. The Stipulating Parties have demonstrated that the percentages of avoided costs under the modified save-a-watt approach provide an appropriate incentive to Duke without resulting in excessive earnings. The Commission concludes that the levels of avoided cost recovery under the Settlement Agreement are in the public interest.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 7 THROUGH 9

The evidence in support of these findings can be found in the Settlement Agreement, as well as the testimony and exhibits of Environmental Intervenors witness Wilson, Public Staff witness McLawhorn, and Duke witness Schultz.

Duke witness Schultz provided testimony regarding the Settlement Agreement's performance targets and earnings caps. He explained that under the Settlement Agreement, Duke is eligible to receive a higher level of incentive based on how well it performs. Specifically, Duke's earnings opportunity is capped and is tied to the percentage of the target energy and capacity savings achieved. The Settlement Agreement provides for an energy savings target for each vintage year. This energy savings target is then converted to a sum of monetary savings that reflects the cost of energy and capacity avoided as a result of the EE measures, over the life of each measure. The resulting avoided cost savings target is determined by multiplying the savings by year by the full avoided costs, which include generation capacity, fuel, and fixed and variable operations and maintenance savings. The target amount of avoided cost savings dollars for the DSM component will be calculated based on an assumed amount of capacity avoided through DSM programs and the avoided costs in effect at the time the Settlement Agreement is approved by the Commission.

Duke's avoided cost target is $754 million (nominal system dollars) based on programs implemented during the four-year term of the Agreement and is tied to the following target MW and cumulative MWh system savings: 234,132 MWh and 368 MW in Year 1; 490,634 MWh and 548 MW in Year 2; 872,548 MWh and 736 MW in Year 3; 1,439,742 MWh and 844 MW in Year 4; and 6,833,078 MWh and 259 MW beyond Year 4.

As witnesses McLawhorn, Schultz and Wilson testified, the Settlement Agreement provides for increased energy savings targets when compared to the original save-a-watt proposal. Witness Wilson testified that the energy savings targets contained in the Settlement Agreement represent a commitment by Duke to ramp up its EE offerings in the Carolinas to levels that will make Duke a leader in the industry. For example, Duke's target incremental reduction in annual energy use by year 4 under the Agreement is equal to 0.75% of its forecasted sales for that year – 250% of the year 4 target in the original save-a-watt proposal. In addition, witnesses Wilson and McLawhorn testified that the Settlement Agreement provides that no more than 35% of the target may be met by DSM programs, providing an emphasis on EE programs that the original save-a-watt model lacked.

Further, witness McLawhorn testified that measures implemented in each vintage year of this Settlement Agreement are expected to continue to operate and produce energy savings throughout the four-year term. Witness Wilson explained that, if Duke meets its savings targets, the cumulative reduction in annual energy consumption by year 4 will be almost 2% of annual sales in that year and over 8% within 10 years.

Based on these target portfolio savings, the Settlement Agreement contains tiered earnings caps based upon varying levels of performance. Duke's revenues recovered on the basis of percentages of avoided costs are limited to the amount necessary to produce an after-tax return on program costs between 5% and 15% depending on its success in reaching a target aggregate DSM and EE avoided cost savings level.

Specifically, if Duke achieves 90% or greater of its avoided cost target, its earnings will be capped at a 15% return on program costs; if Duke achieves 80% to 89% of its avoided cost target, its earnings will be capped at a 12% return on program costs; if Duke achieves 60% to 79% of its avoided cost target, its earnings will be capped at a 9% return on program costs; and if Duke achieves less than 60% of its avoided cost target, its maximum earnings opportunity will be a 5% return on program costs. Witness Schultz testified that program costs will include marketing and advertising expenses, incentives paid to customers, and the costs of impact evaluation studies. The return on program costs will be simply a calculation of the after tax percent return on investment in program costs on a net present value basis.

The Stipulating Parties have demonstrated that the Settlement Agreement provides for a significant increase in the amount of energy and capacity savings Duke aims to achieve. Any incentive earned by Duke will depend upon Duke's ability to actually achieve these target savings on behalf of customers. The Commission concludes that these performance targets are appropriate and that the earning caps tied to these targets help ensure that customers receive fair value and that their rates remain reasonable.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10

The evidence in support of this finding is found in the Settlement Agreement, as well as the testimony and exhibits of Public Staff witnesses Maness and McLawhorn, Duke witness Farmer, and Environmental Intervenors witness Wilson.

The Settlement Agreement provides for the separate recovery of net lost revenues resulting from EE, but not DSM, measures. Net lost revenues are also net of any increases resulting from any activity by Duke's public utility operations that causes a customer to increase demand or energy consumption, whether or not that activity has been approved pursuant to Rule R8-68. The amount of net lost revenues that Duke may recover is limited to those incurred within 36 months of implementation of any particular measure.

Public Staff witness Maness confirmed that recovery of net lost revenues act to make a company whole, and act to replace revenues that Duke has lost from enacting an EE program. He added, "I think another way of saying that is that without that net lost revenue compensation there would be a disincentive to proceed with those types of programs."

Duke witness Farmer testified that the original save-a-watt proposal did not call for the explicit recovery of net lost revenues, but rather the recovery of net lost revenues was embedded in the revenue requirement calculations that were based on 90% of estimated avoided capacity and energy costs. As such, it was not readily evident what portion of the revenues were compensating Duke for incurred DSM and EE program costs, net lost revenues, and additional incentives.

Witness McLawhorn testified that under the Settlement Agreement net lost revenues are now subject to measurement and verification and are recovered separately from program costs and incentives.

Witness Schultz testified that recovery of lost revenues separate from the percentage of avoided cost payment will result in greater transparency.

Environmental Intervenors witness Wilson testified that a mechanism to recover lost revenues is important because it mitigates the disincentive to pursue EE created by the existing electric rate structure in North Carolina. According to witness Wilson, limiting this mechanism to three years ensures that Duke does have a strong incentive to adjust its supply-side resources (power plants and contracts) to reflect reduced demand. Witness Wilson further testified that limiting lost revenue recovery to 36 months will help ensure that customers receive fair value and that their rates remain reasonable.

With regard to the limited period of time for recovery of net lost revenues, witness McLawhorn testified that the Settlement Agreement recognizes the Public Staff's view that revenues that are "lost" due to an EE program do not continue in perpetuity, but are

offset in time by revenue gains, resulting, for example, from customer growth or other increases in demand. He testified that the Public Staff believes that 36 months is a reasonable amount of time for the recovery of net lost revenues and noted that this limited time period is similar to one contained in the Agreement and Stipulation of Partial Settlement, filed by the Public Staff, PEC, and Wal-Mart, in Docket No. E-2, Sub 931, and approved by the Commission by Order dated June 15, 2009.

Witness Farmer explained that the recovery of net lost revenues applicable to EE programs for vintage years three and four will extend two-years beyond the initial four-year cost recovery period, assuming such recovery does not terminate or is not reduced as a result of approval of a decoupling or alternative recovery mechanism or an order in a general rate case proceeding that provides for the recovery of net lost revenues. As witness Maness testified, "[W]hen you have vintage year three and four, installations of measures that caused net lost revenues, the 36 months for those installations will extend beyond year four and, therefore, there are net lost revenues to be recovered in years five and six."

Witness Farmer testified that the estimated amount of net lost revenues to be collected from North Carolina customers totals $151 million at 85% achievement. He clarified that the recovery of net lost revenues will be subject to adjustment (either up or down) based on the level of verified kW and kWh reductions actually realized. For example, at a savings level that equals 100% of target achievement the recovery of net lost revenues would total approximately $178 million.

Witness Farmer provided testimony explaining how Duke will calculate net lost revenues under the Settlement Agreement. He explained that the calculation of net lost revenues (sometimes referred to as lost margins) was estimated by multiplying the portion of Duke's tariff rates that represent the recovery of fixed costs by the estimated kW and kWh reductions applicable to EE programs. Duke calculated the portion of retail tariff rates representing the recovery of fixed costs by deducting the recovery of fuel costs from its tariff rates.

The calculation of net lost revenues does not apply to DSM programs. Witness Farmer testified that Duke is not seeking recovery of net lost revenues for DSM programs because the demand response essentially covers the cost of the program. In other words, if Duke spends a dollar on a DSM program, Duke in turn will not have to provide the amount of electricity needed at the peak period. Witness Farmer then clarified that there are some net lost revenues as peaks are reduced by DSM programs. In particular, if a customer lowers its demand, then the revenue from that customer will be lower. Notwithstanding the net lost revenues resulting from DSM programs, Duke has chosen not to ask for recovery of these net lost revenues.

In his brief, the Attorney General argued that the Settlement Agreement should be approved, with one exception. The exception being that the Agreement should be modified to require that all net lost revenues are to be included, in the manner proposed by the Attorney General, in calculating save-a-watt's maximum profit levels, including

allowable earnings under the earnings cap. According to the Attorney General, if all net lost revenues are not so included, Duke's profits from save-a-watt would be excessive and, as such, would not produce reasonable consumer rates.

In support of his position, the Attorney General presented an example which he contended showed that, if Duke is allowed to recover estimated net lost revenues of $151 million,[9] the Company would realize an after-tax profit of 58% from save-a-watt.

While the Attorney General did not present a detailed calculation of his projected return of 58%, such return appears to have been calculated as shown in Attorney General's Maness Cross-Exam Exhibit No. 1, with one exception. The exception being that net lost revenues of $151 million appear to have been substituted for the estimated $165 million originally included in the aforesaid exhibit. Assuming that to be the case, and it certainly appears to be, the Attorney General, in effect, is arguing that net lost revenues should not be treated as a cost; but rather, as pre-tax operating income for purposes of determining save-a-watt's profitability. Such profitability, of course, is central, if not controlling, in determining the maximum level of save-a-watt revenues the Company is to be allowed to recover under the earnings cap.

As noted above, in their proposed order, the Stipulating Parties contended that reductions in energy use resulting from EE programs may impair the Company's ability to recover sufficient revenues to cover its fixed costs. According to the Stipulating Parties, the evidence shows that, in the near term, the reduction in electricity sales resulting from EE programs will result in net lost revenues, which present a financial disincentive to the Company to implement EE programs.

Accordingly, the Stipulating Parties opined that, to encourage implementation of approved EE programs, the Commission should authorize the Company to recover net lost revenues for 36 months for each installation of an EE measure during a given vintage year, except that the recovery of net lost revenues would end upon Commission approval of an alternative recovery mechanism, or the implementation of new rates in a general rate case or comparable proceeding to the extent that rates set in a rate case or comparable proceeding are set to explicitly or implicitly recover those net lost revenues. The Stipulating Parties further proposed that recovery of net lost revenues for vintage year installations not covered by the new rates should be allowed to continue, subject to the 36-month limitation.

For purposes of resolving this issue in this proceeding, the Commission is of the opinion, and so finds and concludes, that the greater weight should be placed on the evidence and arguments presented by the Stipulating Parties, as generally described above, as opposed to the evidence and arguments advanced by the Attorney General.

The Commission is of the foregoing opinion because, in its view, net lost revenues, when appropriately quantified and deemed recoverable as an incentive by

[9] This amount is set forth in Exhibit B attached to the Settlement Agreement.

the Commission, do not represent pre-tax profits but rather, in effect, represent a provision for the recovery of fixed costs, including cost of capital, which would otherwise go unrecovered.[10]

Clearly, to the extent that decreased sales resulting from EE programs are not offset by growth trends in customer count and per-customer usage or by new rates in a rate case or comparable proceeding set to recover those net lost revenues, absent a cost recovery mechanism such as the one at issue here, the Company would, as a matter of fact, actually incur a real economic loss; and that potential loss would, undoubtedly, serve as a financial disincentive to the Company to implement EE programs.

Therefore, for the foregoing reasons, and based upon the entire evidence of record, the Commission is of the opinion, and so finds and concludes, that the separate recovery of net lost revenues resulting from the Company's implementation of EE, but not DSM, measures as contemplated by the Settlement Agreement and/or the Stipulating Parties' proposed order should be, and hereby is, approved. Further, the Commission is of the opinion that the specific language of this provision of the Agreement should be, and hereby is, modified to read as follows:[11] (Modifications are shown in a track changes format.)

G. Net Lost Revenues

1. Net lost revenues mean revenue losses, net of marginal costs avoided at the time of the lost kilowatt-hour sale(s), incurred by the Company's public utility operation as the result of a new ~~demand-side management or~~ energy efficiency measure. Net lost revenues shall also be net of any increases in revenues resulting from any activity by the Company's public utility operations that cause a customer to increase demand or energy consumption, whether or not that activity has been approved pursuant to R8-68. Programs or measures with the primary purpose of promoting general awareness and education of energy efficiency as well as research

[10] As a matter of fact, according to Company witness Farmer, ". . . net lost revenues was [sic] estimated by multiplying the portion of the Company's tariff rates that represent the recovery of fixed costs by the estimated kW and kWh reductions applicable to energy efficiency programs." This should not, however, be interpreted or construed to mean that the Commission is in agreement with the methodology employed by witness Farmer in estimating fixed costs and/or net lost revenues for purposes of this proceeding, for that is clearly not the case. As discussed subsequently, net lost revenues should be net of all marginal costs, including energy-related and nonenergy-related costs, actually avoided.

[11] To the extent that modifications set forth below have not been previously discussed, they have been excerpted from either the Public Staff's August 18, 2009 comments in response to the Commission's Second Pre-Hearing Order Requiring Verified Information, in the present docket, or from the Commission's Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Commission-Required Modifications, in Docket No. E-2, Sub 931, in the matter of Application by Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc., for Approval of Demand-Side Management and Energy Efficiency Cost Recovery Rider Pursuant to G.S. 62-133.9 and Commission Rule R8-69.

and development activities are ineligible for the recovery of net lost revenues. Pilot programs or measures are also ineligible for the recovery of net lost revenues, unless the Commission approves the Company's specific request that a pilot program or measure be eligible for the recovery of net lost revenues when the Company seeks approval of that pilot program or measure. Utility activities shall be closely monitored by the Company to determine if they are causing a customer to increase demand or consumption, and the Company shall identify and keep track of all of its activities that cause customers to increase demand or consumption, whether or not those activities are associated with demand-side management or energy efficiency programs, as provided in the Settlement Agreement, so that they may be evaluated by the parties and the Commission for possible confirmation as "found revenues." When authorized by Commission Rule R8-69, and unless the Commission determines otherwise in a G.S. 62-133.9 DSM/EE rider proceeding, net lost revenues shall be recovered for 36 months for each vintage year, except that the recovery of net lost revenues will end upon Commission approval of (1) an alternative recovery mechanism, or (2) the implementation of new rates in a general rate case or comparable proceeding to the extent that rates set in a rate case or comparable proceeding are set to explicitly or implicitly recover those net lost revenues.

The Commission concludes that the modifications set forth above are reasonable and should be adopted in this proceeding. They are largely, if not totally, consistent with and track certain provisions adopted by the Commission with respect to the DSM/EE cost recovery plan approved for Progress Energy. In addition, Duke and the Public Staff are hereby requested to work cooperatively to develop practices and procedures which will ensure, to the maximum extent possible, that the Company is able to identify and keep track of all its activities that cause customers to increase demand or consumption, whether or not those activities are associated with demand-side management or energy efficiency programs, so that they may be evaluated by the parties and the Commission for possible confirmation as "found revenues."

There is one remaining related matter which needs to be discussed. NC WARN and the Public Interest Intervenors are of the opinion that the Company should be required to quantify the utility-related nonenergy benefits associated with save-a-watt's energy efficiency programs and recognize those cost savings in the save-a-watt cost recovery process. The Commission agrees.

Under the Settlement Agreement, and as modified and adopted by the Commission herein, the definition of net lost revenues provides, in pertinent part, as follows:

> Net lost revenues mean revenue losses, net of marginal costs avoided at the time of the lost kilowatt-hour sale(s) . . . .

Absent evidence or argument to the contrary, it would appear reasonable to conclude that the instant language is intended to mean that net lost revenues are to be net of <u>all</u> marginal costs avoided at the time of the lost kilowatt-hour sale(s). However, the Stipulating Parties' proposed order contains certain language, which, if taken literally, might lead one to conclude that the Stipulating Parties intended that net lost revenues be net of energy-related avoided cost only. The language in question is as follows:

> Witness Farmer provided testimony explaining how the Company <u>will calculate net lost revenues under the Settlement Agreement</u>. He explained that the calculation of net lost revenues (sometimes referred to as lost margins) was estimated by multiplying the portion of the Company's tariff rates that represent [sic] the recovery of fixed costs by the estimated kW and kWh reductions applicable to EE programs. The Company calculated the portion of retail tariff rates representing the recovery of fixed costs by deducting the recovery of fuel costs from its tariff rates. (Citations omitted.) (Emphasis added.)

Thus, based upon the foregoing, it might be concluded that the Stipulating Parties intended that net lost revenues be net of only fuel or energy-related avoided costs;[12] if so, such a provision would allow the Company, arguably, to recover nonenergy-related costs that it had, in reality, actually avoided. Such a result would, of course, be inappropriate. Consequently, out of an abundance of caution, the Commission is of the opinion, and therefore so finds and concludes, that its approval of the recovery of net lost revenues means the recovery of revenue losses, net of all marginal costs, including energy-related and nonenergy-related costs, actually avoided. Such net lost revenues shall be so calculated and otherwise determined, at the latest,

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[12] That would appear to be the case, notwithstanding the fact that the Company, in its response to Item No. 17, of the Commission's July 30, 2009 Pre-Hearing Order Requiring Verified Information, commented as follows:

> The Company believes that variable O&M costs should also be included in the determination of net lost revenues as a marginal avoided cost and would propose to update its calculations of net lost revenues to subtract variable O&M cost in addition to fuel cost in its compliance filing of Rider EE after the Commission issues a final order. The Company is not aware of other costs at the margin, other than fuel and variable O&M, that are avoided as sales are reduced.

under the true-up[13] and measurement and verification provisions of the Settlement Agreement.

Further, in ruling on this matter, the Commission hereby expressly reserves judgment as to all matters concerning the appropriateness of the methodology employed and/or to be employed in the calculation of net lost revenues for purpose of this proceeding, notwithstanding any provision of the Settlement Agreement approved by the Commission or any provision of the Commission's present ruling; and it retains the discretion to review and decide all aspects of any and all issues that may arise in the future in connection with the net lost revenues true-up provisions of the Settlement Agreement.

Finally, to help avoid or mitigate unintended consequences, if any, that could occur from this new regulatory approach, the Commission is of the opinion, and so finds and concludes, that it should continue to closely monitor the Company's overall North Carolina retail earnings as well as the Company's earnings from save-a-watt on a stand-alone basis. Further, should circumstances and/or events so require, the Commission hereby expressly reserves the right to revisit this entire matter and take such further action as may be required.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11

The evidence in support of this finding is found in the Settlement Agreement, as well as the testimony and exhibits of Duke witness Farmer.

Witness Farmer provided testimony regarding the differences in jurisdictional revenue requirement and customer rate impacts between the original save-a-watt proposal and the modified save-a-watt approach proposed in the Settlement Agreement. He testified that the cumulative jurisdictional revenue that will be billed

[13] The Settlement Agreement, in Section H.3., of Exhibit B, sets forth, among other things, "estimated revenue requirements" for the four year term of the agreement, which includes an allowance for "estimated" net lost revenues based upon an avoided cost target achievement factor of 85%. Presumably, such net lost revenues have been calculated by the Company in the manner described by Company witness Farmer.

With regard to recovery of the Company's full revenue requirements during the four-year term of the plan, Section H.6., of Exhibit B, provides for a "final true-up process based on measured and verified results" once the four-year period of the plan is complete. Section H.7., of Exhibit B, provides as follows:

> Net lost revenues are included in the final true-up process at the end of the four-year plan. The outstanding balance of net lost revenues will be adjusted based on actual measured and verified lost revenues. (Emphasis added.)

North Carolina retail customers under the Settlement Agreement is $27.4 million (8.0%) less than the original save-a-watt proposal over the four-year recovery period.[14]

Witness Farmer explained that this is in part because the original save-a-watt proposal provided for the recovery of lost revenues and program costs spread out over the life of the DSM and EE programs that gave rise to avoided cost savings. For example, if an EE program had a life of ten years, the recovery of program costs would have occurred over ten years. In contrast, under the provisions of the Settlement Agreement, the recovery of program costs applicable to a particular vintage of EE programs will occur during the program vintage year. In addition, witness Farmer testified that the recovery of net lost revenues, which also would have occurred over the life of an approved EE program under Duke's original proposal, will now be limited to the level of estimated net lost revenues that are expected to occur during the 36-month period that begins as of each initial vintage year of customer participation in Company sponsored programs. Witness Farmer also attributed the lower jurisdictional revenue requirement to the lower percentage of avoided cost recovery, fixed avoided capacity cost rates, and the earnings cap.

According to witness Farmer, the Settlement Agreement jurisdictional revenue requirement assumes Duke achieves 85% of the avoided cost savings targeted across Duke's system. He explained that any difference between amounts due Duke based on actual avoided cost savings realized by customers and amounts billed customers at 85% of target achievement will be collected from or refunded to customers as part of the rider true-ups.

Witness Farmer's testimony and exhibits included calculations of monthly billing factors for residential and nonresidential customers that he used to evaluate the impact of the recovery of EE costs on individual customers. He testified that the monthly billing factor for a residential customer taking service under Rate RS is estimated to be $0.001206 per kWh during the first year of the four-year cost recovery period. The estimated monthly billing factor increases to $0.004207 per kWh in the last year of the four-year cost recovery period.[15] The monthly bill of a typical residential customer using 1,000 kWh will increase by $1.21 and $4.03, respectively, during the first and fourth years.

Because the Public Staff and Duke disagree regarding the allocation of costs among the customer classes and the retail/wholesale jurisdictions, witness Maness also

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[14] Witness Farmer clarified that if the recovery of net lost revenues for years 5 and 6 were included when comparing the original save-a-watt proposal to the modified save-a-watt approach, the revenue requirement under the Settlement would exceed that of the first four years of the original save-a-watt proposal. However, under the original save-a-watt proposal, the revenue requirement extended out a number of years – up to 18 years or more. He explained that a fair comparison would necessarily entail comparing the revenue requirement over the life of the original EE measures to the modified proposal under the Settlement Agreement.

[15] Monthly billing factor includes gross receipts tax and North Carolina regulatory fee.

calculated monthly billing factors, reflecting the Public Staff's positions. Maness Exhibit No. 2 shows that the monthly billing factor for a residential customer is estimated to be $0.000710 per kWh during the first year of the four-year cost recovery period and that the estimated monthly billing factor increases to $0.02289 per kWh in the last year of the four-year cost recovery period.[16] These exhibits show that the monthly bill for a typical residential customer using 1,000 kilowatt-hours would increase by an estimated $0.71 and $2.29, respectively, during the first and fourth years, using the Public Staff's cost allocation methods, as described by witness Maness and discussed further with regard to Finding of Fact No. 13.

Witness Farmer testified that residential and non-residential rates will increase by 1.47% and 0.68%, respectively, during the first year of the four-year cost recovery period when compared to 2008 annual jurisdictional revenues. Residential and nonresidential rates will increase by 4.93% and 2.14%, respectively, during the fourth year. Witness Farmer added that these rate impacts do not include the savings that will be realized by customers who participate in Company sponsored programs.

Witness Farmer pointed out that customers who participate in programs offered by Duke will likely, depending on the level of participation, reduce their net bill below the level that would have been incurred had Duke's DSM and EE programs not been in place. Customers who do not participate in programs offered by Duke will benefit to the extent Duke's DSM and EE programs lower the marginal cost of energy and capacity below the level that would have been incurred had Duke not been able to realize avoided cost savings.

In addition, witness Farmer explained that the impacts of customers "opting out" of Rider EE (NC) are not included in these rate impacts. In sum, the percentage change in individual customer rates caused by the implementation of Rider EE (NC) will be dependent on the level of power consumed by the individual customer.

The Stipulating Parties have shown that the cumulative jurisdictional revenue requirement is significantly less under the Settlement Agreement than under the original save-a-watt proposal due to lower avoided cost recovery percentages, earnings caps, and the limited recovery period for net lost revenues. While rates and monthly billing factors will increase slightly under the modified save-a-watt proposal compared to rates prior to the four-year cost recovery period, these rate impacts do not take into account the bill reductions participants in Duke's DSM and EE programs will likely experience. These rate impacts are reasonable in light of Duke's increased energy and capacity savings targets, and as such, the Commission concludes that Duke's revised Rider EE reflecting these rate impacts is in the public interest and should be approved.

[16] Monthly billing factors include gross receipts tax and North Carolina regulatory fee.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12

The evidence in support of this finding is found in the Settlement Agreement, as well as the testimony and exhibits of Public Staff witness McLawhorn and Duke witness Farmer.

Public Staff witness McLawhorn testified that the Settlement Agreement provides a true-up process to shield ratepayers from the risk of Duke collecting revenues for its DSM and EE programs in excess of what is allowed under the Agreement. Witness Farmer described this true-up process. He testified that the Agreement provides for a series of true-ups that will be conducted to update revenue requirements based on actual customer participation results. According to witness Farmer, revenues will be collected from customers based on the participation true-up results plus an updated forecast of customer participation in Duke's DSM and EE programs. He added that a final true-up process, based on independently measured and verified results, will take place after the evaluation of the program results when the four-year period is complete. At that time, amounts due Duke based on the terms of the Settlement Agreement will be compared to revenues collected from customers.

Witness Farmer testified that the Stipulating Parties have agreed to mitigate any potential overbilling of costs to customers by initially billing customers at a rate that assumes Duke will achieve 85% of its target avoided cost savings goals. He explained that the true-up process will capture the difference between revenues billed customers based on 85% of the target DSM and EE program avoided cost savings billed customers and revenues due Duke based on the applicable percentage of verified DSM and avoided cost savings actually realized. If there are amounts owed to customers, such amounts will be refunded with interest at a rate to be determined by the Commission in the first true-up proceeding in which an overcollection occurs. Witness Farmer further testified that the outstanding balance of net lost revenues will be adjusted based on the actual measured and verified lost revenues determined in the final true-up process.

Additionally, witness Farmer testified that the true-up process will include calculations that ensure that the level of compensation recovered by Duke is capped so that the after-tax rate of return on actual program costs applicable to DSM and EE programs does not exceed the predetermined earnings cap levels set out in the Settlement Agreement. Witness Farmer explained that, if the rate of return on actual program costs is less than the capped level provided for in the Settlement Agreement, then no further adjustment will be made. If, on the other hand, the rate of return on actual program costs incurred exceeds the level provided for in the Agreement, then the excess earnings level will be refunded to customers.

Witness Farmer emphasized that the Settlement Agreement does not guarantee or ensure that Duke will realize or achieve the earnings levels set out in the Agreement. In other words, Duke assumes the risk that projected savings will not materialize and that revenues received from customers, based on the percentage of avoided cost

savings retained by Duke, will not result in any management incentive or cover the costs of DSM and EE programs.

Based upon the foregoing and the entire evidence of record, the Commission is of the opinion, and so finds and concludes, that the Stipulating Parties have demonstrated that the true-up process contained in the Settlement Agreement adequately protects ratepayers from the recovery of revenues in excess of what is permitted by the Agreement.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 13

The evidence in support of this finding is based upon the Settlement Agreement, as well as the testimony and exhibits of Duke witness Farmer and Public Staff witness Maness.

Paragraph H.8 of Exhibit B to the Settlement Agreement reads as follows:

> The North Carolina retail revenue requirement applicable to demand-side management, energy efficiency programs, and net lost revenues will be determined by allocating the various inputs to the revenue calculation (avoided costs, program costs, net lost revenues, etc.) to the North Carolina retail jurisdiction and then applying the percentages and other revenue requirement determinants set forth in this agreement.
>
> The Stipulating Parties will present the issue of the appropriate jurisdictional allocation method to the Commission through testimony in this matter. For purposes of determining the North Carolina retail revenue requirement, Duke Energy Carolinas and the Environmental Intervenors agree that (1) for demand-side management programs, inputs will be allocated between the North Carolina and South Carolina retail jurisdictions based on contributions to system retail peak demand by all system retail customers based on the cost of service study, and (2) for energy efficiency programs and net lost revenues, inputs will be assigned to the North Carolina and South Carolina retail jurisdictions based on kWh sales to system retail customers from the cost of service study. The program costs allocated under this methodology will be used to calculate the earnings cap.
>
> The Public Staff does not agree with the allocation methodology proposed by Duke and the Environmental Intervenors and instead proposes that (1) for demand-side management programs, inputs will be allocated to the North Carolina retail jurisdiction based on contributions to total system peak demand by all system customers, retail and wholesale, and (2) for energy efficiency programs, inputs should be allocated to the North Carolina retail jurisdiction based on kWh sales to all system customers, retail and wholesale.

The Stipulating Parties accept, generally, the allocation of EE revenue requirements based on kilowatt-hour sales and the allocation of DSM revenue requirements based on contribution to peak demand but disagree on certain issues related to both jurisdictional allocations and customer class allocations.

Duke witness Farmer testified that Duke proposes that the revenue requirement be allocated to North Carolina and South Carolina retail customers only and that no portion of the Settlement Agreement revenue requirement be allocated to wholesale customers. He explained that, because Duke's DSM and EE programs included in the portfolio of programs approved in this proceeding are programs directed specifically to Duke's retail customers, Duke believes it is appropriate to recover the costs of such programs only from these customers. Like PEC and the Commission, Duke interprets G.S. 62-133.9(e) to mean that costs of new DSM and EE programs should "be recovered only from those customer classes eligible to participate in the program and to which the program is targeted." Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Commission-Required Modifications, Docket No. E-2, Sub 931, at 30 (June 15, 2009) (PEC Order).

Witness Farmer did not dispute the fact that all customers likely will receive indirect benefits from Duke's DSM and EE programs, but pointed out that, to comply with G.S. 62-133.9(e), the costs of a program or measure should only be recovered from those customers eligible to participate in the program. Duke believes its allocation methodology is more consistent with the North Carolina General Assembly's use of the words "only" and "directly" in this statute, which provides that:

> The Commission shall determine the appropriate assignment of costs of new demand-side management and energy efficiency measures for electric public utilities and shall assign the costs of the programs only to the class or classes of customers that directly benefit from the programs. [Emphasis added.]

G.S. 62-133.9(e).

Witness Farmer also testified that Duke proposed in the Settlement Agreement that inputs applicable to DSM programs be allocated between North Carolina and South Carolina retail jurisdictions based on contributions to system retail peak demand by all system retail customers based on Duke's cost of service study. The North Carolina retail amount would be further allocated between residential and non-residential customer classes based on the relative contribution of each customer class to the North Carolina retail peak demand. Inputs for EE programs and net lost revenues would be assigned to the North Carolina and South Carolina retail jurisdictions based on kWh sales to system retail customers, also from the cost of service study, but, as explained below, in a manner such that residential customers pay for residential programs and non-residential customers pay for non-residential programs. Program costs applicable to DSM and EE programs would be allocated between North Carolina and South Carolina jurisdictions on the same basis as revenue requirements.

Witness Maness testified that the Public Staff believed that G.S. 62-133.9(e) does not control the jurisdictional allocation of system DSM and EE costs and revenues to North Carolina retail operations. He testified that G.S. 62-133.9(e) refers specifically to assignments of costs to customer classes; there is no language in the statute that refers to the methods to be used to allocate costs between jurisdictions for North Carolina retail ratemaking purposes. Witness Maness noted that, in Rule R8-69(b)(1), the Commission refers to jurisdictional allocation and class assignment as separate processes and associates G.S. 62-133.9(e) only with class assignment. Further, he pointed out that, in the rulemaking proceeding that resulted in Rule R8-69, the Commission declined to indicate that the statute applied to jurisdictional allocation and explicitly declined to require that the DSM and EE costs be recovered solely from retail customers.

Witness Maness explained that the Public Staff believes that allocating costs only to the retail jurisdictions, as Duke proposes, does not reflect the system benefits that will arise from implementation of DSM and EE programs. According to witness Maness, the benefit of a DSM or EE program to the utility system is the long-term reduction in cost of service achieved by the utility as a result of it acquiring DSM and EE resources to serve load growth at a lower cost than would have been incurred had the utility instead been required to serve that load growth through acquisition of supply-side resources. He testified that this reduction in cost can typically be expected to accrue to the benefit of all system customers because the costs themselves, if incurred, would be allocated to the entire system, including the wholesale jurisdiction. The Public Staff believes that the appropriate and reasonable manner of allocating the costs and incentives reflected in the DSM/EE rider is to treat them as total system costs and to allocate them across the total system, including the wholesale jurisdiction.

Witness Farmer clarified the difference in opinion between the Public Staff and Duke as to the allocation of costs between residential and non-residential customers. He explained that Duke believed that residential customers should pay the cost of the residential programs and that non-residential customers should pay for the non-residential programs. Because DSM programs for residential and non-residential customers are similar in nature, Duke's proposed allocation of DSM costs across system retail customers based on system peak demand accomplishes this objective. In the case of EE programs, however, residential and non-residential costs and benefits can be quite different in nature. Accordingly, Duke's proposed cost recovery mechanism captures the cost of residential EE programs offered to retail customers across the system separately from the cost of non-residential EE programs offered to retail customers across the system. For the residential class and the non-residential class, separately, the North Carolina portion of retail system EE costs would be determined based on the North Carolina kWh sales for the customer class relative to the system retail kWh sales for the customer class. The rider amounts proposed in Farmer Settlement Exhibit 3 and Farmer's settlement testimony reflect the allocation methods as proposed by Duke. Program costs applicable to DSM and EE programs would be

allocated between North Carolina and South Carolina jurisdictions on the same basis as revenue requirements.

The Public Staff, on the other hand, believes that allocation of both system DSM and system EE revenues and costs to the North Carolina jurisdiction should precede any allocation of revenues and costs to customer classes. Then, after jurisdictional allocation, allocation of North Carolina retail revenues and costs between residential and non-residential customers should be based on relative residential and non-residential contributions to kWh sales and peak load within the North Carolina jurisdiction itself, not on a determination of the customer class at which a program is targeted. In other words, the Public Staff recognizes that class allocation is governed by G.S. 62-133.9(e), but interprets this provision to mean that allocation of North Carolina DSM and EE revenue requirements to customer classes should be based on the same contribution to system peak load and system energy requirements methodology that it believes is appropriate for jurisdictional cost allocations. The Public Staff acknowledged that the Commission has recently disagreed with it on the class allocation issue, in Docket No. E-2, Sub 931, but requested that the Commission reach a different conclusion in this proceeding.

In the PEC Order, the Commission concluded as follows:

> It is a well-established principle of statutory interpretation in North Carolina that a statute should not be interpreted in a manner which would render any of its words superfluous. Each word of a statute is to be construed as having meaning, where reasonable and consistent with the entire statute, because it is always presumed that the Legislature acted with care and deliberation. State v. Haddock, ____, N.C. App. ____, 664 S.E.2d 339, 345 (2008); State v. Ramos, _____, N.C. App. ______, 668 S.E.2d 357, 363 (2008).
>
> The Commission agrees with the Public Staff that, to some degree, all customers benefit from the implementation of new DSM and EE programs. To conclude, however, that this general benefit encompasses the direct benefit contemplated by the General Assembly [in G.S. 62-133.9(e)] fails to interpret the statute in a logical manner. Accordingly, the Commission agrees with PEC that to interpret the statute in the manner proposed by the Public Staff would render the words "directly" and "only" meaningless. Clearly, the General Assembly intended for those words to have meaning and the most logical meaning they can have is that the cost of a new DSM/EE program is to be recovered only from those customer classes eligible to participate in the program and to which the program is targeted. While the Public Staff is correct that all retail customer classes benefit from DSM/EE programs, the Commission is of the opinion that there would have been no need for such a statutory provision if not to direct the Commission to allocate these costs in a different manner. The Commission concludes that the law favors PEC's interpretation and disfavor's the Public Staff's position.

The Commission is unaware of any change in the law, nor has the Public Staff brought forth any new evidence or arguments since the Commission's June 15, 2009 PEC Order that convinces the Commission that it should change its position on this issue. Accordingly, for the reasons stated in the PEC Order, the Commission sides with Duke and concludes that the costs of residential programs should be borne by the residential customer class and that costs of non-residential programs should be borne by the non-residential customer class; and that Duke's proposed methods for determining the costs for North Carolina residential and non-residential classes are appropriate.

As to the issue of inclusion of wholesale customers in the jurisdictional cost allocation, the Commission notes that the Public Staff was one of the Stipulating Parties in Docket No. E-2, Sub 931, and as such, agreed that PEC's expenses for DSM and EE measures should be allocated to the North Carolina and South Carolina retail jurisdictions and not the wholesale jurisdiction. In this proceeding, the Public Staff did not agree to so stipulate and is making similar arguments to those of the Attorney General that were rejected in the PEC Order. Again, the Public Staff has presented no evidence or arguments to lead the Commission to decide differently here. The Commission finds that the costs and incentives at issue are for DSM and EE programs targeted to retail customers. Wholesale customers cannot participate directly in these programs. Any benefit that wholesale customers receive is clearly an indirect benefit. Finally, Duke's North Carolina wholesale customers are electric power suppliers covered by Senate Bill 3. Just like Duke, they are required to meet their own requirements for the use of renewable energy and EE. As they do so, it is reasonable to assume that their retail customers will pay for their programs, just like Duke's retail customers will pay for its programs.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 14

The evidence in support of this finding is based upon the Settlement Agreement and testimony of Duke witness Schultz and Environmental Intervenors witness Wilson.

Witness Schultz explained the terms in the Settlement Agreement relating to the Advisory Group. He testified that, as in Duke's initial proposal, the Settlement Agreement recognized that the successful development and implementation of EE programs required constant monitoring and modification, and that an advisory group is helpful in that regard. Specifically, the Settlement Agreement provides that the Advisory Group will be established for the term of this Settlement Agreement. Witness Schultz testified that the role of the Advisory Group is to collaborate on new program ideas, review modifications to existing programs, ensure greater public understanding of the programs and funding, and review the measurement and verification process. Witness Wilson also testified that the Advisory Group is intended to ensure transparency and encourage new ideas. The Stipulating Parties envision that the Advisory Group will be comprised of a broad spectrum of regional stakeholders that represent balanced interests in the programs, as well as national EE advocates and

experts. The Advisory Group will meet at least twice each year and may establish working groups on specific topics. A third party will facilitate the Advisory Group's discussions.

The Commission finds that the Advisory Group provides an important forum for Duke to receive input from a variety of stakeholders. The implementation of the Advisory Group will facilitate innovation and accountability. Accordingly, the Commission concludes that the Advisory Group is in the public interest.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 15 THROUGH 17

The evidence in support of these findings can be found in the Settlement Agreement, the settlement testimony of Duke witness Wiles, and the entire record in this proceeding.

With respect to the nature of the accounting data to be submitted by the Company in periodic reports to the Commission regarding save-a-watt, in their proposed order, the Stipulating Parties stated that Company witness Wiles

> . . . described changes to the accounting and reporting treatment originally requested by the Company as a result of the Settlement Agreement and the Commission's Order. He explained that in compliance with the Order, the Company will include actual program revenues and actual program costs for purposes of calculating and reporting its regulated earnings to the Commission in its quarterly ES-1 reports. It will provide supplementary schedules setting forth the Company's jurisdictional earnings excluding the effects of its DSM and EE programs. <u>The Company also will provide schedules separately stating the costs associated with each program or activity, and actual revenues received from the DSM and EE programs.</u> Witness Wiles testified that Duke Energy Carolinas will provide detailed calculations supporting these . . . schedules. (Emphasis added.)

The Commission is of the opinion that the information and data described in the narrative underlined immediately above, as proposed by the Company for submission to the Commission, would not, in fact, constitute compliance with the Commission's February 26, 2009 Order, in the instant regard, and as such, would be inadequate from the standpoint of satisfying the Commission's needs. In contrast to the foregoing highlighted information, which the Company has proposed to provide, the February 26, 2009 Order, in pertinent part, actually provided as follows:

> Furthermore, the Commission is of the opinion and, therefore, so finds and concludes that . . . the Company should be required . . . (3) to provide schedules separately stating the earnings impact of its DSM and EE programs on a combined basis as well as on a stand-alone, program-class basis, that is, with earnings from DSM programs,

> collectively, and earnings from EE programs, collectively, shown separately. [The Commission also required, in its Order, that detailed calculations of the foregoing be provided, including schedules and/or calculations showing, at a minimum, actual revenues; expenses; taxes; operating income; investment base, including major components where applicable; and applicable capitalization ratios and cost rates, including overall rate of return and return on common equity.]

In consideration of the foregoing, the Commission is of the opinion, and, therefore, so finds and concludes, that, in ruling on this matter, it should clarify its earlier findings and conclusions in regard to the specific nature of the accounting procedures and the reporting format that the Company should be required to follow in the present regard. Accordingly, for the reasons previously set forth in the Commission's February 26, 2009 Order, Duke shall not follow the accounting and reporting procedures that it has proposed with respect to its save-a-watt model, but, instead, shall be, and hereby is, required to follow the approach as set forth below:[17]

> With regard to save-a-watt, the Company shall be, and hereby is, required: (1) to include all actual program revenues (estimated, if not known) and only actual program costs (estimated, if not know) for purposes of calculating and presenting its regulated earnings to the Commission for ES-1 purposes; (2) to provide supplementary schedules setting forth the Company's jurisdictional earnings excluding the effects of EE and DSM programs; and (3) to provide schedules separately stating the earnings impact of its DSM and EE programs on a combined basis as well as on a stand-alone, program-class basis, that is, with earnings from DSM programs, collectively, and earnings from EE programs, collectively, shown separately. Detailed calculations of the foregoing shall also be provided. Such schedules and/or calculations shall show, at a minimum, actual revenues; expenses; taxes; operating income; investment base, including major components where applicable; and applicable capitalization ratios and cost rates, including overall rate of return and return on common equity. Net lost revenues realized (estimated, if not known) for each reporting period shall be clearly disclosed as supplemental information.

In regard to other accounting matters, witness Wiles, in his June 19, 2009 settlement testimony, explained that certain accounting rules require that the Company record a regulatory asset on its books if the level of save-a-watt revenues recoverable under the Settlement Agreement is expected to be greater than the level of revenues billed under the rider. Alternatively, according to witness Wiles, Duke will record a

[17] This accounting and reporting approach is virtually the same as that ordered in regard to the Matter of Application by Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc., for Approval of Demand Side Management and Energy Efficiency Cost Recovery Rider Pursuant to G.S. 62-133.9 and Commission Rule R8-69, in Docket No. E-2, Sub 931. (See Order issued November 25, 2009.)

regulatory liability if the level of revenues billed customers is in excess of the level expected to be ultimately recoverable.

Witness Wiles explained that, in those situations where Duke owes customers, the Company will record a reduction to revenues in recognition of the fact that Duke has an obligation to refund overcollected amounts.

Witness Wiles described the recommended method of accounting for amounts owed the utility under alternate rate recovery plans, such as save-a-watt. He explained that the Emerging Issues Task Force[18] reached consensus that, once specific events have occurred that provide for future customer billings, the utility can then recognize the additional revenues if certain conditions are met.

According to witness Wiles, a rate recovery plan, such as save-a-watt, must first be established by an order from the Commission that allows for the automatic adjustment of future rates.[19] Second, the amount of additional revenues for the period must be objectively determinable and probable of recovery. Lastly, witness Wiles explained that the revenue in question must be collected within 24 months following the end of the annual period in which they are recognized. Witness Wiles further observed that, while the terms of the Settlement Agreement meet these conditions, a Commission order approving the Agreement should acknowledge clearly that future rates may be adjusted in accordance with these provisions.

Finally, consistent with Commission Rule R8-27(a)(2), witness Wiles requested that the Commission, in ruling on this matter, include an ordering paragraph authorizing Duke, for regulatory accounting purposes, to use regulatory asset and liability accounts for purposes as described in his settlement testimony.

No intervenor offered any evidence or argument in contravention of witness Wiles' settlement testimony. In addition, no intervenor cross-examined witness Wiles, nor was he asked any questions by the Commission.

Based upon the foregoing and the entire evidence of record, the Commission finds and concludes that the accounting procedures described by witness Wiles, in the instant regard, are reasonable. Consequently, pursuant to Commission Rule R8-27(a)(2), the Commission authorizes Duke, for North Carolina jurisdictional regulatory accounting purposes, to utilize Account 182.3 – Other Regulatory Assets and Account 254 – Other Regulatory Liabilities for the present purposes as described by witness Wiles. The Commission further finds and concludes that its approval of the

[18] The Emerging Issues Task Force is an organization formed in 1984 by the Financial Accounting Standards Board (FASB) to provide assistance with timely financial reporting. The main purpose of the task force is to identify emerging issues and resolve them with a uniform set of practices, before widespread divergent methods arise.

[19] Based upon witness Wiles' testimony, the Commission understands that verification and/or potential modification of the adjustment to future rates by the Commission would not preclude the adjustment from being considered automatic.

Settlement Agreement in this Order is sufficient to support deferral accounting for North Carolina jurisdictional regulatory accounting purposes.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 18

The evidence in support of this finding can be found in the Commission's February 26, 2009 Order, the testimony of Public Interest Intervenors witness Colton, Public Staff witness McLawhorn and the rebuttal testimony of Duke witness Smith.

In its joint post-hearing brief, NC WARN and the Public Interest Intervenors observed that, the Commission, in its previous Order, held that Duke's proposed low income EE programs "strike an appropriate balance between assisting low-income customers and maintaining cost-effectiveness." They then argued that such "balance," based on previous levels of recommended usage reduction, must now be reviewed and modified by the Commission, as Duke has since committed in its proposed Settlement Agreement to substantially increase energy savings for EE program participants by 250%, while its commitment to low income and low and fixed income senior customers remains unchanged and relatively meaningless. According to NC WARN and the Public Interest Intervenors, to more than double the total usage reduction proposed through save-a-watt without also substantially enhancing the EE programs specifically directed towards Duke's low income and low and fixed income senior customers is unreasonable.

NC WARN and the Public Interest Intervenors requested that the Commission disapprove Duke's proposed Settlement Agreement because Duke's proposed Settlement Agreement, if approved, would not provide rates and services that are just, reasonable, or nondiscriminatory as related to low income ratepayers, in violation of both G.S. 62-131(a) and (b) and G.S. 62-140(a). NC WARN and the Public Interest Intervenors argued that, as a result, Duke's proposed Settlement Agreement is not in the public interest, as required under G.S. 62-2, and should therefore be disapproved or significantly modified by the Commission.

According to NC WARN and the Public Interest Intervenors, the just, reasonable, and nondiscrimination standard requires that Duke not exclude the vast majority of its low income customers from its save-a-watt EE programs. NC WARN and the Public Interest Intervenors asserted that approval of Duke's Settlement Agreement, as currently proposed, will violate both G.S. 62-131 and 62-140 by systemically and intentionally excluding the vast majority of Duke's low income and low and fixed income senior customers from its proposed EE programs, and will prohibit those same low income customers from obtaining any meaningful EE usage reduction. This exclusion, in effect, will cause Duke's low income and low and fixed income senior customers to assume increased energy bills by denying them the same program benefits that Duke's EE program participants will be able to receive. NC WARN and the Public Interest

Intervenors stated that Duke's own witness, Judah Rose, acknowledged this result in discussing the impact of Duke's EE plan on nonparticipants, stating:

> However, energy efficiency might unintentionally increase average electric rates for, and bills of, nonparticipants as utility fixed costs are carried by fewer sales. Further, the greater the energy efficiency, the greater the chance that this might happen. Put another way, rates could increase for those customers that simply choose not to participate.

Witness Rose also acknowledged that:

> However, as energy efficiency lowers the electricity demand of program participants, the utility's fixed costs (e.g., capital recovery of legacy investment) are borne by lower amounts of electricity sales, and hence, average rates and bills of nonparticipants could unintentionally increase under some specific circumstances.

In concluding that Duke's EE program will benefit all customers, witness Rose acknowledged that this is "assuming that all customers participate equally in the program. . . ."

NC WARN and the Public Interest Intervenors asserted that, under G.S. 62-2(a)(4) and (b) (2007), the Commission must ensure that a public utility, such as Duke, does not institute any rate plan or service programs that would result in the systemic and unilateral exclusion of the vast majority of a segment of its customers from the benefits of any program, or that result in those excluded customers being prejudiced or disadvantaged by higher rates or bills than those charged to non-excluded customers. Without substantial modifications to the proposed Settlement Agreement, such exclusion of, and prejudice to, Duke's low income and low and fixed income senior customers will occur.

NC WARN and the Public Interest Intervenors further argued that this systemic exclusion by Duke of almost all low income and low and fixed income senior residential customers is intentional. Regarding the costs of its energy efficiency programs, Duke "has the incentive to get those costs lower, because the more energy it can save, the greater it can earn under the rate rider provisions that it's proposing. . . ." Because Duke's proposed Settlement Agreement is still based on an "avoided cost" model, it allows the Company greater financial benefits for those programs where the spread between the avoided costs and the program costs are the greatest (i.e., where the cost-effectiveness is the highest). Given this incentive structure created by save-a-watt (unchanged by any possible concessions brought about by the proposed Settlement Agreement), NC WARN and the Public Interest Intervenors maintained that Duke is incentivized to "cream-skim," i.e., to take only those programs that are the most cost-effective, and exclude other cost effective programs (such as low-income programs). In sum, Duke, in order to maximize its revenue under the save-a-watt plan, has a financial incentive not to allow most of its low income and low and fixed income

senior customers to participate in its EE programs, even if doing so would still be "cost effective."

NC WARN and the Public Interest Intervenors observed that the Public Utilities Act prohibits discrimination among a public utility's customers and specifically states that:

> No public utility shall, as to rates or services, make or grant any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates or services either as between localities or as between classes of service. (G.S. 62-140(a)) (2007).

According to these Intervenors, the legislative purpose of the "no discrimination" law is to prohibit a public utility from unreasonably discriminating among its customers. (State ex rel. Utilities Comm. v. Southern Bell, 88 NC App. 153, 363 S.E.2d 73 (1987).

NC WARN and the Public Interest Intervenors argued that one of the goals of the electric utility rate structure established under the Public Utilities Act is the elimination of intra-class prejudice or disadvantage, such as intra-class cross-subsidies. (State ex rel. Utilities Comm. v. Edmisten, 314 NC 122, 169, 333 S.E. 2d 453, vacated on other grounds, 477 US 902, on remand 318 NC 279, 347 S.E.2d 459 (1985). Where substantial differences in services or conditions exist, the unreasonable application of the same rates may be discriminatory and improper under G.S. 62-140(a). (State ex rel. Utilities Comm. v. Edmisten, 291 NC 424, 230 S.E. 2d 647 (1976).

NC WARN and the Public Interest Intervenors explained that, even if under Duke's proposed Settlement Agreement the same increased rate would be charged to middle and upper class customers/EE plan participants and low income customers/EE plan non-participants, application of the same rate is unreasonable, discriminatory, and improper under G.S. 62-140(a). That is because there are substantial differences in the conditions and services Duke is offering to each group. This unequal ability to participate in EE usage reduction programs and thus benefit from lower rates results from Duke's unilaterally imposed program eligibility and availability restrictions. According to NC WARN and the Public Interest Intervenors, such a discriminatory cost-shifting or cross-subsidization between participating customers and nonparticipating customers would in fact still occur in the EE Rider and programs Duke proposes to implement in the Settlement Agreement.

NC WARN and the Public Interest Intervenors stated that, rather than address this increased disparity between its residential customers, Duke's proposed Settlement Agreement does not propose any specific portfolio of low income EE programs. Instead, it merely states that Duke will "convene the Advisory Group . . . to guide efforts to expand cost-effective programs for low-income customers." This discussion, however, occurs only after the Commission approves the Company's efficiency plan for

the year. By design, therefore, this work will not influence what the Company offers in the near-term. The Company does not commit to expanding its low-income programs.

Moreover, NC WARN and the Public Interest Intervenors explained that there is no time frame placed on the work of the Advisory Group regarding low-income programs. For example, the Advisory Group only meets twice a year. While the Advisory Group may "establish working groups on specific topics," no specific commitment to establish a low-income working group is made, let alone a work group with a specific workplan and a specific timeframe within which to complete that workplan. The Advisory Group delay exacerbates the exclusion of many Duke ratepayers from benefiting from save-a-watt.

In order to address these issues, NC WARN and the Public Interest Intervenors offered the following recommendations to the Commission for inclusion in the final order in this docket:

1. In addition to offering weatherization services to customers below 150% of the Federal Poverty Level (FPL), Duke should commit to implementing a baseload electric usage reduction program modeled on the "exemplary" low-income programs presented in the catalogue of such programs developed by the American Council for an Energy Efficient Economy (ACEEE), previously discussed in this proceeding.

2. In addition, Duke should commit to importing its own successful low-income programs from Indiana and Ohio to North Carolina beginning in the first year. Duke should also incorporate into its North Carolina program two key elements of its existing Indiana refrigerator replacement program: a) inclusion of households below 150% of the FPL; and b) inclusion of households with Duke customers, whether or not the household lives in a 100% electric usage home.

3. The scope and funding for the program components identified above should be made subject to the deliberations of the Advisory Group identified in the Settlement Agreement. A plan to deliver efficiency services, including baseload electric efficiency services, to low-income and low and fixed-income senior customers should be delivered to the Commission for approval within 60-days after a final order in this proceeding. The Advisory Group should be directed to respond to the question: what level of programs should be offered to low-income and low and fixed-income senior customers? The Settlement Agreement should be modified, however, and the Order should be clear that the question of *whether* such programs should be offered to low-income and low and fixed-income senior customers has been decided.

4. The plan to be developed by the Advisory Committee should include:

- a specific dollar commitment to low-income programs, including either a specific commitment to the number of low-income units to be served, or a specific proportion of total residential budget to be devoted to low-income customers;

- a commitment to pursue electric baseload programs, including refrigerator replacements;
- a commitment to deliver energy efficiency services to households with income below 150% of the FPL;
- a commitment to a program directed specifically toward rental properties, including investments directed toward property owners participating in the Section 8 housing program; and
- a specific workplan through which housing units treated not only through the Department of Energy's Weatherization Assistance Program (WAP), but housing units constructed or rehabilitated through public programs such as HOME and the Low-Income Housing Tax Credit (LIHTC), will be reached.

5. Duke should amend its 2009 Integrated Resource Plan (IRP), filed in Docket No. E-100, Sub 124, to reflect its save-a-watt goals and include such goals in future IRP filings. Decisions about the construction or cancellation of generating plants should reflect mandatory save-a-watt goals.

Duke argued that the concerns expressed by Public Interest Intervenors witness Colton in his supplemental testimony are no different from the recommendations he made during the August 2008 evidentiary hearing in this docket. As noted by Duke witness Smith, the Company addressed those concerns in its testimony as well as in its October 7, 2008 proposed order. Furthermore, according to Duke, the Commission ruled on the recommendations made by witness Colton in its February 26, 2009 Order. Specifically, at pages 21 and 22 of the Order the Commission discussed witness Colton's testimony as follows:

> . . . Colton criticized Duke's proposed portfolio of EE programs as failing to serve low-income households, and described a number of exemplary programs that he suggested the Company model its programs after instead. Specifically, witness Colton expressed concern that the Low Income Energy Efficiency and Weatherization Program will not be widely available to low-income households because its application is restricted to households with incomes of 150% to 200% of the federal poverty level and is limited to owner-occupied, single-family, all-electric residences. Witness Colton criticized the Company for assuming that weatherization agencies are available to distribute and install weatherization and starter kits. He based this criticism on his assumption that Duke is planning to leverage federal funds for these purposes, and federal regulations disallow federal weatherization assistance for households above 125% of the poverty level. Witness Colton cited the Public Service of Indiana's (now Duke Energy Indiana) low-income program as an exemplary program that Duke should emulate.

Duke pointed out that the Commission concluded that it was ". . . of the opinion that Duke's Low Income Energy Efficiency and Weatherization Assistance Program strikes an appropriate balance between assisting low-income customers and

maintaining cost-effectiveness . . . and that the Low Income Energy Efficiency and Weatherization Assistance Program, as proposed, is in the public interest and will benefit Duke's customer body as a whole. As such, the Commission approves this program."

Duke explained that, while witness Colton urged the Commission to require the Company to commit to the implementation of a refrigerator replacement program, the Company's Commission-approved Low Income Energy Efficiency and Weatherization Assistance Program already contains a refrigerator replacement component. Further, as Public Staff witness McLawhorn testified, the Settlement Agreement contains a provision requiring the Company to make residential programs available to low-income customers without regard to whether they own or rent homes. According to witness McLawhorn, the Company has also committed to pursuing partnerships with third-party agencies to implement programs and offer assistance to low-income customers. He further stated that the Public Staff will continue to monitor the extension of EE programs and benefits to all customers, regardless of income, through its involvement in stakeholder groups or other mechanisms.

The Commission agrees with Duke that it has already addressed Duke's portfolio of EE programs in its February 26, 2009 Order, including the Low Income Energy Efficiency and Weatherization Program. The only substantive issue that the Commission sees here is whether Duke's proposal to substantially increase energy savings from EE programs creates a requirement that Duke now also enhance the EE programs specifically directed towards Duke's low income and low and fixed income senior customers, as herein argued by NC WARN and the Public Interest Intervenors.

NC WARN and the Public Interest Intervenors have asserted statutory legal arguments for their position that Duke's low income and low and fixed income senior customers are a separate class of customers that are entitled to a proportionate share of an expanding EE pie. While the Commission does indeed agree that it is important to offer meaningful programs to all spectrums of Duke's customer base, it does not believe that the statutes require some type of mandatory proportional balance between different types of customers.

G.S. 62-131(a), G.S. 62-131(b), and G.S. 62-140(a) allow the Commission considerable discretion in weighing the evidence and determining what is a reasonable rate and what constitutes unreasonable discrimination. The Commission has previously held that the proposed EE programs strike an appropriate balance as to assisting low-income customers. The Commission has again considered the arguments presented on this issue and reaches the same conclusion. The Commission does not believe that G.S. 62-131(a), G.S. 62-131(b), and G.S. 62-140(a) are violated by the present proposal. The Commission therefore concludes that NC WARN and the Public Interest Intervenors have not presented any new or different evidence to justify changes for low-income customer programs, and have not presented a case for modification or rejection of the Settlement Agreement.

That having been said, the Commission does find value in specifically directing the Advisory Group to study the feasibility of expanding programs for low-income customers to the extent possible. The Commission does not, however, direct that the Advisory Group respond to a specific timetable for a response, nor require specific mandates on required action as requested by NC WARN and the Public Interest Intervenors. There is simply no precedent to support such action.

NC WARN and the Public Interest Intervenors also maintained that Duke should be required to incorporate save-a-watt goals into the IRP planning process. As the Commission has scheduled an evidentiary hearing on the 2009 IRP plan filed by Duke in Docket No. E-100, Sub 124, it agrees that it is important that the information and tables presented in the IRP plan properly reflect the most recent and appropriate information regarding Duke's EE and DSM goals. Therefore, the Commission directs Duke to address this issue in its direct testimony to be filed in the IRP docket and to file any other revised information as may be necessary with its direct testimony.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 19

The evidence in support of this finding can be found in the Settlement Agreement, as well as the exhibits and testimony of Public Staff witness McLawhorn, Environmental Intervenors witness Wilson, and Company witnesses Schultz and Farmer.

Duke witness Schultz testified that the Settlement Agreement furthers the important goal of providing an incentive to the Company and its customers to be aggressive in developing new EE and DSM programs. The Agreement also reflects the Company's concept that compensation for successful implementation of EE and DSM programs should be predicated on a discount to the "avoided costs" of a power plant in order to place EE and DSM on a level playing field with supply-side resources. He emphasized that EE and DSM programs enable the Company to avoid future generation costs, benefiting all customers. In addition, witness Schultz explained that DSM and EE programs allow the Company to meet customer demand for electricity with a zero-emission resource and to lower usage and bills for customers who participate in these programs.

As noted by witness Schultz, the Agreement sets an aggressive target for the Company to deliver $754 million of avoided future generation costs. This is a dramatic increase in results from EE and DSM programs in comparison with the original save-a-watt proposal. Public Staff witness McLawhorn testified that considering the increase in the projected energy savings, the Public Staff believes that the incentives that Duke has the opportunity to recover under the Settlement Agreement are more reasonable than those set forth in the original save-a-watt proposal.

Environmental Intervenors witness Wilson agreed that the Settlement Agreement protects ratepayers and the environment while providing the Company with a reasonable incentive to pursue EE, and is therefore in the public interest. He explained

that the revised level of avoided cost recovery is in the public interest because it is set at a level that gives Duke the ability to recover its program costs plus achieve a reasonable level of earnings under the cap. However, if the Company's costs are higher than expected, then it might not achieve the full level of earnings allowed under the cap. Witness Wilson asserted that in combination with the earnings cap, the avoided cost recovery structure provides customers with an assurance that the Company has an incentive to control costs. Further, as witness Schultz explained, under the Settlement Agreement, the Company will only get paid for implementing programs that produce actual energy and capacity savings, as measured and verified by an independent third party. In other words, Duke assumes the risk of recovering its EE and DSM program costs or any management incentive based upon its performance.

One question that was raised during the Settlement Hearing was whether the Commission should mandate that Duke achieve the targets set out in the Settlement Agreement. NC WARN and the Public Interest Intervenors argued that, on its face, the Settlement Agreement is only for the first four years, although it does contain long-term performance goals, and that Duke agreed to a ramped target of two percent savings over the first four years and then an additional one percent a year after that. NC WARN and the Public Interest Intervenors noted that the result of that commitment is best shown by Environmental Intervenors witness Wilson in Exhibit 2 to his direct testimony.

NC WARN and the Public Interest Intervenors further argued that, at best, the new commitment for savings in the stipulation brought a commitment made earlier by Duke up a couple of years. The difference between the Settlement Agreement and the earlier save-a-watt commitment is that the new commitment allows Duke to start later but moves the one percent annual savings up two years. NC WARN and the Public Interest Intervenors noted that Duke CEO Rogers, in his testimony in the record, touted Duke's agreement with the national efficiency associations to start an EE program in 2015 that will increase one percent a year for 10 years. NC WARN and the Public Interest Intervenors pointed out that, in the first set of hearings on save-a-watt, Duke witness Schultz, and others, made it clear that this commitment was contingent "upon approval of its save-a-watt initiative." In the most recent hearing on the stipulation, witness Schultz also agreed that Duke should be able to meet its goals, but continued to hedge when pushed on whether Duke would actually meet those goals. He testified that:

> We are designing our programs to go after all cost-effective energy efficiency and striving towards the commitments that are here in this four-year plan and our national commitment assuming we still have the save-a-watt mechanism in place at one percent a year.

NC WARN and the Public Interest Intervenors argued that, in essence, Duke's commitment to EE is only as long as save-a-watt is in place.

NC WARN and the Public Interest Intervenors stated that the recommendations by earlier witnesses of an immediate one percent annual savings were not given

credibility by Duke witnesses. In the earlier hearings, NC WARN witness Blackburn testified that a one percent a year decrease in demand was economic and achievable through proven EE measures, although he believed that the one percent could start almost immediately, with a 10% decrease in demand in ten years.[20] He based this on studies in North Carolina, Duke's own Forefront study and what was being achieved in other states. Public Interest Intervenors witness Colton testified that many of the programs Duke should consider to achieve this were actually in use by Duke in other states. The principal differences between those recommendations and the goals in the Settlement Agreement are that Duke ramps up its save-a-watt programs over four years and then goes into the one percent a year savings.

If the Commission approves the Settlement Agreement in full or in a modified form, then NC WARN and the Public Interest Intervenors believe that the Commission, in its Order, should make the "goals" in the agreement binding on Duke. Otherwise, the commitment has relatively little substance and may not influence the way Duke, as a corporation, does business in North Carolina.

NC WARN and the Public Interest Intervenors offered that, if at some future point Duke wishes to modify its save-a-watt goals, it should be able to do so. Increasing the levels of EE savings could be simply a part of the annual REPS reporting requirement. On the other hand, if Duke wished to decrease its level of EE savings, it should be required, at a minimum, to show cause why the goal is no longer economical, as well as show that a lower goal was in the public interest. The Commission should then ask Duke serious questions about its corporate commitment to EE as the "fifth fuel," as characterized by witness Rogers.

NC WARN and the Public Interest Intervenors asserted that this is in line with the "off-ramp" provisions of Senate Bill 3. Pursuant to G.S. 62-133.8(i)(2), the Commission has the authority to modify or delay the Senate Bill 3 provisions if it finds that it is in the public interest to do so and if it finds that the utility demonstrates it "made a reasonable effort to meet the requirements."

Witness Schultz responded that the Company has "taken a different tack from the mandate approach to create something that really aligns all parties and their interests." In addition, as witness Farmer explained, the Company's results are dependent upon customer acceptance of the Company's DSM and EE programs: "If customers don't participate in the programs then there are no results." Further, it would be difficult for the Company or the Commission to mandate customer performance in these programs. Regardless, witness Farmer testified that the Company has an incentive to achieve these targets not only to increase its chances to recover its program costs and a management incentive, but also because these targets are reflected in the Company's IRP Plan. To fall short of achieving these targets would "put us in a . . . spot. It's tough to build a plant in that kind of a time frame, so you end up in

[20] See report of Dr. Blackburn, "North Carolina's Energy Future: Data Shows We Can Close Power Plants Instead of Building New Ones," March 31, 2009, filed in Docket No. E-7, Sub 790 and Docket No. E-100, Sub 118.

the short term . . . looking at some alternative regarding purchase power," testified witness Farmer.

In response to questioning by Chairman Finley, witness McLawhorn testified that Senate Bill 3 contains REPS that function as a mandate. The ability of Duke and other North Carolina utilities to meet this mandate is derived, in part, by implementing EE programs. Chairman Finley asked, "So Senate Bill 3 has both carrots and sticks? It has mandates and it has incentives?" to which witness McLawhorn answered affirmatively.

The Commission sees no need or requirement to supplement this legislative scheme by mandating Duke to reach the DSM and EE targets set out in the Settlement Agreement, especially where results are so dependent on customer participation, and where the Company has plenty of incentive to achieve these targets without a Commission directive.

The North Carolina General Assembly has recognized that an increased emphasis on EE is necessary, by declaring through the enactment of Senate Bill 3 that the promotion and development of DSM and EE resources in North Carolina is in the public interest. To implement this policy, the General Assembly authorized the Commission to approve a broad array of incentives, including "rewards based on capitalization of a percentage of avoided costs achieved" and "[a]ny other incentive that the Commission determines to be appropriate." (G.S. 62-133.9(d)). In addition, Commission Rules R8-68 and R8-69 implementing Senate Bill 3 expressly provide that the Commission will review and evaluate, as a package, proposed DSM and EE programs, cost recovery, lost revenue, and management incentive mechanisms. Under Commission Rules R8-68 and R8-69, recovery of lost revenues and management incentives are appropriate considerations within a least-cost framework. The modified save-a-watt approach, including limited recovery of net lost revenues and a management incentive based on a percentage of avoided costs, is consistent with G.S. 62-133.9(d) and Rules R8-68 and R8-69.

The Commission believes that the decision on the issue of incentives is by nature a balancing act. The incentives should not be excessive, but they must be sufficient to motivate the Company to deploy DSM and EE programs effectively and aggressively. The Stipulating Parties have demonstrated that the modified save-a-watt approach strikes the right balance between incentivizing the Company to pursue DSM and EE and protecting customers' interests in fair rates. Moreover, the Agreement provides increased energy savings for customers, while offering a fair earnings opportunity for investments in DSM and EE. Further, the Agreement creates greater transparency to the Company's earnings opportunity by making lost revenues a direct recovery component of the rider and true-up calculations. Finally, there are performance targets tied to earnings caps that will ensure the Company's profits are just and reasonable. The Commission therefore concludes that the Settlement Agreement is in the public interest and should be accepted by the Commission as a fair and reasonable resolution of the issues in this proceeding.

IT IS, THEREFORE, ORDERED as follows:

1. That the Settlement Agreement and Joint Stipulation filed by Duke, the Environmental Intervenors, and the Public Staff as modified by the Commission herein, and consistent with the findings, conclusions, and decretal paragraphs as set forth in this Order, shall be, and hereby are, approved;

2. That the costs of Duke's DSM and EE programs should be allocated to the North and South Carolina retail jurisdictions, and such costs should be recovered from only the class or classes of retail customers to which the programs are targeted. No costs of any approved DSM or EE program should be allocated to the wholesale jurisdiction. The reduced energy consumption resulting from the implementation of EE measures, or EE RECs, thus paid for by Duke's retail customers should be used solely for Duke's REPS compliance obligation;

3. That Paragraph G of the Settlement Agreement shall be, and hereby is, modified to read as follows:

G. Net Lost Revenues

1. Net lost revenues mean revenue losses, net of marginal costs avoided at the time of the lost kilowatt-hour sale(s), incurred by the Company's public utility operation as the result of a new energy efficiency measure. Net lost revenues shall also be net of any increases in revenues resulting from any activity by the Company's public utility operations that cause a customer to increase demand or energy consumption, whether or not that activity has been approved pursuant to R8-68. Programs or measures with the primary purpose of promoting general awareness and education of energy efficiency as well as research and development activities are ineligible for the recovery of net lost revenues. Pilot programs or measures are also ineligible for the recovery of net lost revenues, unless the Commission approves the Company's specific request that a pilot program or measure be eligible for the recovery of net lost revenues when the Company seeks approval of that pilot program or measure. Utility activities shall be closely monitored by the Company to determine if they are causing a customer to increase demand or consumption, and the Company shall identify and keep track of all of its activities that cause customers to increase demand or consumption, whether or not those activities are associated with demand-side management or energy efficiency programs, as provided in the Settlement Agreement, so that they may be evaluated by the parties and the Commission for possible confirmation as "found revenues." When authorized by Commission Rule R8-69, and unless the Commission determines otherwise in a G.S. 62-133.9 DSM/EE rider proceeding, net lost revenues shall be recovered for 36 months for each vintage year, except that the recovery of net lost revenues will end upon Commission approval of (1) an alternative recovery mechanism, or (2) the

implementation of new rates in a general rate case or comparable proceeding to the extent that rates set in a rate case or comparable proceeding are set to explicitly or implicitly recover those net lost revenues;

4. That Duke and the Public Staff shall be, and hereby are, requested to work cooperatively to develop practices and procedures which will ensure, to the maximum extent possible, that the Company is able to identify and keep track of all its activities that cause customers to increase demand or consumption, whether or not those activities are associated with demand-side management or energy efficiency programs, so that they may be evaluated by the parties and the Commission for possible confirmation as “found revenues;”

5. That the Settlement Agreement, as approved in this Order, shall be, and hereby is, deemed sufficient to support deferral accounting for North Carolina jurisdictional regulatory purposes;

6. That Duke shall be, and hereby is, consistent with the findings and conclusions set forth herein, authorized to utilize, for North Carolina jurisdictional regulatory accounting purposes, Account 182.3 – Other Regulatory Assets and Account 254 – Other Regulatory Liabilities;

7. That Duke shall be, and hereby is, required (1) to include all actual program revenues (estimated, if not known) and only actual program costs (estimated, if not known) for purposes of calculating and presenting its regulated earnings to the Commission for NCUC ES-1 purposes; (2) to provide supplementary schedules setting forth the Company’s jurisdictional earnings excluding the effects of EE and DSM programs; and (3) to provide schedules separately stating the earnings impact of its DSM and EE programs on a combined basis as well as on a stand-alone, program-class basis, that is, with earnings from DSM programs, collectively, and earnings from EE programs, collectively, shown separately. Detailed calculations of the foregoing shall also be provided. Such schedules and/or calculations shall show, at a minimum, actual revenues; expenses; taxes; operating income; investment base, including major components where applicable; and applicable capitalization ratios and cost rates, including overall rate of return and return on common equity. Net lost revenues realized (estimated, if not known) for each reporting period shall be clearly disclosed as supplemental information;

8. That Duke shall be, and hereby is, required to direct the Advisory Group in studying the feasibility of expanding programs for low-income customers and, to the extent found appropriate, shall file such additional programs for Commission approval;

9. That Duke shall be, and hereby is, required to address, update, and revise, as appropriate, information and tables presented in the Company’s September 1, 2009 IRP report, in Docket No. E-100, Sub 124, to reflect information as approved in this Order, as part of its direct testimony filing in the IRP docket; and

10. That the time for filing appeal of the Notice of Decision, issued December 14, 2009, shall run from the date of this Order.

ISSUED BY ORDER OF THE COMMISSION.

This the 9th day of February, 2010.

THE NORTH CAROLINA UTILITIES COMMISSION

Gail L. Mount

Gail L. Mount, Deputy Clerk

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