

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

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VERIFIED PETITION OF DUKE ENERGY INDIANA,)
INC. REQUESTING THE INDIANA UTILITY)
REGULATORY COMMISSION TO APPROVE AN)
ALTERNATIVE REGULATORY PLAN PURSUANT TO)
IND. CODE § 8-1-2.5-1, *ET SEQ.*, FOR THE OFFERING OF)
ENERGY EFFICIENCY CONSERVATION, DEMAND)
RESPONSE, AND DEMAND-SIDE MANAGEMENT)
PROGRAMS AND ASSOCIATED RATE TREATMENT)
INCLUDING INCENTIVES PURSUANT TO A REVISED)
STANDARD CONTRACT RIDER NO. 66 IN)
ACCORDANCE WITH IND. CODE §§ 8-1-2.5-1 *ET SEQ.*)
AND 8-1-2-42(a); AUTHORITY TO DEFER PROGRAM)
COSTS ASSOCIATED WITH ITS ENERGY EFFICIENCY)
PORTFOLIO OF PROGRAMS; AUTHORITY TO)
IMPLEMENT NEW AND ENHANCED ENERGY)
EFFICIENCY PROGRAMS, INCLUDING THE)
POWERSHARE® PROGRAM IN ITS ENERGY)
EFFICIENCY PORTFOLIO OF PROGRAMS; AND)
APPROVAL OF A MODIFICATION OF THE FUEL)
ADJUSTMENT CLAUSE EARNINGS AND EXPENSE)
TESTS)

CAUSE NO. 43374

APPROVED: FEB 19 2010

BY THE COMMISSION:

David E. Ziegner, Commissioner
Loraine L. Seyfried, Administrative Law Judge

On October 19, 2007, Duke Energy Indiana, Inc. (“Duke Energy Indiana,” “Company” or “Petitioner”) filed its Verified Petition with the Indiana Utility Regulatory Commission (“Commission”) in this Cause. Therein, Duke Energy Indiana requested: (1) the approval of an alternative regulatory plan for the offering of energy efficiency conservation, demand response, and demand-side management programs and associated rate treatment including incentives pursuant to revised Standard Contract Rider No. 66 in accordance with Ind. Code §§ 8-1-2.5-1 *et seq.* and 8-1-2-42(a); (2) authority to defer program costs associated with its energy efficiency portfolio of programs; (3) authority to implement new and enhanced energy efficiency programs, including the PowerShare® program in its energy efficiency portfolio of programs; and (4) approval of a modification of the fuel adjustment clause earnings and expense tests.

The participants in this proceeding, other than Duke Energy Indiana and the Indiana Office of Utility Consumer Counselor (“OUCC”), included: the Citizens Action Coalition of Indiana, Inc. (“CAC”), Indiana Gas Company, Inc. d/b/a Vectren Energy Delivery of Indiana, Inc. (“Vectren North”), Duke Energy Indiana Industrial Group (“DEI-IG”), Nucor Steel, a Division of Nucor Corporation (“Nucor”), Wal-Mart Stores East, LP (“Wal-Mart”), Steel

Dynamics, Inc. – Engineered Bar Products Division (“SDI”), and Kroger Company (“Kroger”) (collectively, “Intervenors”).

Pursuant to notice, and as provided for in 170 IAC § 1-1.1-15, a Prehearing Conference was held on November 19, 2007, at 10:00 a.m. in Room 222 of the National City Center, 101 West Washington Street, Indianapolis, Indiana. On November 28, 2007, a Prehearing Conference Order was issued setting forth the procedural schedule in this Cause. Subsequent to the issuance of the Prehearing Conference Order, the procedural schedule was modified several times in various docket entries.

On December 19, 2007, Duke Energy Indiana filed its testimony and exhibits constituting its case-in-chief as well as a Motion for Protection of Confidential and Proprietary Information, which information was preliminarily granted confidential treatment on January 2, 2008. Duke Energy Indiana also requested that the Commission take administrative notice of its Integrated Resource Plan, submitted to the Commission on November 1, 2007, which was granted on January 2, 2008. The Prehearing Conference Order contemplated technical conferences, and one was held on February 1, 2008. On March 26, 2008, Duke Energy Indiana filed supplemental testimony and exhibits reflecting updates to the avoided capacity and energy costs and the rate impacts flowing therefrom.

On May 21, 2008, the Intervening parties filed their testimonies and exhibits constituting their cases-in-chief. On May 29, 2008, Duke Energy Indiana and Vectren North filed a stipulation and settlement agreement (“Vectren Settlement Agreement”), supported by testimony filed on July 2, 2008, along with Petitioner’s rebuttal testimony. Also, on July 2, 2008, Duke Energy Indiana filed a Motion for Protection of Confidential and Proprietary Information, which was preliminarily granted on July 9, 2008.

On August 1, 2008, the OUCC and Petitioner filed a motion to modify the procedural schedule, which had an established hearing date of August 12, 2008, due to an agreement in principle resolving all outstanding issues between them and committing to file their settlement agreement with the Commission by August 15, 2008. The motion was granted on August 7, 2008 and the settlement agreement (“Settlement Agreement”) was filed on August 15, 2008. On August 20, 2008, DEI-IG filed a motion requesting that Petitioner be required to make an election identifying the proposed plan on which it wished to proceed. Petitioner and the OUCC filed testimony in support of the settlement agreement on September 5, 2008. On September 26, 2008, after the filing of responses and replies, the Presiding Officers issued a Docket Entry denying DEI-IG’s motion. On October 27, 2008, the CAC, DEI-IG, Wal-Mart, Nucor, SDI and Kroger filed supplemental testimony in opposition of the Settlement Agreement. On November 3, 2008, the Company filed rebuttal testimony and the OUCC filed additional supplemental settlement supporting testimony.

On November 3, 2008, Duke Energy Indiana, the OUCC, Nucor, SDI, and Kroger filed their Submission of Settlement Agreement and Request to Modify Procedural Schedule requesting that the Commission establish dates for the filing of additional testimony concerning a Stipulation and Agreement (“Opt-Out Settlement”) and retain the November 20, 2008, scheduled hearing date. This Commission issued a Docket Entry on November 6, 2008, converting the November 20, 2008, evidentiary hearing into an Attorneys’ Conference to establish a modified

procedural schedule and evidentiary hearing. Also on November 3, 2008, the Company filed settlement supporting testimony and on December 19, 2008, the CAC, DEI-IG, and Wal-Mart filed testimony opposing the Opt-Out Settlement. On January 30, 2009, the Company filed rebuttal testimony.

On January 15, 2009, Duke Energy Indiana filed an Amended and Restated Stipulation and Agreement (“Amended Opt-Out Settlement”) entered into between Duke Energy Indiana, the OUCC, Nucor, SDI, Kroger, Wal-Mart, and DEI-IG along with their supporting testimony. On February 6, 2009, the CAC filed testimony opposing the Amended Opt-Out Settlement and on February 17, 2009, the Company filed rebuttal testimony.

Pursuant to notice given and published as required by law, proof of which was incorporated into the record, an evidentiary hearing in this Cause was commenced on February 27, 2009, at 9:30 a.m., in the Room 222 of the National City Center, 101 West Washington Street, Indianapolis, Indiana. At the close of the record, the parties were authorized to file proposed orders and/or exceptions to proposed orders, in accordance with an agreed upon procedural schedule.

The Commission, having examined the evidence and being duly advised in the premises, now finds that:

1. Notice and Jurisdiction. Due, legal, and timely notice of the evidentiary hearing herein was given and published by this Commission as required by law. Duke Energy Indiana is a public utility as defined in Ind. Code § 8-1-2-1 and is subject to regulation by this Commission in the manner and to the extent provided for in the Public Service Commission Act, as amended. Duke Energy Indiana is also an “energy utility” as that term is defined in Ind. Code § 8-1-2.5-2 engaged in the provision of “retail energy service” as that term is defined in Ind. Code § 8-1-2.5-3. Accordingly, this Commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. Petitioner’s Characteristics and Business. Petitioner is an Indiana corporation with its principal office in Hendricks County at 1000 East Main Street, Plainfield, Indiana 46168. It is engaged in the business of supplying electric utility service to the public in the State of Indiana. Duke Energy Indiana owns, operates, manages and controls plants, properties and equipment used and useful for the production, transmission, distribution, and furnishing of electric utility service to the public in the State of Indiana. It directly supplies electric energy to customers located in 69 counties in the central, north central, and southern parts of the State of Indiana. It also sells electric energy for resale to municipal utilities, Wabash Valley Power Association, Inc., Indiana Municipal Power Agency and to other public utilities that in turn supply electric utility service to numerous customers in areas not served directly by Duke Energy Indiana.

3. Relief Requested and Overview of Petitioner’s Save-A-Watt Approach to Energy Efficiency. Petitioner requests approval of an alternative regulatory plan (“ARP”) pursuant to Ind. Code § 8-1-2.5-6 for the authority to offer conservation, demand response, and demand-side management (collectively “energy efficiency”) programs and associated rate treatment including incentives pursuant to revised Standard Contract Rider No. 66. In its

Verified Petition, Duke Energy Indiana states that it has aggressively pursued cost effective energy efficiency programs in the past, but believes a new, innovative approach to energy efficiency is needed in order to respond to rising demand for electricity and increasing concerns relating to environmental issues such as global climate change as well as to provide all customers with additional options that will allow them to manage their electricity use and bills in a rising price environment.

The Company states that its proposed new approach to energy efficiency fundamentally changes both the manner in which energy efficiency is perceived and the role of the Company in achieving cost effective energy efficiency initiatives. Duke Energy Indiana also indicates that it has the expertise, infrastructure, and customer relationships to produce cost-effective energy efficiency and the ability to effectively incorporate energy efficiency in its integrated resource planning for the benefit of its customers. Although not able to meet all new generation needs, Duke Energy Indiana states that its proposed ARP, which it calls its Energy Efficiency Plan (“EE Plan” or “save-a-watt”), intends to address a significant portion of the rising demand for electricity. The Company states that its EE Plan, as proposed, is estimated to produce increased energy savings and incremental demand savings over current levels.

Duke Energy Indiana proposes to treat energy efficiency as a resource – a “fifth fuel” – capable of providing a cost-effective and emissions-free option for meeting the Company’s growing electricity demands. The Company states that under its proposal, energy efficiency is treated as a virtual power plant. However, instead of iron in the ground, the Company proposes to create “virtual energy efficiency plants” comprised of programs designed to meet customers’ electricity needs by saving watts instead of generating watts. The Company refers to this as the save-a-watt approach to energy efficiency. Duke Energy Indiana states that this emissions-free resource helps customers meet their energy needs with less electricity, less cost, and less environmental impact.

Duke Energy Indiana has requested approval to convert its Standard Contract Rider No. 66 – Demand Side Management Adjustment (“Rider 66”) to an energy efficiency rider (“Rider EE”) in order to implement the save-a-watt model. Through independent measurement and verification, the Company proposes to be paid only for the actual demand- and energy-reduction impacts it achieves (*i.e.*, watts saved) through its energy efficiency programs. The independent measurement and verification results will be filed annually.

Under this proposal, the Company states that it has an opportunity, but not a guarantee, of recovering program costs and achieving earnings comparable to supply-side resources on their energy efficiency investments. The Company originally sought to be compensated at 90% of the generation costs avoided by the watts saved under its save-a-watt approach. Through various settlement agreements, which are discussed later in this Order, that amount was subsequently reduced to 75% for demand response programs and 60% for conservation programs.

4. History of Petitioner’s Energy Efficiency Programs. Historically, Petitioner has offered energy efficiency programs to its customers in Indiana. Most recently, in Cause No. 42612 Duke Energy Indiana sought approval of a new set of energy efficiency programs and associated cost recovery including recovery of lost revenues and recovery of a shared savings

incentive. Although the Commission declined to approve the Company's petition, as part of the Order in that proceeding, Duke Energy Indiana was encouraged to continue to meet with its customer groups and discuss specific changes or additions to its programs. The Commission also ordered the Company to maintain the status quo of approximately \$6 million per year until the final order in Cause No. 42693 or December 31, 2009. The Commission also encouraged the parties to collaborate on a market potential study ("MPS"). On November 19, 2009, the Commission's Order in Cause No. 43079 DSM 4 authorized Petitioner to continue to deploy and recover costs for DSM programs after December 31, 2009, initially for three-months and thereafter on a month-to-month basis, until other DSM programs and cost recovery mechanisms are approved, or unless otherwise ordered by the Commission.

In 2006, in Cause No. 43099, the Commission approved a settlement agreement between the OUCC and Petitioner providing authority to Petitioner to implement a new Personalized Energy Report program for one year. In addition, Duke Energy Indiana committed to hire and fund a MPS in the amount of \$125,000. Duke Energy Indiana formed an energy efficiency collaborative, consisting of the OUCC, CAC, and DEI-IG ("EE Collaborative"). The EE Collaborative met on several occasions to choose a consultant to conduct the MPS, to review the recommendations contained therein, and to discuss Duke Energy Indiana's new energy efficiency proposal.

5. Petitioner's Case-In-Chief. In support of its Verified Petition, Duke Energy Indiana presented the testimonies of James E. Rogers, Jim L. Stanley, Judah Rose, Jane Sadowsky, Michael Goldenberg, Theodore E. Schultz, Richard G. Stevie, Nick Hall, Diane L. Jenner, Bruce L. Sailors, Dwight L. Jacobs, and Stephen M. Farmer.

Mr. Rogers testified regarding the Company's vision for energy efficiency and stated that there are several compelling reasons for increasing the electric utility industry's focus on energy efficiency programs. He stated that the electric utility industry continues to be subject to increasingly stringent emissions reduction requirements, which will only continue to become more stringent. Mr. Rogers said customer demand for electricity in the Company's service territory is growing rapidly and the costs of providing the required supply-side resource options to meet this demand are increasing significantly. Mr. Rogers opined a different regulatory approach is necessary to achieve the Company's vision and that the current regulatory approach creates a natural incentive for utilities to focus more on supply-side options for meeting demand because utilities have the opportunity to increase earnings on their supply-side investments. In contrast, Mr. Rogers said, the conventional regulatory treatment for demand-side investments consists of actual, out-of-pocket cost recovery, and perhaps lost revenue recovery and/or a shared savings incentive. Additionally, unlike supply-side options, energy efficiency programs actually reduce utilities' energy sales creating a natural disincentive for fully capitalizing on energy efficiency.

Mr. Rogers testified that the right regulatory framework will help ensure a reliable, affordable, and clean supply of energy to fuel a growing economy and a sustainable energy future. Mr. Rogers stated that a new regulatory model must (1) treat energy efficiency as a resource, (2) recognize that as energy savings increase, electricity sales will diminish (as will generation additions), and (3) focus on performance, on resource impacts achieved and on value

created for customers. He also identified several reasons why the Company believes utilities are well positioned to play an important part in the delivery of energy efficiency products and services.

Mr. Rogers outlined the key attributes of the Company's EE Plan: (1) creating value for customers; (2) providing universal access to energy efficiency; (3) treating energy efficiency as a true resource, on a level playing field with supply-side options; (4) aligning risk and reward; and (5) independent verification of energy efficiency impacts. To meet these attributes, Mr. Rogers proposed that the Company implement a comprehensive set of cost-effective energy efficiency programs, and be compensated by receiving through a rider, 90% of the avoided fixed and variable supply-side costs. Further, Mr. Rogers explained that, under this proposal, the Company will have an opportunity, but not a guarantee, to cover program costs and earn a return on energy efficiency investments. Rogers explained that, by tying compensation to the Company's proposal for independent measurement and verification, the Company will only be paid for the actual demand- and energy-reduction impacts achieved through the program.

Mr. Stanley testified regarding the Company's native load supply obligations and its responsibility to provide service to its customers. He stated that Duke Energy Indiana's native load customers consume approximately 36 million MWhs of energy annually, and during peak hours, native load customer demand has been as high as 6,702 MWs. Mr. Stanley stated that this demand continues to increase by about 1% (approximately 65 MW) annually.

Mr. Stanley testified that a portfolio approach to resource planning is likely to produce the best economic mix of resources while at the same time mitigating risk through diversification. Mr. Stanley explained that the Company uses a fairly sophisticated integrated resource planning ("IRP") process that analyzes and considers three basic options for meeting customer load obligations: (1) build, or otherwise acquire, new supply resources; (2) buy power from the wholesale markets; and/or (3) initiate additional energy efficiency and demand response programs.

Mr. Stanley described the results of the Company's 2007 IRP as demonstrating that, without additional resources, Duke Energy Indiana's reserve margin would be consistently below 15%. He added that, even with the Company's aggressive approach to energy efficiency, it will still have a need for additional capacity. Mr. Stanley explained that the Company proposes to treat energy efficiency as a fifth fuel capable of providing a cost-effective and emissions-free option for meeting the Company's growing electricity demands. Mr. Stanley testified the Company's approach creates programs designed to meet customers' electricity needs by saving watts instead of generating watts.

Mr. Stanley stated that this new recovery mechanism will more appropriately compensate and encourage the Company to produce a portion of the capacity and energy projected in its 2007 IRP through saved watts. Mr. Stanley explained that the save-a-watt approach offers two principal benefits to customers: (1) reduced overall cost, and (2) reduced environmental impact. He said that if Duke Energy Indiana achieves significant energy efficiency impacts with its proposed save-a-watt approach, customers will realize an automatic savings of 10% compared to the Company's avoided generation costs. He said that the Company believes that a new

regulatory paradigm, such as the proposed save-a-watt approach, is needed for utilities to aggressively pursue energy efficiency.

Mr. Stanley testified that the Company's proposal satisfies the alternative utility regulation statute's goals and purposes. He stated that the Company believes that the proposed ARP satisfies each of the four areas the Commission must consider in approving an ARP: (1) technological improvements have occurred that will allow more sophisticated energy efficiency programs as well as more accurate estimating of customer's usage; (2) the proposed approach will benefit the Company, its customers and the State by providing incentives to the Company to pursue energy efficiency initiatives that lower overall customer bills compared with bills from generation resources, creating more options for customers to manage and lower their bills and creating new jobs in the energy efficiency field in its service territory; (3) the EE Plan will promote energy efficiency because it will encourage the Company to invest in all cost-effective energy efficiency in its service territory; and (4) it will allow Duke Energy Indiana to effectively compete with other providers of functionally similar energy services or equipment. Additionally, Mr. Stanley said, the Company's proposal includes performance-based rewards, in that Duke Energy Indiana will be paid based on results achieved.

Mr. Stanley reported that the Company's save-a-watt approach will result in a modest rate increase of approximately 2% in year one, in terms of absolute price per kWh – but that the proposal also will reduce overall revenue requirements compared with building new generation. Customers participating in the Company's energy efficiency programs should actually see their monthly bills go down, Stanley said.

Mr. Stanley also explained how the save-a-watt approach is supported by the Commission's current demand-side management rules. Even though the Company has filed its request as an ARP, he stated that the approach is also consistent with the Commission's rules applicable to both conservation and demand response programs that provide for recovery of program costs, lost revenues and shareholder incentives in an effort "to eliminate or offset regulatory or financial bias against demand-side management ("DSM"), or in favor of a supply-side resource, a utility might encounter in procuring least-cost resources." 170 IAC 4-8-3(a).

Judah Rose, Managing Director of ICF International, provided economic and policy analysis related to energy efficiency in general and Petitioner's proposed save-a-watt model in particular. Mr. Rose testified that there is a greater potential for increased energy efficiency and that the Company's proposal addresses impediments to achieving greater results, such as creating a formula that strongly creates incentives for the utility to pursue energy efficiency by allowing the utility an opportunity to earn a return and grow revenues for successful energy efficiency activities in exchange for undertaking risks. He stated that most states that have significant customer energy efficiency programs have formal utility incentives for energy efficiency. He stated that there are alternative approaches to energy efficiency, such as "command and control" cost oriented regimes and third-party administration models. He explained that the concerns with third-party administration include the lack of positive customer value-oriented incentives that tend to stifle innovation and action, and the fact that third-party administration fails to exploit potential utility implementation advantages. Mr. Rose testified that the save-a-watt

model is enticing because it creates incentives for action and innovation, has value orientation, and has the potential to create breakthroughs in energy efficiency.

Mr. Rose testified as to the importance of applying economic efficiency to utility actions because actions that are economically efficient minimize the costs of meeting total demand for electricity. He explained that avoided costs of supply-side options are currently higher than the costs of incremental energy efficiency programs, making an increase in the amount of energy efficiency economic from the perspective of minimizing customer costs. He also stated that the economic advantages of energy efficiency programs increase to the extent that they include benefits that supply-side options do not, such as CO₂ emission reductions.

Mr. Rose testified regarding the economics of save-a-watt and explained that there are several features that need to be highlighted, including the fact that the Company receives 90% of the utility's estimated avoided costs, only Commission approved programs are implemented, the Company is not guaranteed to recover its incurred costs, and the funds received from Rider EE are provided contingent upon verification by an independent third-party. Mr. Rose explained that Petitioner incurs the risk of program costs being higher than expected overall as well as the risk that program costs will be higher than expected on a per MW or MWh saved level. He provided an illustrative example to demonstrate that the save-a-watt model is economically efficient because the utility action is lowering the overall costs of providing service.

Mr. Rose compared save-a-watt to programs with little or no incentives and risks. He stated that customer benefits might be greater under save-a-watt when compared to programs with less incentive payments because energy efficiency may be greater and/or more innovative. He stated his belief that Petitioner's proposal will change utility behavior and increase energy efficiency over and above programs with little or no incentives because the focus is on value created rather than costs incurred.

Mr. Rose presented an overview of energy efficiency programs and incentives across the country. He stated that the reported estimated average energy efficiency cost is \$19/MWh, although he stated that there is a lot of uncertainty around this number. He explained that there is significant variation in energy efficiency savings activity across the country. Mr. Rose stated that the top six¹ states in terms of total dollars expended accounted for 64% of total estimated U.S. expenditures and 58% of estimated demand reductions. He explained that, with one exception², rates and avoided costs in these states are among the highest in the nation.

Mr. Rose contrasted programs that provide for cost recovery only and approaches that layered on incentives. He stated that half of the 36 states that have utility funded energy efficiency programs provide incentives in addition to cost recovery and that the number is increasing. He then described the various incentive mechanisms, including shared savings, a rate-of-return adder, and performance targets. Mr. Rose presented an overview of approaches utilized in other states and concluded that save-a-watt is an innovative, comprehensive, and streamlined approach to maximizing energy efficiency potential via utility incentives. He concluded that the save-a-watt model creates risks for the utility in the event that verifiable

¹ California, New York, Massachusetts, New Jersey, Washington, and Texas.

² Washington.

savings are not achieved or that costs exceed expectations. Mr. Rose stated that, in light of the potential economic advantages of energy efficiency, he believes the Commission should approve the save-a-watt regulatory model.

Ms. Sadowsky provided her opinion as to what investors demand from utility companies, which includes dividend policy/yield, stable and predictable earnings streams (lower risk in exchange for lower growth), a solid management team that understands local regulations and has good relationships with regulators, a compelling fundamental story supported by a sustainable (and growing) dividend, rate of reinvestment into utility assets, and social and environmental responsibility. She stated that regulatory certainty is also an important criterion for utility investors. The opportunity to recover prudently incurred costs and a reasonable return on their investment is important to investors, Ms. Sadowsky stated. She indicated that an unusually large proportion of equity owners of investor owned utilities (“IOU”) are comprised of retail investors, who tend to own the stock because of the familiarity with the company and its services. Ms. Sadowsky explained that these investors will likely remain long-term holders, but that the balance of investors will select among comparable investments based on dividend yield and earnings per share (“EPS”) growth dynamics and the sustainability of the dividend and EPS growth.

Ms. Sadowsky stated that jurisdictions in which cost recovery for investments in energy efficiency is generally through rate filings have lagged behind jurisdictions that incorporate some manner of affirmative incentive to the utility for its energy efficiency programs in both per capita expenditures and results obtained. Ms. Sadowsky also examined the programs of states with the highest per capita spending on energy efficiency programs and determined that a common commitment to performance incentives for those programs appears. Among the top ten states, seven of them (Vermont, Massachusetts, Connecticut, Rhode Island, New Hampshire, Minnesota, and California) have program incentives for utilities above and beyond cost recovery. The incentives in Oregon and New Jersey are administered by state organizations, leaving Washington lacking both performance incentives and a state-administered electricity sector.

Ms. Sadowsky stated that it is important to investors that utilities have an opportunity to generate an earnings stream comparable to what they would earn from a power plant investment for several reasons. First, management must prioritize and rank the utility’s capital projects to evaluate the allocation of a company’s resources relative to the investment opportunities available. Given this dynamic, she said utilities will prioritize supply-side projects that are granted a regulatory rate of return on investment as well as costs recovery of expenditures, over opportunities that allow cost recovery and/or lost revenue recovery only. Second, she said, the U.S. electricity industry is about to undergo a wave of utility infrastructure investment encompassing transmission, distribution, generation, and environmental remediation. This investment will be in response to both the historical underinvestment seen in the past several decades and to the forecasted increase in the demand by the Department of Energy (“DOE”) and other organizations. For companies to allocate the desired amount of capital to energy efficiency projects given the overall investment required, energy efficiency programs will need to generate earnings that are comparable in both size and amount to a utility’s alternative uses of capital. Next, Ms. Sadowsky stated that programs like save-a-watt align national objectives focusing on the criticality of energy efficiency and conservation with the need for every company to invest its limited capital in a way that achieves an optimal return. Finally, she stated, once energy

efficiency programs begin to have more of an impact on the earnings of utilities, the financial implications of regulatory jurisdictional disparities in the design of energy efficiency programs are likely to become apparent in the relative earnings and growth rate of earnings among utilities. Utilities operating in regulatory regimes that allow them to replace most or all of their avoided supply-side earnings are likely to be valued more highly by equity investors than the utilities who have received cost recovery, lost revenue recovery or a share of savings in their regulatory design.

Ms. Sadowsky also explained that investors would prefer the payment for the save-a-watt model be guaranteed, as this greatly enhances their visibility into the utility's future earnings, but will compare the risks of achieving the save-a-watt objectives to the risks associated with building a new power plant. She then stated that investors will benefit from the save-a-watt model as it gives them a more certain methodology to calculate the financial impact of the Company's energy efficiency investments.

Mr. Goldenberg described the history of Duke Energy Indiana's energy efficiency efforts, beginning in 1991 when the Company implemented its first set of energy efficiency programs targeting multiple end uses for all customer classes under a settlement agreement in Cause No. 38986. In that case, the Commission approved recovery of program costs, lost revenues (defined as the component of fixed costs that would not be recovered due to retail sales losses resulting from the DSM programs) and a shared savings incentive. Mr. Goldenberg stated that the initial portfolio of programs included conservation programs for residential, commercial and industrial customers as well as demand response programs for larger customers. In 1996, he said, the Company collaborated with the OUCC, CAC and DEI-IG for a second DSM settlement agreement, which resulted in several changes to the initial portfolio. The second agreement continued utility-sponsored DSM programs for residential and small to medium-sized commercial and industrial customers, but discontinued programs for larger commercial and industrial customers because the parties believed those market segments were being served by non-regulated energy service companies. Mr. Goldenberg reported that the Company added various programs along the way, including a lighting incentive plan, an energy efficient cooling system and motor programs, and the residential audit program (known as Home Energy House Call).

Mr. Goldenberg testified that Duke Energy Indiana filed for approval of a more aggressive portfolio of energy efficiency programs – substantially increasing the amount the Company spends on energy efficiency programs and requesting recovery of lost revenues and shareholder incentives in 2002. The Commission denied recovery of lost revenues and shared savings, but encouraged the Company to continue to collaborate with intervenors to develop additional programs. Mr. Goldenberg reported that the Company added a new residential direct load control management program (“Power Manager”) and the Personalized Energy Report. Since 1992, Mr. Goldenberg testified that the Company has saved approximately 616 MWs and 682,621 MWhs through its energy efficiency efforts and had over 347,000 customers participate over the past fifteen years.

Mr. Goldenberg next described the Company's MPS for energy efficiency in its service territory. He stated that the EE Collaborative decided to hire a consultant to perform the MPS in

order to provide data for the design of programs aimed at increasing investment in energy efficiency. The EE Collaborative hired Summit Blue Consulting (“Summit Blue”) and Wisconsin Energy Conservation Corporation (“WECC”) to perform the MPS and to provide an action plan for the Company to use in meeting the potential energy efficiency impact from the study. The MPS concluded that the total estimated residential energy efficiency potential over a 20-year forecast period is approximately 1,600 GWh of first-year energy savings. This residential estimate amounts to approximately 15% of the Company’s forecast 2028 residential energy consumption of about 12,200 GWh – equal to annual average energy savings of about 85 GWh or 1% of the Company’s forecast 2006 residential sales. Mr. Goldenberg stated that the MPS also estimated that the total residential energy efficiency program costs over the 20-year forecast period is \$190 million, or about \$9.5 million per year on average.

Mr. Goldenberg testified that for residential demand response, the MPS estimated a potential of about 340 MW over the 20-year forecast period, assuming that about 40% of Duke Energy Indiana customers with central air conditioning sign up for the Company’s Power Manager direct load control program. This demand reduction estimate amounts to approximately 15% of the forecast 2028 residential peak demand of about 2,300 MW. This program was estimated to cost about \$52 million over 20-years or about \$2.6 million per year on average.

Mr. Goldenberg explained that for small commercial and industrial customers, the MPS estimated 660 GWh of energy efficiency conservation potential over the forecast period, approximately 9% of the Company’s forecast small commercial and industrial energy consumption of about 7,330 GWh in 2028. The total estimated small commercial and industrial demand response potential is estimated to be about 54 MW over the forecast period, equaling about 4% of the forecast peak demand of 1,500 MW in 2028. The MPS did not look at large commercial and industrial customers as they have been excluded from participating in programs since the original settlement with the OUCC, CAC, and DEI-IG in 1996.

Mr. Schultz testified that many reports state that it should be cost-effective for customers to aggressively pursue energy efficiency on their own, but this is clearly not happening. To address this challenge, Duke Energy conducted customer research in several of its operating company states, including Indiana, to determine why customers were not taking advantage of existing energy efficiency opportunities. Mr. Schultz reported that the research identified the following impediments: (1) customers do not often have the data, time or desire to evaluate efficiency options; (2) many customers lack the capital to invest in energy efficiency; and (3) most customers are not aware of the positive impact their individual behaviors can have on the welfare of others on such issues as climate change and national energy independence. Based on this research, Duke Energy identified the following customer prerequisites for participation: productivity and lifestyle cannot be compromised; minimal up front investment; quick and material pay off; and problem-free solution that must be easy to understand and act upon, convenient, one-step, and can be fulfilled immediately.

Mr. Schultz indicated that, as part of save-a-watt, the Company intends to build energy efficiency into its standard service offerings to make it part of the customer’s everyday life without customers having to sacrifice the comfort and convenience of electricity use. Under its

save-a-watt approach, to compensate and encourage the Company to become a leader in producing capacity and energy by “saving” watts, Duke Energy Indiana requested that it be compensated through the amortization of and a return on 90% of the costs avoided by saving watts. Mr. Schultz stated that this proposal will not only produce savings for customers, but customers will not have to pay for energy savings that the Company does not achieve. He said that the Company has proposed that all customers pay for demand response programs based on the customers’ peak demand because all customers truly benefit from reduced peak demand as the Company can delay building generation or buying capacity. Duke Energy Indiana has proposed that residential customers pay for residential conservation program and non-residential customers pay for non-residential conservation programs.

Mr. Schultz then described the main differences between save-a-watt and other regulatory models for energy efficiency. He stated that the single biggest difference is that the utility only gets paid for the energy efficiency results that it delivers, *i.e.* the impacts in kWh and kW realized by customers and verified by an independent third-party. Most approaches to energy efficiency pay utilities, or other administrators, for their marketing, administration, program incentives and measurement and verification expenses regardless of the energy efficiency impacts they achieve. This type of approach places the risk of not achieving the energy efficiency impacts and the risk of achieving them at a higher unit cost than planned on the customer – while save-a-watt shifts this burden to the utility. Mr. Schultz also explained that the external verification by an independent third-party proposed in save-a-watt helps ensure the utility is producing quality resources that it can depend on to meet customer demand, even as this demand continues to grow. He noted that another important difference in the save-a-watt approach is that it treats energy efficiency just like a supply-side resource, requiring the Company to be accountable for results over the energy efficiency resource’s useful life in a manner similar to a supply-side resource. Another difference is the flexibility in program offerings that will allow the Company to make program changes and reallocate resources among programs over the lives of the programs to optimize results. Mr. Schultz reported that the Company proposes to review and adjust programs and overall portfolio funding levels on an annual basis – and to report annually to the Commission on significant changes and results.

Mr. Schultz stated that the save-a-watt approach is fundamentally based on payment for results with customers only paying for the resources – be they energy efficiency or supply side – that the Company actually has acquired. He indicated that the Company is seeking approval of Rider EE, which will compensate the Company for delivering verified energy efficiency results. Rider EE will be updated annually, based on updated projections of results, including projected incremental avoided costs, and actual results achieved by the Company. Mr. Schultz said that this process will ensure that customers only pay for capacity and energy savings actually realized by customers and the Company.

Mr. Schultz next described the energy efficiency program offerings the Company has proposed in this proceeding:

- Residential Energy Assessments
- SmartSaver™ for Residential Customers
- Low-Income Services

- Energy Efficiency Education Program for Schools
- Power Manager
- Non-Residential Energy Assessments
- SmartSaver™ for Non-Residential Customers
- PowerShare®

In addition, Mr. Schultz stated that there are two research programs included to begin pilots with customers to determine the potential impacts of these new programs – the Efficiency Savings Plan and the Advanced Power Manager Program. However, Mr. Schultz said that these programs are just the beginning given that the save-a-watt approach provides the Company the incentive to pursue all cost-effective energy efficiency initiatives.

Mr. Schultz testified that the Company envisions a future in which all customers are participating in energy efficiency as part of the utility's standard offer. Customers would have to opt-out of rather than opt-into participation in energy efficiency measures and programs. He explained that Duke Energy is currently evaluating smart grid technology that would enable two-way communications to every customer with the ability for time-differentiated prices. This technology would help to enable the Company's "Phase II" vision of the new energy efficiency standard offer to customers.

Mr. Schultz stated that the Company proposes to enhance its current PowerShare® program by offering customers more options and increased customer credits for participation. Under the new proposal, customers can choose between mandatory, voluntary, or emergency participation. Mr. Schultz testified that these new options, made possible by the proposed save-a-watt model, will increase the value of PowerShare® to customers, and therefore, the Company anticipates an increase in participation and demand savings. The Company also proposes to incorporate PowerShare® program offerings and associated revenue requirements in its proposed Rider EE. Mr. Schultz stated that Duke Energy Indiana's base electric rates currently include approximately \$1,023,000 in PowerShare® expenses, which are reconciled to actual PowerShare® programs costs via Rider 70. The Company proposes to include a credit in Rider 70 annually for the amount of PowerShare® expenses in base rates, thereby ensuring that customers are made whole for the amount they are currently charged. Thereafter, PowerShare® revenue requirements would be subject to and recovered under the new save-a-watt model. Mr. Schultz added that in the transition period, crediting and collecting of all PowerShare® program amounts incurred prior to the effective date of an Order in this proceeding, including any reconciliation amounts associated with such costs or credits billed under Rider 70, will continue to be included in Rider 70.

Mr. Schultz next explained why the Company plans to include its larger commercial and industrial customers in its energy efficiency offerings. By excluding customers above 500 kW, approximately 70% of the Company's total non-residential kWh sales are excluded from participating in efficiency options. Mr. Schultz stated that the Company's energy efficiency programs can address some of the historical barriers to participation, such as longer than acceptable payback periods and the lack of understanding regarding the size and number of energy savings opportunities available. In addition, Mr. Schultz said, energy efficiency results, whether conservation programs or demand response initiatives, benefit all customers by delaying

the need for the Company to build more generation or buy more power. However, he indicated Duke Energy Indiana recognizes that many of its larger commercial and industrial customers have undertaken significant energy efficiency initiatives on their own in an effort to reduce their cost of energy. Because of this, the Company proposed that customers with an aggregate load on the Duke Energy Indiana system of 5 MW or higher may have the ability to opt-out of conservation program participation, and therefore, opt-out of paying for the proposed conservation programs. In order to opt-out, Mr. Schultz added, the customers must self-certify that they have undertaken energy efficiency projects or measures at their sites within the last three years. If, however, a customer who is eligible to opt-out has taken advantage of an energy efficiency program offered by Duke Energy Indiana, then that customer should be required to stay on Rider EE for the entire period of the useful life of the measures that they installed (estimated at eleven (11) years from the installation date). Mr. Schultz stated that the Company performed some sensitivity analyses to determine the effect of customers opting-out on the rates paid by other participating non-residential customers and determined that it would be minimal.

Mr. Schultz reported that the Company will provide the Commission with an annual update to its EE Plan based on the performance of the programs, market conditions, economics, consumer demand, and avoided costs. The Company currently projects a cumulative system energy efficiency result of 317 MW in year one, 412 MW in year two, 644 MW in year three, and 882 MW in year four. Assuming all customers can be successfully converted to the proposed energy efficiency programs, there would be incremental demand impacts greater than 10 times what is being realized today. Mr. Schultz concluded that the save-a-watt approach allows the Company to meet part of the increasing energy needs of Indiana customers without building new generation facilities – the “greenest” approach available to meeting those needs. The save-a-watt approach would also allow the Company to (1) lower bills for customers on average, compared to the bills that would result from additional generation resources, (2) offer the potential to substantially lower bills for customers who participate in energy efficiency programs, and (3) provide more options to help customers manage their bills in a rising energy price environment.

Ms. Jenner testified that the goal of the IRP process is to determine an optimal combination of resources that can be used to reliably and cost-effectively meet customers’ future electric service requirements. Ms. Jenner testified that the IRP process involves taking a myriad of resource options, and, through screening and analysis, methodically funneling down until you reach an optimal combination of feasible and economic alternatives that will reliably meet the anticipated future customer loads.

Ms. Jenner stated that the Company considers a multitude of options and combinations of options, including energy efficiency programs, environmental compliance alternatives, and supply-side alternatives in its IRP analysis process. Once the options are narrowed down to a more manageable number, the next step is to integrate the options by using the system expansion model, STRATEGIST[®], which uses the load forecast, in concert with data concerning existing generating units, demand-side resources, environmental compliance alternatives and future supply-side resource alternatives, to simulate electric production system operation. STRATEGIST[®] then analyzes the cost-effectiveness of a multitude of combinations of the resource alternatives resulting from screening analyses, ultimately producing a number of

resource expansion plans that meet the prescribed reliability criteria. Ms. Jenner said that the model also compares the present value revenue requirements (“PVRR”) of the various plans generated by the model, but she stated that judgment on other issues such as flexibility, risk, availability of equipment, constructability, and transmission constraints, must be applied to the results.

Ms. Jenner explained that energy efficiency was treated differently in this IRP than in the past in two ways: (1) the Company chose to model demand response and conservation programs in “bundles” to allow the optimization model to select demand-side alternatives in the same way the model can select supply-side and environmental compliance alternatives; and (2) the proposed save-a-watt approach to energy efficiency was utilized. In the IRP, the energy efficiency programs were screened for cost-effectiveness and those programs that were demonstrated to be cost-effective were then included in the integration/optimization process. Ms. Jenner stated that the demand response programs were modeled as two separate bundles (one bundle of non-residential programs and one bundle of residential programs) that could be selected by the model based on economics. The conservation energy efficiency programs were modeled as three separate bundles. Bundle 1 corresponded to the costs and impacts for conservation programs assumed at the time the IRP was developed for the Company’s energy efficiency filing for 2008-2012. Bundles 2 and 3 were made available to the model starting in 2012 and 2016, respectively, which utilized the costs of Bundle 1 escalated at the rate of inflation.

Ms. Jenner reported that all of the energy efficiency bundles were selected by the optimization process as being economic, and thus, were included in the chosen plan. The remainder of the chosen resources included the Benton County wind purchased power agreement, purchases in 2008-2011, the Edwardsport Integrated Gas Combined Cycle Plant (“IGCC”) in 2012, the addition of trona injection on Gallagher Units 1-4 and Wabash River Unit 6, an upgrade at Markland Hydro Station, and a combination of simple cycle CTs, combined cycle units and renewable resources. Ms. Jenner also stated that she performed some updated energy efficiency STRATEGIST[®] model runs with updated revenues and impacts for the proposed energy efficiency programs subsequent to the 2007 IRP. The proposed energy efficiency programs continued to be economic under the reference case, carbon case and high carbon case conditions, producing between \$957 million and \$1.2 billion PVRR of savings compared with a supply-side only case. Ms. Jenner concluded by stating that the save-a-watt approach can play an important role in addressing the total need of the Company’s customers by meeting a portion of its near-term capacity resource needs on a cost-effective basis, while also reducing overall air emissions.

Dr. Stevie explained that the energy efficiency programs and measures considered by the Company and the EE Collaborative included: (1) programs already offered and tested by the Company and its affiliates; and (2) new programs developed through collaborative efforts across the jurisdictions served by Duke Energy Indiana. The Company utilized the DSMore model to analyze each potential program or measure, applying multiple cost-effectiveness tests to compile the list of energy efficiency programs discussed by Mr. Schultz. Dr. Stevie stated that DSMore is a financial analysis tool designed to evaluate the costs, benefits and risks of energy efficiency programs and measures by estimating the value of an energy efficiency measure at an hourly

level across distributions of weather and/or energy costs or prices. DSMore also provides the results of the “California Standard” tests for energy efficiency programs: Utility Cost Test (“UCT”), Ratepayer Impact Measure (“RIM”) test, Total Resource Cost (“TRC”) test, Participant Test, and Societal Test.

Dr. Stevie testified that the following energy efficiency program information is input into the model: (1) the number of program participants, including free ridership or free drivers; (2) projected program costs, contractor costs and/or administration; (3) customer incentives, demand response credits or other incentives; (4) measure life, incremental customer costs and/or annual maintenance costs; (5) load impacts (kWh, kW and the hourly timing of reductions); and (6) hours of interruption, magnitude of load reductions or load floors. The Company also input its discount rate, loss ratio, either for annual average losses or peak losses, rate structure, or tariff appropriate for a given customer class, avoided costs of energy, capacity, transmission and distribution, and cost escalators. Dr. Stevie next explained how analysts and program managers developed the inputs for each program or measure by using information from sources such as Electric Power Research Institute, ENERGY STAR®, E-Source, other utility program information, as well as from external experts in the industry. Over time, Dr. Stevie reported, as impact and process evaluations are performed on Indiana program results, information and input specifically related to Indiana customers will begin to emerge and be used within future cost-effectiveness analyses.

Dr. Stevie explained that allowing the avoided energy costs to reflect initial Company IRP hourly production costs, and then annually escalating these costs along a market forecast, permits energy efficiency to be valued on a level playing field with supply-side resources and ensures that energy efficiency will be appropriately valued. Initializing the avoided costs to the Company’s current IRP also mitigates against possible over-spending in the short run, in the event that current market prices are significantly above average, and not reflective of a more reasonable and prudent long-run forecast of avoided costs. Dr. Stevie stated that this approach further provides the most accurate screen for energy efficiency cost-effectiveness, in preparation for the IRP model run comparisons with and without the energy efficiency programs inserted as resource options.

Dr. Stevie testified that it’s the Company’s intent to ultimately develop estimates of avoided energy costs consistent with the methodology used in avoided cost filings and with the level of load impacts expected from the energy efficiency programs. He said this would provide the best overall estimate of the avoided energy costs that also embody any base load and intermediate avoided capacity costs not captured in the peaker capacity cost. Dr. Stevie said that this approach and analysis will be conducted annually to ensure that the estimation and valuation of avoided energy costs is consistent with the Company’s alternative supply-side resources and with future expectations of avoided energy costs.

Dr. Stevie explained that the energy efficiency programs and measures are analyzed by assessing the net present value of the financial stream of costs versus benefits, *i.e.*, the costs to implement the measures are valued against the savings or avoided costs. The resultant benefit/cost ratios provide a summary of the measure’s cost-effectiveness relative to the benefits of its projected load impacts. Dr. Stevie then described the “California Standard” tests for

energy efficiency programs. He stated that the use of these multiple tests can ensure the development of a reasonable set of energy efficiency programs, indicate the likelihood that customers will participate, and also protect against cross-subsidization. Generally, he stated, the proposed energy efficiency programs or measures pass the UCT, and TRC, and the RIM test. The Company is also seeking to implement research programs in order to investigate whether or not they can prove to be cost-effective in the future. Dr. Stevie stated that the Company also considers the Advanced Power Manager Program to be a research program because, although it has relatively high scores, the technology is unproven at this time.

Dr. Stevie then compared the projected load impacts from the portfolio of proposed energy efficiency programs to the recommended impacts from the MPS. He noted that the projections of cumulative annual MW impacts from the Duke Energy Indiana proposed energy efficiency programs are significantly higher over the four years than from the MPS. The projections of cumulative annual GWh impacts from the proposed energy efficiency programs track relatively closely those from the MPS for the first three years, but fall lower in the fourth year. Dr. Stevie noted that a difference between the two is that the MPS only targets residential and small/medium-sized commercial/industrial customers while the proposed energy efficiency programs target all customers.

Dr. Stevie also indicated that there are a few differences in the projected load impacts for the demand response programs between the DSMore screening process and the Company's 2007 IRP. First, a large interruptible contract is expiring and therefore, the IRP analysis of the projected impacts from existing programs was adjusted to remove the load reduction impact of the expiring interruptible contract. Second, the PowerShare[®] program options were expanded to increase participation. Although it is not guaranteed, the interruptible load was included in the proposed energy efficiency programs at a lower level with the intent to secure the load with new program options.

Dr. Stevie stated that the Company believes that successful, reliable and cost-effective energy efficiency programs require valid evaluation, measurement and verification ("EM&V") activities to (1) assure that measures are installed and tracked properly; (2) verify or revise impacts; (3) monitor and ensure customer satisfaction; and (4) establish independent third-party evaluations and reviews to confirm energy impacts and to improve program delivery, efficiency and effectiveness. There are generally five types of evaluation of energy efficiency programs: cost effectiveness, impact evaluation, measurement of load reduction, verification and evaluation. Dr. Stevie testified that the Company proposed to perform paper and electronic verification, field verification and monitoring, customer satisfaction surveys and system performance tests to measure, monitor and verify the energy efficiency programs. The Company estimates that 5% of the total program costs will be required to adequately and efficiently perform evaluations, monitoring and verification.

Dr. Stevie testified that the EM&V process will produce results on actual customer participation and actual load impacts, which are both important to the reconciliation and true-up process in that the original evaluation of program cost-effectiveness utilized projected numbers for participants in the programs and estimates of the load impacts. Dr. Stevie stated that the results on customer participation are available more quickly than the load impacts because

information on load impacts is more complex and tends to require rigorous impact evaluation studies, statistical billing analyses of pre- and post-usages, participant and non-participant surveys, and related activities. Dr. Stevie expects that for the first true-up process, the Company will have actual participant information and possibly some load impact results, most likely for demand response programs. Load impact results for all programs will not be available until the completion of the second year of program implementation – at that point, a true-up of load impacts can be undertaken from the beginning of the program through the second year. The Company anticipates that the participant results will be reconciled each year and load impact results every other year.

Dr. Stevie also explained how the Company's proposed EM&V plans satisfy the Commission's rules on DSM program evaluation. The EM&V analysis will be conducted over time to verify the magnitude and persistence of the energy efficiency impacts achieved from both program participants, as well as from non-participants. Over time, Dr. Stevie said, the Company's energy efficiency programs can affect the nature of the energy efficiency market such that customer behavior, vendor behavior and even manufacturer behavior is altered. When significant momentum is generated with respect to the adoption of increased energy efficiency, it is possible to transform markets such that customers begin to demand more energy efficiency from their vendors, equipment providers and manufacturers. This transformation of the market is often referred to as free driver behaviors, or sometimes labeled as spillover effects, in contrast to the more familiar concept of free ridership. Free riders are those customers who receive an incentive but would have purchased the energy efficiency equipment even without the incentive, whereas free drivers are those customers who purchase energy efficiency equipment without an incentive as a result of market transformation.

Dr. Stevie provided supplemental testimony on the process that the Company is using to update the avoided production (energy) costs used in the evaluation of energy efficiency measures/programs and used as the basis for the production cost component of the Company's proposed recovery mechanism. Dr. Stevie stated that the applicable estimate of avoided production costs should come from the difference between an IRP with energy efficiency programs and an IRP where load reductions from the energy efficiency programs have been removed. At the time of the Petition in this Cause, the Company had not yet completed an IRP that included the proposed energy efficiency programs. Thus, the Company used information on avoided hourly energy costs from its most recent IRP. Since that time, the avoided capacity cost has been updated and an IRP has been completed, thus, the Company could develop estimates of the avoided energy costs specific to the conservation energy efficiency programs in the application.

Dr. Stevie explained that estimating the avoided production costs associated with the conservation programs requires finding the difference in production costs between the two IRP runs (with and without the conservation programs). The difference in production costs is then divided by the amount of energy efficiency load reductions to compute the cost saved per kWh. The cost per kWh is then put back in the DSM cost-effectiveness model and the Company's energy efficiency financial model to compute new levels of avoided costs and revenue requirements to compare against the levels in the original filing in the proceeding.

Dr. Stevie further explained that the avoided production costs from the new analysis are higher. He further stated that the new avoided capacity cost reduces the present value of the avoided capacity for both demand response and conservation programs and as expected, the present values of the avoided costs from the demand response programs declines while the avoided costs from the conservation programs slightly rise.

Dr. Stevie concluded that this process made sense in order to screen programs because (1) it makes the results consistent with the IRP, (2) the increase in the avoided production costs slightly offsets the impact of the reduction of avoided capacity costs for the conservation programs, and (3) the reduction in avoided capacity costs reduces the present value of avoided costs for the demand response programs, which causes the total avoided costs for all of the programs to decline from that in the Company's original filing.

Mr. Nick Hall provided his expert opinion of Duke Energy Indiana's overall approach to the energy efficiency program evaluations. He stated that the Company has adequately provided for the independent review and evaluation of its proposed programs by establishing initial evaluation plan summaries that propose specific energy efficiency evaluation studies and activities that will be competitively bid, designed, managed, supervised or conducted by independent and qualified evaluation professionals. Mr. Hall said that he finds the Company's approach reliable because it moves the evaluation function that documents the amount of energy saved, or how effective a program design or delivery system may be, outside of the company with a vested interested in the outcome of the studies. Further, Mr. Hall noted, by specifying proposed evaluation activities in advance of program initiation, the Company is better able to collect the necessary data required for quality evaluations to be conducted.

Mr. Hall also stated that Duke Energy Indiana's energy efficiency program evaluation summaries are consistent with state-of-the-art evaluation protocols. He said that the Company's plans employ the kinds of evaluation efforts, studies and activities that are associated with the state-of-the-art evaluation research and comply with the approaches described in the California Evaluation Protocols, the National Action Plan for Energy Efficiency approaches and the International Performance Measurement and Verification Protocol approaches. Mr. Hall stated that the results from studies conducted by the approaches presented in the Company's save-a-watt programs will be reliable and can be trusted if the evaluations are conducted in accordance with these approaches. He further explained that the California Evaluation Protocols represent a set of evaluation approaches that can be used for almost any kind of energy efficiency program evaluation. They were written for California's portfolio of over 250 programs, and therefore, had to be comprehensive and cover a wide variety of programs. They were also based on reliable state-of-the-art approaches and employ procedures that allow for site-specific data collection to confirm installations, baseline conditions, use conditions and operational environments.

Mr. Hall stated that the percentage of installed measures that the Company proposes to verify (*i.e.*, 5%) is adequate for the initial year of implementation with the condition that if and when a problem with the accuracy of the installations is identified, there should be increased verification for that program to confirm that any installation or accounting issues have been corrected. He also noted that where thousands of measures are being deployed (such as compact

fluorescent bulb promotion), verification tracking at the 1% to 2% level is often sufficient in light of the cost/precision tradeoff that occurs with larger sample sizes.

Mr. Hall testified that, after the first year of evaluation activity, the Company will be in a position to begin to judge the relative reliability and precision of the energy savings estimates; but without direct evaluation findings within Indiana for these programs, such a quantitative forecast is difficult, if not impossible, to assess. In Mr. Hall's experience, the greatest threat to reliability of the evaluation results is often due to evaluation budgets being set too low to establish reliable evaluation approaches. Mr. Hall indicated that with a 5% evaluation budget, it will be important to allocate evaluation dollars to the most important programs, leverage assets already within the Company (e.g. meters, expertise, data systems) and focus on the most important technologies so the programs that provide the highest savings or uncertainty in savings receive the funding that allow those saving estimates to be accurate.

Mr. Hall further testified that he believes the evaluation reporting timeline proposed by the Company to be both reasonable and achievable. He said that it is important to give the programs time to come up to full implementation speed before a full-scale evaluation effort is initiated.

Mr. Sailors testified that market participants may submit and/or utilize demand response resources in the Midwest Independent Transmission System Operator ("Midwest ISO") energy markets via two avenues: (1) a market participant may submit a price responsive demand bid, which is when a market participant schedules a variable hourly demand for energy based on price; or (2) a market participant who is also a load serving entity can adjust their daily forecast of energy needs to reflect the impact of demand response resources and submit the adjusted load forecast to the Midwest ISO, which reflects a decision by a load serving entity to initiate a demand response resource the next day. Mr. Sailors said that the Company's demand response programs are not offered into the Midwest ISO energy market through price responsive demand bids because their programs are a scarce resource and not designed for use on just any day during the year.

Mr. Sailors described the difference between the Company's internal target planning reserve margin and the Midwest ISO's resource adequacy requirement. He said Duke Energy Indiana plans for capacity to meet its native load customers' peak demand requirements based on its projected peak load plus a minimum 15% installed reserve margin above the forecasted peak load. The Midwest ISO has requirements for operating reserves for members of the Contingency Reserve Sharing Group (of which Duke Energy Indiana is a member) of: 1% of load as regulation; 36 MW of spinning reserves and 55 MW of contingent reserves.

Mr. Sailors testified that a planning reserve margin reflects generation capability prior to forced outages and the operating reserve margin is the generation capability after forced outages are taken into account. He also explained that a load serving entity ("LSE") must provide capacity to meet its state or reserve sharing group requirement to comply with Module E. To cover daily needs, an LSE can specify generation and/or demand response resources – these Module E demand response resources are referred to as alternative capacity resources. Mr. Sailors stated that Duke Energy Indiana uses demand response resources in the annual Module E

filing to demonstrate to the Midwest ISO that resource adequacy planning reserve requirements are met.

Mr. Sailers testified that the Midwest ISO filed its Ancillary Services Market (“ASM”) proposal with the Federal Energy Regulatory Commission (“FERC”) on September 14, 2007 and that demand response resources are included in that filing. The ASM will be integrated with the Midwest ISO energy markets so that both these markets will function together and there will be no incentive to provide resources to the energy market in lieu of the ASM or vice versa. Ms. Sailers said the Company’s current demand response programs are not suitable for participation in the ASM because they have customer notice requirements of 30 minutes or more and are oriented to provide continuous load reduction over multiple hours – not to continuously receive dispatch instructions from the Midwest ISO to turn on/off load reduction.

Mr. Sailers also indicated that the Midwest ISO Demand Response Working Group has crafted a new schedule called the Emergency Demand Response (“EDR”) schedule – a temporary schedule to incorporate demand response resources into the energy markets during emergency events such as a NERC emergency level 2 event. If its demand response programs meet the EDR requirements, then the Company would bid them under the EDR schedule if it is filed with and approved by FERC. Mr. Sailers stated that the Company is actively participating in the Midwest ISO committees working on demand response resources as well as tracking events and developments with the ASM proposal.

Mr. Dwight L. Jacobs testified that the Company proposes to be compensated for all costs associated with the EE Plan, including all program costs, education, awareness and administration costs, measurement and verification costs, research and development costs and an appropriate return on investment, to be achieved through the amortization of and a return on 90% of the costs avoided by the Company as a result of reductions in capacity and energy costs resulting from its energy efficiency programs. To implement this approach, Duke Energy Indiana requested that the Commission grant the Company the authority to defer certain program costs and to amortize such costs over the life of the applicable program, with an acknowledgement that the revenues established in Rider EE specifically provide for the recovery of the costs. Mr. Jacobs stated that the costs that the Company seeks to defer are those that will occur in one period but which are related to benefits received in multiple future periods, such as the upfront development costs incurred prior to the implementation of the programs and one-time incentives paid upfront for the installation of energy efficiency measures or equipment. Ongoing costs incurred after a program is implemented will be expensed as incurred.

Mr. Jacobs testified that deferral and amortization of energy efficiency program costs match the expenses to the associated capacity and energy savings benefits produced over the life of the program. He said that this treatment is consistent with the theme of the Company’s proposed energy efficiency initiative in that it treats investment in this program similarly to an investment in a generating plant, which is capitalized on the Company’s balance sheet and subsequently depreciated through its income statement over a period equal to its estimated life. Mr. Jacobs also indicated that the proposed accounting treatment is in accordance with generally accepted accounting principles.

Finally, Mr. Jacobs stated that the Company requested that the Commission find that revenues from Rider EE be included in the Fuel Adjustment Charge (“FAC”) earnings test and that the greater of 90% of the avoided generation costs or actual program costs be included in the FAC earnings and expense tests.

Mr. Stephen M. Farmer testified that the Company requested authorization to implement Rider EE in order to be compensated for achieving verified capacity and energy savings and so that the Company’s customers may realize the benefits of the Company’s proposed EE Plan. He explained that the EE Plan was designed to produce energy and demand savings at an overall cost to customers that is lower than comparable supply-side investments. Customers will realize savings by (1) reducing their consumption of energy and (2) paying 10% less than they would have been charged based on the incremental cost of avoided capacity and energy.

Mr. Farmer testified that amounts billed to customers under Rider EE will be comprised of two basic elements: (1) a charge based on 90% of the jurisdictional revenue requirement applicable to projected avoided capacity and energy costs, and (2) a Balance Adjustment (“BA”), which captures jurisdictional revenue requirement differences that result from variances between projected and actual energy efficiency capacity and energy load reductions in addition to variances between projected and actual kWh sales. Amounts billed under Rider EE will be increased to the extent actual load reductions exceed projected load reductions while customers will receive a credit if the Company is unable to achieve projected energy and capacity savings.

Mr. Farmer said that the Company is proposing that the rate used to quantify the value of avoided capacity costs be based on the methodology, data inputs and sources that are normally used to calculate the standard offer rate that Duke Energy Indiana pays qualifying cogeneration facilities (“QFs”) under Standard Contract Rider No. 50. The energy efficiency demand (kW) and energy (kWh) load impacts or savings are determined based on the cost-effectiveness analyses performed by the Company. The Company proposed to use the updated avoided capacity costs from its 2008 QF filing and updated energy avoided costs for the initial term of Rider EE.

Mr. Farmer explained that a vintage year is defined as the beginning year of participation in energy efficiency programs by a group of customers. The energy efficiency measures implemented in vintage year 2008 will begin to produce savings that year and will continue to produce savings over the assumed life of each measure in each program. For example, total energy and demand savings in 2009 will include those achieved by customers in both the 2008 and 2009 vintage years. The significance of the vintage year concept, Mr. Farmer said, is that the price applied to avoided energy and capacity savings, both for the first year and all succeeding years of participation for a particular vintage, will be fixed based on the initial year of participation or vintage year. Prices applied to avoided capacity and energy savings will be reset for each vintage in order to capture changes in the beginning-year rates.

Mr. Farmer stated that the determination of annual avoided capacity costs ultimately billed customers under the Company’s Rider EE is based on a multi-step process. First, the Company will calculate the projected annual avoided capacity cost savings in nominal dollars for each year that programs are in place for a particular vintage. This annual avoided capacity rate is

determined based on the standard offer QF avoided capacity rate calculation of the particular vintage escalated at 4% over the life of the programs. Mr. Farmer explained that if the calculation of avoided capacity costs is priced based strictly on the QF rate, then the value of the avoided capacity will be back-end loaded and the revenue requirement that results from this process will not match up with the revenue requirements under traditional ratemaking.

Mr. Farmer stated that the Company's proposal corrects the back-end loading issue by reshaping the energy efficiency revenue stream. The stream of avoided cost revenue requirement is converted to a present value amount by discounting the future avoided cost revenue stream using the Company's before-tax weighted average cost of capital as the discount rate. He said that the Company then amortizes the present value revenue requirement over the life of the programs that gave rise to the avoided cost capacity savings and calculates carrying costs on the unamortized balance at the Company's before-tax weighted average cost of capital. Mr. Farmer testified that the Company believes the return on avoided capacity costs should be based on the weighted average cost of capital, including both a debt and equity component, just as the Company is compensated for generation plant financing costs based on the weighted average cost of capital that includes both debt costs and equity returns. Mr. Farmer stated that the reshaping of the stream of energy cost savings has the effect of mitigating to some extent the negative cash flow effects resulting from the difference between cash flow out and in.

Mr. Farmer indicated that the Avoided Capacity Revenue Requirement and the Avoided Energy Revenue Requirement are summed and multiplied by 90% to determine the Avoided Cost Revenue Requirement to be collected from customers during the Rider period. The Rider only collects the revenue requirements associated with the year in which the Rider is in effect, thus programs with measure lives of five years have revenue requirements included over five successive years, and programs with 15-year lives over 15 years.

Mr. Farmer explained that when evaluations of programs and measures are complete, the true-up mechanism or BA will ensure that the Company's revenues are adjusted such that the Company is paid only for results achieved. The BA mechanism compares revenues actually collected to revenues that would have been collected at the time if the actual results had been known.

Mr. Farmer stated that the Company will know the actual total Rider EE revenues collected during previous periods, but they will be different than the revenue requirement to which the Company is entitled because the Rider was based on projected kWh sales that will differ from actual kWh sales and because the verified kW and kWh energy efficiency impacts will be greater or less than expected at the time the Rider was calculated. He also explained that each year the avoided cost value and the BA will be summed separately for residential and non-residential customers and that these sums will be divided by the projected Indiana kWh sales for the class to arrive at the Rider EE value. The Company's proposed first-year Rider EE billing factor were \$0.001572 per kWh for residential customers and \$0.00161 per kWh for industrial customers taking service under rate HLF.

Mr. Farmer testified, two rate adjustment riders are used to collect and track costs associated with the Company's energy efficiency initiatives. The Company's traditional DSM

programs for residential and small commercial and industrial customers are currently recovered through Rider 66 while costs of the PowerShare[®] program are included in base rates, subject to adjustment up or down based on actual expenditures in Rider 70. All of these programs would be moved into Rider EE under the Company's proposal, and the Company will include a credit to retail customers in subsequent Rider 70 proceedings equal to the amount of PowerShare[®] costs in base rates.

Mr. Farmer stated that demand response program costs are to be recovered from all customer classes based on peak demand, similar to how PowerShare[®] costs are allocated today. For conservation programs, the Company proposes to split recovery on a class basis (*i.e.*, residential customers pay for residential conservation programs while nonresidential customers pay for nonresidential programs) – similar to how Rider 66 operates presently. Mr. Farmer indicated that the Company's analysis shows that the cost to customers will increase by an average of approximately 2% in the first year for all customer classes. The Company requested recovery of only first year Rider amounts in this proceeding while subsequent Rider EE filings will provide updated revenue requirement projections for future years.

Mr. Farmer testified that the Company requests that actual implementation of Rider EE begin approximately one month after approval. Once the Rider takes effect, the Company will begin collecting data that is necessary for the true-up and BA process for the first evaluation period. The Company also proposes that approximately four months after the end of the first evaluation period, it will file a subdocket case to update Rider EE. Mr. Farmer said the Company would propose a procedural schedule that would allow for a Commission Order on the new Rider EE amounts on or before the second anniversary date of Rider EE.

Mr. Farmer also provided supplemental testimony giving an updated estimate of the change in projected jurisdictional rate impacts since updating the avoided capacity and energy cost estimates. Mr. Farmer explained that the Company's estimates of avoided costs and related jurisdictional revenue requirements included in the original filing were based on the Company's best estimate at the time, and, since then, the QF avoided capacity rate was filed with the Commission resulting in a moderate decrease when compared to the first-year avoided capacity rate previously used. In comparison, the initial first-year avoided cost capacity rate used to develop the jurisdictional revenue requirement was \$5.93 per kW per month, or \$71.15 per kW per annum and the new rate was \$5.22 per kW per month, or \$62.64 per kW per annum, which represents a 12% reduction from the rate used in the original filing. Mr. Farmer further stated that the net present value of the combined avoided capacity and production costs decrease by approximately 5% compared to the original filing.

Mr. Farmer also provided an update on the first-year customer billing factors stating that the residential billing factor went from \$0.001572 per kWh in the original filing to \$0.001545 in the updated Rider EE and the billing factor for rate HLF of \$0.001061 per kWh changed to \$0.000972 per kWh, noting that this excluded any potential effects of the opt-out provisions. Mr. Farmer also gave estimates on the customer rate impacts over the first four years of the program.

6. **OUCC's Case-in-Chief.** Joan M. Soller, OUCC Director of the Resource Planning, Emerging Technologies and Telecommunications Division testified regarding several OUCC concerns.³ First, Ms. Soller addressed Duke Energy Indiana's cost recovery proposal. She noted that energy efficiency programs, which conserve energy by reducing energy consumption measured in kilowatt hours ("kWhs"), and demand response programs, which reduce electrical capacity requirements measured in kilowatts ("kW") usually during peak usage periods, achieve different results. She stated that Duke Energy Indiana's cost recovery proposal fails to treat conservation/demand response programs differently and that grouping them together overstates the value of the conservation based measures.

Next, she addressed Duke Energy Indiana's existing and proposed conservation and demand response programs. She noted that although some elements have been slightly modified, the energy efficiency programs are essentially the same as those currently offered. She opined that none of these modifications required the radical change that save-a-watt would produce.

Ms. Soller testified concerning Duke Energy Indiana's overly aggressive forecasted results from energy efficiency and demand response programs included in its 2007 IRP. Ms. Soller noted that save-a-watt would spend ten times the annual average Duke Energy Indiana had spent in the prior ten years and save more than six times the kWh saved in 2006. She also pointed out that the Advanced Power Manager Program accounted for a substantial portion of Duke Energy Indiana's projected savings, but the program details were incomplete and the projected results did not appear achievable.

Ms. Soller addressed the increased need for robust EM&V of energy efficiency results. She testified that save-a-watt inappropriately rewards shareholders before any energy efficiency savings are verified. Ms Soller stated that OUCC believes successful EM&V results, including participation levels, program costs containment and actual energy and demand savings, should be analyzed first and then form the basis of any graduated cost recovery to which the Company may be entitled.

Addressing the relationship between increased energy efficiency and Duke Energy Indiana's potential for additional off-systems sales, Ms. Soller pointed out the potential double recovery by Duke Energy Indiana of avoided costs via save-a-watt and increased earnings from additional off-system sales made possible by save-a-watt energy savings. She recommended that Duke Energy Indiana track increases in off-system sales and energy and capacity savings from energy efficiency concurrently. If Duke Energy Indiana is permitted to recover any portion of lost revenues from energy efficiency, the effect of the off-system sales should be subtracted from that equation.

Ms. Soller highlighted four distinct concerns with using avoided costs as a measure of energy efficiency benefits. First, she stated that the actual generating assets Duke Energy Indiana will avoid (coal-fired baseload units, hydro-units and gas-fired Combustion Turbine ("CT") peaker units depreciated based upon their respective in-service dates between 1944 – 2001) are not used to calculate Duke Energy Indiana's avoided cost. Save-a-watt uses avoided

³ At hearing, Ms. Soller's direct testimony was adopted by OUCC witness Andrew J. Satchwell.

costs of an unbuilt CT and are not representative of reality. She stated this represents only a portion of Duke Energy Indiana's future generating assets, not the total existing or forecasted generation fleet. As proposed, avoided costs do not vary based on the type of generation that is avoided. Second, energy efficiency measures are not "dispatchable" like actual generation, cannot be called upon as a whole and are not available 24/7. Therefore, she stated avoided costs are not an equitable proxy for energy efficiency. Third, avoided costs include annual escalation factors that are added at the discretion of the utility. She pointed out this is inconsistent with base rate regulation where all costs and charges are reviewed for prudence. In addition, she said that when applied on a large scale, such as in this Cause, escalation factors skew regulatory treatment of supply and demand options. Finally, she said that avoided costs do not reflect how Duke Energy Indiana currently recovers costs in the energy market. Duke Energy Indiana recovers costs associated with energy and consumption based upon Locational Marginal Prices in the Midwest ISO energy market. She said because these prices vary greatly, it is inappropriate to compensate Duke Energy Indiana as though those prices are constant.

Ms. Soller also discussed Duke Energy Indiana's demand response programs and their current cost recovery mechanisms. She pointed out that save-a-watt would increase ratepayer costs 48% per kilowatt for the PowerManager program, compared to the 2006 costs, and nearly 400% per kilowatt for the PowerShare[®] program, compared to 2007 costs. She described the OUCC's belief that save-a-watt would eliminate any incentive for Duke Energy Indiana to participate in Midwest ISO demand response markets and to capture additional revenue streams that might benefit ratepayers. She concluded her criticism of save-a-watt by pointing out how the proposal would increase rates by as much as 5.64% in year 4, that the proposed incentives were excessive given Duke Energy Indiana's least-cost planning obligations and how the proposal deprives customers of the benefits of reduced energy efficiency program costs that could come from retail competition.

Ms. Soller explained the OUCC's recommendation that the Commission approve a more gradual approach to energy efficiency cost recovery. She stated that if future energy efficiency cost recovery included incentives, the Commission should consider the following nine issues:

- (1) Creating an Oversight Board comprised of energy efficiency stakeholder representatives to actively and regularly review specific utility programs, results and forecasted energy efficiency expenditures.
- (2) The Commission should *not* authorize the proposed, and not fully developed, Advanced Power Manager Program.
- (3) Requiring Duke Energy Indiana to present evidence of actual savings in terms of demand and energy that are measured, verified and audited by third-party vendors selected by Oversight Board members. The results of such studies should form the foundation of cost recovery and be used as inputs to the utility IRP models.
- (4) Duke Energy Indiana shareholder incentives should be tiered based upon how actual results relate to program goals.
- (5) Duke Energy Indiana should track off-system sales related to energy efficiency measure implementation and equitably allocate costs to avoid double-recovery.
- (6) Cost recovery of any shareholder incentives based upon avoided costs should be closely linked to actual Midwest ISO market based savings.

- (7) Duke Energy Indiana should fully utilize all Midwest ISO market-based options and related revenue sources for demand response and share revenues equitably with its ratepayers.
- (8) The Commission should consider a reasonable rate impact for Duke Energy Indiana ratepayers based on a holistic review of other pending or active regulatory ratemaking treatments.
- (9) Energy efficiency savings and related decreases in program costs must be shared equitably between Duke Energy Indiana's ratepayers and its shareholders.

Andrew J. Satchwell, Utility Analyst in the OUCC Resource Planning, Emerging Technologies and Telecommunications Division, testified about Midwest ISO demand response ("DR") opportunities and the interaction between the Midwest ISO proposed DR market options and save-a-watt. Mr. Satchwell explained how FERC's February 21, 2008 DR notice of proposed rulemaking supported comparable requirements and treatment of generating (supply-side) and demand side resources in wholesale energy markets in an effort to eliminate barriers to DR participation in the organized power markets, like the Midwest ISO. He pointed out that contrary to FERC's intent, save-a-watt fails to eliminate all barriers to DR participation by including guaranteed and incented returns to Duke Energy Indiana for DR outside of any wholesale market and by not proposing DR programs designed to participate in the Midwest ISO DR markets. He opined that save-a-watt included no plans to share DR market benefits with customers, essentially requiring them to pay for DR while Duke Energy Indiana shareholders, who incur no risk, receive all the benefits.

Mr. Satchwell described how Duke Energy Indiana's DR resources could participate in both the Midwest ISO Day-Ahead and Real-Time Energy Markets, as well as the EDR program. He noted that most demand response programs are less costly than supply-side resources, have been fully funded by ratepayers, and would provide a potential revenue stream, so participation in these markets should be beneficial. In addition to these current Midwest ISO DR opportunities, Mr. Satchwell identified another seven (7) significant Midwest ISO DR market initiatives. He noted that Duke Energy Indiana already recovers all costs for DR through a combination of base rates and Rider 70 and that it was premature to "revamp" or drastically change existing mechanisms by implementing save-a-watt.

Mr. Satchwell also addressed the Midwest ISO ASM and how DR resources could participate, but noted that Duke Energy Indiana had asserted that none of its programs were suitable. He further testified that Duke Energy Indiana was understating the value of ancillary services, including DR resources. He concluded that the Commission should not approve the Company's proposal for the following reasons:

- (1) it was premature to guarantee cost recovery prior to a decision on ASM treatment of charges and credits pending before the Commission in Cause No. 43426 and FERC's ruling on DR resources in the Midwest ISO ASM,
- (2) save-a-watt creates barriers to DR participation in competitive wholesale energy markets, contrary to FERC's intent, and
- (3) save-a-watt does not include plans to share demand response market benefits with customers.

Wes R. Blakley, a Senior Analyst in the OUCC Electric Division, described the rate impact of save-a-watt in conjunction with Petitioner's other pending asset expansion efforts, including its IGCC plant and its Qualified Pollution Control Plan. Mr. Blakley, citing to Witness Farmer's estimated ascending annual rate increases from 2.04% to 5.64% during the first four years of save-a-watt, opined that Mr. Farmer's estimated increases were incomplete because they failed to take into account the effect of Duke Energy Indiana's other trackers. Mr. Blakley pointed to Duke Energy Indiana's on-going pollution control tracker recently approved in Cause No. 42061 ECR 10, which resulted in Duke Energy Indiana collecting \$109 million in return, depreciation, taxes and operation and maintenance expense over a six-month period. He also noted Duke Energy Indiana's approximately \$2 billion total investment approved for construction of the on-going pollution control program, the approved \$2 billion estimated price for the IGCC plant construction, and Duke Energy Indiana's recently requested approximate \$400 million increase in estimated IGCC costs. Combined, these programs add billions of dollars of investment, millions of dollars of depreciation expenses, and millions of dollars of operation and maintenance expense, none of which are included in Mr. Farmer's estimates.

Mr. Blakley also testified about save-a-watt's proposed avoided cost based on a "virtual plant" and traditional ratemaking. He explained that under save-a-watt, Duke Energy Indiana will not actually invest in plant, so the basis for collecting a return on and return of plant investment does not exist in a traditional ratemaking sense. With no plant, there is nothing to depreciate and there are no actual operational costs. He opined that Duke Energy Indiana's use of avoided costs for a "virtual plant" was created to deal with these limitations affecting revenue elements and simulate a traditional recovery of revenue requirement.

Mr. Blakley explained that save-a-watt proposed to calculate avoided costs using Duke Energy Indiana's Standard Contract Rider No. 50, which calculates the offer rate Petitioner pays qualifying facilities. Mr. Blakley provided an exhibit summarizing avoided cost information filed with the Commission between 2006-2008 to assist in understanding how Duke Energy Indiana's avoided costs compare to those of other Indiana utilities. He described how variances in operation and maintenance costs create volatile QF rates from year to year and how capital costs can also exhibit large variations. Duke Energy Indiana has historically had one of the highest capital costs (\$409.14/kW in 2007 and \$715/kW in 2008) and that will, in turn, significantly impact rates. Mr. Blakley also pointed out that because Duke Energy Indiana did not report its off-peak energy cost in 2007 or 2008, the save-a-watt rates are calculated at on-peak energy rates, charging customers who save energy during the off-peak periods a higher rate. Mr. Blakley concluded his testimony recommending that the Commission consider large rate impacts as part of the global impact for Duke Energy Indiana customers and the inherent weaknesses in save-a-watt's proposed avoided costs recovery methodology, including Petitioner's ability to control those costs.

James A. Polito, Ph.D, Director of OUCC Economic and Regulatory Analysis, testified for the OUCC regarding his economic and policy analysis of the Company's proposed save-a-watt regulatory model. He testified that:

- (1) save-a-watt exposes consumers to supply-side risks previously not associated with investments intended to influence the timing and level of ratepayer consumption of electricity.
- (2) save-a-watt shields the Company from the risk of non-performance. The Company need only achieve approximately 41% – 66%⁴ of total estimated save-a-watt revenues in order to be held financially harmless.⁵ Alternatively, the majority of energy efficiency program measures have estimated lives in the range of 15 - 20 years, but save-a-watt only requires these measures be operational for 4 – 6 years to hold the Company harmless.
- (3) save-a-watt “shareholder incentives”, on average, range from approximately 112% - 42%⁶ of total program costs depending on the inclusion or exclusion of Duke Energy Indiana’s proposed Advanced Power Manager program. These ranges equate to net present values of shareholder incentives equal to \$219,000,000 - \$72,000,000⁷ respectively. These incentives both significantly increase ratepayer costs and significantly reduce the energy efficiency programs’ cost-effectiveness. Dr. Polito also noted the vast difference in the magnitude of program returns between Duke Energy Indiana’s proposed conservation and demand response programs.
- (4) save-a-watt exposes ratepayers to an indeterminable rate impact because:
 - (a) the proposal allows for unlimited program expenditures, and
 - (b) the Company cannot conclusively determine the effect save-a-watt will have on Company behavior.
- (5) save-a-watt both fails to streamline regulation and increases the complexity of regulation because it:
 - (a) does nothing to eliminate the complexity and contention associated with estimating lost sales and the impact of investments in energy efficiency,
 - (b) relies upon an unnecessarily complex process that reshapes the stream of avoided energy and capacity cost savings.
- (6) save-a-watt incents the Company to increase the sale and consumption of electrical energy, allowing Company profits to increase with the increasing sales of electricity. This failure to remove fully the “throughput incentive” undermines the extent to which the save-a-watt regulatory model serves as a suitable model for a new way of thinking about energy efficiency.

Dr. Polito also provided a set of minimum conditions that save-a-watt would need to address to better align the proposal with the public interest. Dr. Polito’s conditions included:

⁴ 45% - 70% based on Duke Energy Indiana’s supplemental submission.

⁵ Including or excluding the Company’s proposed Advanced Power Manager Program accounts for the spread.

⁶ 96% - 36% based on Duke Energy Indiana’s supplemental submission

⁷ \$186,000,000 - \$60,000,000 based on Duke Energy Indiana’s supplemental submission.

- (1) Limited term pilot. Save-a-watt should be a limited term pilot with a firm expiration date and subject to all other conditions he set forth.
- (2) Reduced shareholder incentives. Because save-a-watt as proposed provides shareholders with an opportunity to earn returns that exceed competitive market returns, Duke Energy Indiana should be required to:
 - (a) Exclude the proposed Advanced Power Manager Program (the Company's demand response programs, especially Advanced Power Manager Program, contribute significantly to the excessive returns), and
 - (b) Be limited to both: (i) a factor no greater than 66% by which to weight avoided cost savings, and (ii) shareholder incentives as a percentage of total program costs no greater than 10.5% as described in his Appendix B.
- (3) Reduced ratepayer risk.
 - (a) Save-a-watt must provide a method of shielding ratepayer costs from the risks of linking energy efficiency and utility supply-side costs. This could occur, for example, by fixing avoided costs to some pre-established and reasonable level. This does not imply that the Company should fix avoided costs for the purposes of determining the cost-effectiveness of energy efficiency investments.
 - (b) Because save-a-watt collects estimated revenues from ratepayers in advance, and because those revenues may exceed revenues to which the Company is entitled, Duke Energy Indiana should shield ratepayers from both the risk and costs of utility over-collection. Duke Energy Indiana should return to ratepayers any excess revenues collected plus an additional amount that compensates ratepayers for the time value of their money.
- (4) Quantify the rate impact. The Company's proposal exposes ratepayers to an indeterminable rate impact. Because the total rate impact of the proposal is a function of avoided supply-side costs, which, in turn are a function of energy and capacity savings, the Company must propose pre-determined, not-to-exceed capacity and energy savings goals that balance both the benefit of investments in energy efficiency and the related rate impact.
- (5) Reduce regulatory complexity. Save-a-watt should be simplified by basing revenues on contemporaneous (same period) estimates of avoided costs.
- (6) Shareholder-funded measurement and verification.
 - (a) The Company should commit to funding with shareholder dollars all EM&V activities, including both costs incurred by the Company and by the OUCC on behalf of ratepayers.
 - (b) The Company should agree to provide the OUCC with Duke Energy Indiana's schedule for EM&V of results it will use in its reconciliation and true-up process. The OUCC, in addition to the Commission, should also have the ability to comment. A procedure under which the OUCC if necessary may formally contest

in a hearing before the Commission the Company's measurement and verification activities must also be included.

7. **CAC's Case-in-Chief.** The CAC submitted the testimony of Messrs. J. Richard Hornby and Donald Gilligan. Mr. Hornby, a Senior Consultant at Synapse Energy Economics, described his analysis of Petitioner's proposal and recommended against its approval. He stated that the Company is placing more emphasis on reducing peak demand than on reducing annual energy use, and expressed his preference for reductions in total electricity use through energy conservation because those actions result in greater reductions in annual supply costs and environmental impacts than reductions in peak demand through demand response. He presented various exhibits to illustrate his point.

Mr. Hornby expressed his concern that the proposed EE Plan is a value of service plan in which the Company will receive a much higher share of the net dollar savings from these reductions than it would under the types of energy efficiency shared savings mechanisms in place in other states, such as Ohio and California. He stated that under a cost of service approach, the Company could request the Commission to approve revenue requirements that would recover the direct costs of its energy efficiency programs, its net lost revenues and a shared savings incentive. Mr. Hornby evaluated the requirements for an ARP and stated his belief that the Company has not justified a departure from a cost-of-service ("COS") paradigm.

Mr. Hornby opined that the Company's proposal is not in the public interest because of his belief that Duke Energy Indiana could achieve the same reductions in annual energy use at the same or lower revenue requirements under a COS based framework. He further stated that the level of incentive that the Company is proposing to receive under save-a-watt is inconsistent with the low level of reductions in annual energy, and associated air emissions, that it is proposing to achieve. His final concern was that the proposal does not provide the Company with a strong financial incentive to pursue all cost-effective reductions in annual energy because there is no separate recovery for lost revenues; thus, for the subset of reductions whose program costs are close to their avoided costs, save-a-watt does not provide a stronger financial incentive than a COS ratemaking framework.

Mr. Hornby recommended against Commission approval of the Company's proposal and suggested that the Commission should make Duke Energy Indiana meet with stakeholders and submit a filing requesting new programs and budgets under a ratemaking framework that would, subject to Commission review, set revenue requirements that would recover actual incurred costs, address verified revenue erosion or lost revenues, and provide a shared saving incentive based on performance, as well as penalties for poor performance.

Mr. Gilligan, the President of the National Association of Energy Service Companies testified regarding the importance of a sustainable utility energy efficiency program. He defined a sustainable energy efficiency program as one that is operated by a regulated utility using customer funds to provide substantial value to customers while affording the utility an opportunity to make a fair profit. Mr. Gilligan stated that an energy efficiency program can be characterized as a shift in the business emphasis of a utility from manufacturing to management.

Mr. Gilligan stated his general support of increased energy efficiency opportunities. He expressed concern that Duke Energy Indiana has not publicly disclosed many of the details of its proposed energy efficiency programs, such as details of the cost/benefit analysis of potential program measures; detailed costs by program and by major costs category; detailed program benefits by program; and detailed compensation to the utility, by measure, program and in aggregate. Without this information, he expressed his concern that it is not possible for the Commission to determine if the proposed programs deliver sufficient value to ratepayers and provide a fair rate of return.

Mr. Gilligan testified that stakeholder support is important because customers need to respond proactively by accepting and purchasing energy efficiency equipment to be installed in their own facilities. He stated that energy efficiency programs require that vendors provide services that are critical to the program success, such as actually selling efficiency projects to customers. Mr. Gilligan explained that the states with the most advanced energy efficiency programs and the most experienced program administrators also have the highest level of stakeholder participation in program development, review and evaluation.

Mr. Gilligan offered a litany of criticisms of Duke Energy Indiana's proposal, including his belief that that the Company has significantly underestimated the amount of energy efficiency that is available in Indiana at a cost less than new generating plant options. He expressed his disagreement with the omission of programs for large Commercial and Industrial customers. He disagreed that Petitioner's proposal is a good deal for customers as it limits the benefit to ratepayers. Mr. Gilligan also noted that Duke Energy Indiana has not proposed a radically new set of programs and has omitted from its proposed program portfolio a number of programs that are the foundation of most large-scale energy efficiency programs across the country.

8. Petitioner's Rebuttal Testimony. On rebuttal, Mr. Schultz outlined changes to the EE Plan that Duke Energy Indiana proposed to make in response to concerns raised about the level of earnings the Company could achieve under its save-a-watt model. He stated that the Company will remove the Advanced Power Manager Program from its filing and that it will reduce its requested compensation to 85% of the avoided cost of generation.

Mr. Schultz provided rebuttal to Mr. Hornby's valuation of demand response impacts. He explained that demand response and conservation program categories are both integral parts of any IRP and energy efficiency filing because the goal of energy efficiency is to avoid or delay building all types of power plants, not just baseload or intermediate generation resources that are offset from conservation programs or peaking generation resources that are offset from demand response programs. Mr. Schultz testified that, if the Company were not allowed to include demand response programs in its filing, it would limit the Company's ability to achieve least-cost solutions under the Company's IRP because it would require Duke Energy Indiana to build new generation rather than implement efficiency programs.

In response to Dr. Polito's allegation that Petitioner is not assuming any material risk of failing to recover its program costs, Mr. Schultz reiterated that Duke Energy Indiana only gets

paid for energy efficiency results it delivers; the Company bears the risk of achieving the specific energy efficiency targets outlined in the Company's plan without the explicit recovery of costs.

Mr. Schultz responded to Mr. Gilligan's concerns regarding transparency by explaining that the proposed programs included those that were recommended by stakeholders during the collaborative process leading up to the filing the Verified Petition in October of 2007. In addition, the proposed programs were also vetted against the MPS commissioned by the Company and the EE Collaborative. Mr. Schultz further explained that the annual regulatory review of the Company's EE Plan will also afford transparency because it will allow an opportunity for all parties to review the Company's energy efficiency program portfolio and suggest additions or revisions to programs, as appropriate.

Mr. Schultz disagreed with Mr. Hornby's assertion that Petitioner's projected reductions in annual energy are low in comparison to utilities in other states by explaining that the Company's calculations indicate that Duke Energy Indiana would achieve a cumulative 1% reduction in annual sales by 2012, which places the Company within the range of leading companies. In response to Mr. Hornby's recommendation of a rate recovery mechanism that bases incentives on program costs, Mr. Schultz testified that this approach encourages spending, not results.

Mr. Goldenberg responded to Ms. Soller's testimony regarding the similarity of the proposed programs to existing programs and projected impacts. Mr. Goldenberg explained that Duke Energy Indiana has assembled a portfolio of programs that are meant to appeal to a significant percentage of the Company's local customers. The save-a-watt portfolio has a blend of programs never before offered by Duke Energy Indiana and existing programs that are similar to those in the current portfolio. He stated that the existing programs will utilize new techniques for targeting, marketing, and delivery that will change how these programs go to market, reach, and interact with customers and work with trade allies, retailers, and manufacturers. Mr. Goldenberg provided specific details regarding the proposed Energy Efficiency Program for Schools and marketing techniques around compact fluorescent lightbulbs.

In response to Mr. Hornby's assertion that the projected impacts from the Company's EE Plan are too low, Mr. Goldenberg stated that the annual energy reductions forecasted by Duke Energy Indiana actually track for the first few years of what was called for in the recent MPS.

Dr. Stevie presented an exhibit detailing program results under the company's revised proposal. He also rebutted Dr. Politio's claim that customers should not bear increased costs associated with the measurement and verification process by explaining that the Company intends to treat the costs for EM&V as part of the costs for offering the programs and not as an additional charge. Dr. Stevie also testified that the Company is willing to implement, with Commission approval, a method for removing the throughput incentive that would involve an associated reduction in the percentage of avoided costs in the save-a-watt model structure, the level of which would depend upon the type of method used to remove the throughput incentive. He explained that the typical approach to remove the throughput incentive involves some form of "decoupling," whereby the level of sales is decoupled from the level of revenues. Dr. Stevie presented a list of decoupling design issues that will need to be resolved.

Dr. Stevie addressed Ms. Soller's concerns that the avoided costs represent only a portion of future generating assets by explaining that the DSMore model runs capture the hourly variation in load reductions and hourly change in avoided energy costs. As to Ms. Soller's statement that customers could buy through, preventing Petitioner from using those resources, Dr. Stevie stated that if a customer does buy-through, that still means that Duke Energy Indiana does not have to serve the load. In response to Ms. Soller's statement that the escalation factors used to estimate variable costs are modified at the discretion of the utility and that this is inconsistent with base rate regulation, he explained that the Company has an interest in keeping avoided cost estimates as low as possible because alternate merchant generators can require the Company to pay them the avoided cost rates set for energy efficiency as the standard to be received for their generation.

Ms. Jenner testified that Petitioner's proposed EE Plan does not result in customers paying twice for resources if demand reduction goals are not achieved.

Mr. Sailers explained the differences in the proposed PowerShare[®] program because two new options will be added under the save-a-watt proposal: emergency only and interruptible. He testified that there are numerous changes that may be required to the current PowerShare[®] CallOption program as a result of new Midwest ISO requirements regarding resource adequacy. Mr. Sailers testified that if a customer decides not to curtail usage during a CallOption event, the customer must pay market-based prices for the amount of load reduction promised but not curtailed. He also explained that the buy-through provision of the PowerShare[®] agreement will be revised for the 2009 program and going forward to state more clearly that during emergency events, the buy-through option will not be available and that curtailment shortfalls will be subject to a maximum of \$3.50 per kilowatt-hour penalty during emergency situations.

Mr. Sailers responded to Ms. Soller's concern that the Petitioner's proposal creates a disincentive for the Company to participate in the Midwest ISO's demand response initiatives. He stated that Duke Energy Indiana is interested in participating in viable revenue streams and that Duke Energy Indiana will enroll current and proposed save-a-watt programs as EDRs and/or Load Modifying Resources if eligible. He responded to Mr. Satchwell's concerns about then-impending FERC rules and Midwest ISO issues.

Charles J. Cicchetti, co-founder of Pacific Economic Group, L.L.C., responded to the testimonies of Ms. Soller, Mr. Satchwell, Dr. Polito, and Mr. Blakely of the OUCC as well as CAC witnesses Messrs. Hornby and Gilligan.

Mr. Cicchetti explained that despite twenty years of regulatory discussion of utility-sponsored conservation, efforts have often largely failed the sustainability test. The Company's proposal establishes a new utility service, save-a-watt, and a new business/regulatory paradigm designed to grow and sustain this effort. Mr. Cicchetti testified that the Company's energy efficiency proposal has been designed to actually succeed where past efforts have largely failed to be sustained after public support wanes. In Mr. Cicchetti's opinion, the breakthrough is the allowance of the utility to earn money from a new utility service, which makes energy efficiency both an input and a resource, and a new profit-regulated service, that could become a core utility business. This paradigm shift creates a new hybrid regulatory business model that Mr. Cicchetti

believes will sustain energy efficiency efforts. He said Duke Energy Indiana has a difficult task because it has relatively low overall retail utility prices (approximately 24% below the national average in 2006).

Mr. Cicchetti stated that the Company's approach helps Duke Energy Indiana and its retail customers find a profitable balance between electricity (kWH) consumption and economic efficiency. The EE Plan uses the already defined and accepted concept of avoided costs to establish utility earnings on conservation. This means that the avoided costs of supply-side alternatives are the basis for the save-a-watt plan's ratemaking. Energy efficiency is both an input or fifth-fuel for utility production and a new consumer product or utility service. Also, conservation is treated in a revenue-requirements manner similar to a new supply-side addition.

Mr. Cicchetti responded to the testimony of Ms. Soller and Dr. Polito and their objections to using avoided costs as a reference for establishing the "value" of energy efficiency by noting that Ms. Soller and Dr. Polito ignored the facts that avoided cost is already calculated and its value is known in Indiana and elsewhere. In addition, the verified savings under save-a-watt always trump supply-side choices.

Mr. Cicchetti also responded to Dr. Polito's concern that any year-to-year volatility in the supply-side estimate of avoided cost would create consumer risk by stating that as a matter of economic theory and efficiency, when the price or costs of substitution change, society should alter its consumption, as well as the values assigned to alternatives. In addition, if the opportunity cost increases on the supply-side for electricity, society should favor more demand-side response and EE, and vice versa.

Mr. Cicchetti believes that COS regulation trumps value-of-service pricing because COS could be more easily quantified. The challenge for regulators is to determine how to graft energy efficiency onto a traditional build, own, and operate vertically-integrated electric utility company. Duke Energy Indiana's plan aligns the consumer benefits with strong shareholder support and incentives to utilize value-of-service principles to expand energy efficiency onto COS regulation using integrated resource planning, avoided cost, regulated revenue requirements, and rate riders.

Mr. Cicchetti testified that the crux of the save-a-watt plan is regulatory approval of the Company's future investments and conservation efforts, and an opportunity to earn a return "on" and "of" these choices. This means the two solutions (new generation and conservation) to meeting Duke Energy Indiana's customers' energy needs would treat shareholders similarly and regulated revenue requirements would be less. Mr. Cicchetti testified that Rider EE is intended to cover the program costs and provide an opportunity for earning a return from conservation and load management activities, however revenue is not guaranteed. He noted there are additional costs that Duke Energy Indiana would incur that exceed the so-called "direct" or program costs. Mr. Cicchetti testified that there is no true-up ability for Duke Energy Indiana to call "mulligan" and recover money that it spends for programs that do not work. Mr. Cicchetti concluded that Duke Energy Indiana is assuming significant risk under its proposed EE Plan and is insulating retail customers and virtually guaranteeing lower future revenue requirements.

Mr. Cicchetti responded to the criticism that Duke Energy Indiana's revenue requirements recovery under save-a-watt would cost too much and allow the company to earn too much by expressing his belief that such criticism is misguided. Mr. Cicchetti stated that under the Company's proposal, customers are better off than under a mandated program because they would be credited for any projected savings that do not pass the third-party EM&V tests and the Company has selected a known and already measured concept - avoided costs. Even non-participating customers benefit from environmental, national security, and macroeconomic gains, as well as lower overall regulated revenue requirements.

Mr. Cicchetti discussed the fact that Duke Energy Indiana's proposal has a profit incentive for meeting customers' demand, through both generation resources and demand-side resources. He believes if the Company has reasonable incentives, such as save-a-watt, to cause customers to pay a portion of the direct costs of energy efficiency, Duke Energy Indiana would grow and expand its energy efficiency efforts at lower costs. Mr. Cicchetti also disagreed with Mr. Hornby's allegation that the Company is not doing enough to expand energy efficiency and load management in Indiana. He explained that Duke Energy Indiana's plan beat projections and that the Company is establishing a new business/regulatory paradigm that can be sustained.

Mr. Cicchetti concluded his testimony by opining that the save-a-watt plan has the potential to succeed where others have failed because overall annual revenue requirements will be less and by using avoided costs to establish energy efficiency revenue and earnings.

Mr. Farmer provided rebuttal testimony updating his exhibits to remove the Advanced Power Manager Program and to include the effect of the Company's proposal to lower the percentage of avoided costs used to develop the jurisdictional revenue requirements from 90% to 85%. The reduction in the avoided cost percentage will cause jurisdictional revenue requirement to decrease by approximately 5.5% across all programs, which when combined with the effect of removing Advanced Power Manager will reduce the impact of the Company's recovery of estimated energy efficiency costs on retail rates during the four-year period.

Mr. Farmer responded to Mr. Blakely's statement in his testimony that the Commission should consider other increases in rates when deciding whether to approve the Company's EE Plan stating that Mr. Blakely failed to look at the overall value proposition for customers in the proposed EE Plan. Mr. Farmer also disagreed with Mr. Blakely's characterization of the Company's avoided costs by stating that Mr. Blakely incorrectly made a side-by-side comparison of certain components. Mr. Farmer referred to Dr. Stevie's testimony that the Company differentiates between peak and off-peak avoided production/energy costs, but that avoided energy costs are estimated on an hourly basis that provided a level of granularity.

Mr. Farmer responded to certain recommendations relating to the rate treatment of off-system sales in Ms. Soller's testimony stating that the credit to customers is far more generous to customers than Ms. Soller acknowledges and that her recommendations add an additional level of complexity, which is unnecessary.

9. **Settlement Agreements and Supporting Testimony.** Throughout this proceeding, Petitioner and Intervenors have worked towards settling this case and have been able to reach agreement on several fronts.

A. **Settlement Agreement with Vectren North.** As mentioned previously, Duke Energy Indiana and Vectren North filed the Vectren Settlement Agreement with the Commission on May 29, 2008. Vectren North filed settlement supporting testimony of Mr. Robert C. Sears and Duke Energy Indiana filed settlement supporting testimony of Mr. Schultz. The Vectren Settlement Agreement provides: (1) Vectren North and Duke Energy Indiana will continue to work cooperatively together on customer benefits that can be achieved on energy efficiency programming between overlapping electric and natural gas utilities service territories; (2) Duke Energy Indiana agreed that its program flexibility request within a specific program year be limited to the amount it spends on the various approved programs and measures and not to add new energy efficiency programs without further Commission approval; (3) the Company revised its program description for the energy savings plan pilot; and (4) the Company revised its program description of residential SmartSaver™ air conditioners and heat pumps incentive program.

Robert C. Sears, Director of Conservation for Vectren Utility Holdings, Inc., explained that Duke Energy Indiana and Vectren North share many customers in overlapping service territories in 43 counties. Mr. Sears stated that the Vectren Settlement Agreement contains provisions for Vectren North and Duke Energy Indiana to work cooperatively on energy efficiency programming, which will provide opportunities for the companies to seek joint efforts on how to deliver programs to specific customer segments to better serve the customer and improve the cost effectiveness of energy efficiency programs. The coordinated approach will provide greater benefit to the customer and maximize the delivery of the program benefits by not duplicating program administration and delivery efforts.

Mr. Sears testified that, as a result of the Vectren Settlement Agreement, the Company has agreed to either revise or clarify certain aspects of its energy efficiency programs to provide assurance that the programs will not be used to grow electric load by displacing gas service and that new programs will be reviewed prior to Commission approval. In addition, heat pump rebates were limited to dual fuel systems. Mr. Sears also opined that the Vectren Settlement Agreement was in the public interest.

Mr. Schultz testified that the Vectren Settlement Agreement resolves all issues between the Company and Vectren North. Mr. Schultz stated that Paragraph 2 of the Vectren Settlement Agreement expresses the commitment of Petitioner and Vectren North to work together on energy efficiency programming, particularly energy efficiency audits and low-income offerings, as well as the development of advanced metering infrastructure solutions. Petitioner and Vectren North reserved their rights to propose individual programs, as well as object to programs offered by the other party.

Mr. Schultz also testified that in Paragraph 3 of the Vectren Settlement Agreement, Duke Energy Indiana agreed that its program flexibility request within a specific program year is limited to the amount it spends on the various approved programs and measures as well as not to add new energy efficiency measures or programs without Commission approval. Further,

Vectren North retains the right to object to new measures or programs and Petitioner agrees not to object to the right of Vectren North's intervention or filing of testimony in future proceedings.

Mr. Schultz testified that in Paragraphs 4 and 5 of the Vectren Settlement Agreement, Petitioner revised its program descriptions for the proposed Efficiency Savings Plan pilot and Residential Smart Saver™ Air Conditioners and Heat Pumps incentive programs. Mr. Schultz further expressed his belief that the Vectren Settlement Agreement is in the public interest because customers will benefit from increased program offerings through a coordinated effort.

B. Settlement Agreement with the OUCC. The Settlement Agreement entered into between Duke Energy Indiana and the OUCC makes a number of modifications to the proposal as filed and modified in rebuttal. The Settlement Agreement states that the term of the settlement shall be four (4) years and lists the programs to be included in Petitioner's initial portfolio of programs. Those programs are:

Residential Customer Programs

- Residential Energy Assessments
- Smart Saver™ for Residential Customers
- Low-Income Services
- Energy Efficiency Education Program for Schools
- Power Manager

Non-Residential Customer Programs

- Non-residential Energy Assessments
- Smart Saver™ for Non-Residential Customers
- PowerShare®

The Settlement Agreement continues to tie Duke Energy Indiana's compensation to a portion of avoided cost, which is intended to cover the cost of marketing, implementing and administering the programs, EM&V and to provide Duke Energy Indiana with an incentive for the successful management of the EE Plan. The Company will only be paid avoided cost based on actual reductions in MW and MWh as verified by an independent third-party. The percentage of avoided cost shall be 75% for demand response programs and 60% of Net Present Value ("NPV") for conservation programs. The Settlement Agreement states that the parties agreed to different percentages for demand response and conservation to mitigate any bias that may exist between DR and energy conservation programs, so that the Company will be indifferent to the percentage relationship of the two types of programs.

The Settlement Agreement also establishes performance targets and earnings caps. The EE Plan is forecasted to produce total avoided cost savings of \$260 million (nominal dollars), which ties to targeted MW and MWh savings as follows:

Portfolio Impacts at 100% Participation

	Indiana				
Year	1	2	3	4	Beyond Yr 4
MWh	69,296	146,592	215,334	296,466	1,585,571
MW	317	403	451	496	96

The Settlement Agreement also provides for management incentives at the following maximum amounts tied to verified results at the end of the four-year period.

% Target Achievement	Capped Rate of Return on Program Costs
90% to 100%	15%
80% to 89%	12%
60% to 79%	9%
<60%	5%

The percentages above are a maximum incentive amount and not a guaranteed return for Duke Energy Indiana. Recovery of program cost is not guaranteed.

The Settlement Agreement provides that the Company shall collect at 85% of performance for the four-year term of the agreement. At the end of four years, the Company shall true up all amounts. To the extent the Company has over-collected, it will refund those amounts to the customers at 6% interest. If the Company has under-collected, it shall collect those amounts at no interest, over a two-year period.

An additional customer protection in the Settlement Agreement is that the maximum rate impact to the residential (“RS”) rate class is 3%. Customers are also protected from fluctuations in the capacity avoided cost amount by freezing the avoided cost amount at the 2008 approved QF rate. However, if the approved capacity credit of the QF rate changes by more than 25%, the capacity avoided cost will be adjusted to enable modification to the portfolio of programs and the energy efficiency avoided cost percentages will be changed to maintain the relationship between the target achievement and the target management incentives. In addition, the Company and the OUCC agreed to meet and establish an avoided cost rate to incorporate a market-based component to the value of the avoided costs. Such methodology will weight the 2008 approved QF rate with data such as capacity purchases, the value of demand response resources in the Midwest ISO through its EDR tariff, and the value of DR resources in the Midwest ISO ASM. The methodology may be used for the avoided costs for program cost/benefit analysis and cost recovery for any additional programs offered during the term of the settlement.

Duke Energy Indiana and the OUCC agreed that the Company shall collect lost revenues over the term of the agreement until such time that a decoupling or alternative recovery mechanism is implemented or a general rate case is implemented. The Company agreed to initiate a proceeding, no later than 60 days from the issuance of a final order in this proceeding, to address the throughput issue by proposing a cost recovery mechanism that addresses both (1) the financial incentive to increase retail sales between rate cases, and (2) the financial disincentive under the existing regulatory framework to invest in energy efficiency or otherwise decrease the retail sales of electricity between rate cases.

The Settlement Agreement establishes an Advisory Committee with voting members from Duke Energy Indiana, the OUCC and the Commission if it so chooses. The Settlement Agreement also provides for other non-specified, non-voting members. The Advisory Committee will meet at least twice per year and have responsibility to design an appropriate methodology for EM&V, to collaborate on new program ideas, and approve modifications to the existing portfolio. To the extent the Advisory Committee approves modifications to existing programs, no Commission approval is needed for implementation; the Commission shall approve all new programs and any proposals that result in an increase in rates.

Duke Energy Indiana's EM&V proposal remains intact, with additional input from the Advisory Committee. The Settlement Agreement states that EM&V will be conducted by an independent third-party and that the EM&V reports shall be completed and provided to the Commission and the parties to this Cause annually. Additionally, free ridership and MW and MWh savings will be updated as part of the EM&V process in evaluating the continued cost-effectiveness of existing programs. In determining cost effectiveness, the overall program portfolio will be evaluated using the TRC test and will include management incentives as a component of direct costs.

The OUCC and Duke Energy Indiana agree that participation in Midwest ISO's demand response initiatives is important. To further that participation, Duke Energy Indiana commits to offer DR programs that will be compatible with the various Midwest ISO demand response tariff provisions. Planning resources that qualify under Midwest ISO Module E resource adequacy requirements will be eligible for recovery under Rider EE. Economic customer demand response program costs, which do not qualify for resource adequacy, will be recovered through Rider 70 at cost. Revenues and charges received from or allocated to Duke Energy Indiana by the Midwest ISO related to such programs will be allocated to FAC, RTO and Rider 70 proceedings. Future demand response program offerings will be recovered as described above, either through Rider EE or Rider 70.

The Settlement Agreement contains a number of Indiana-specific commitments. Duke Energy Indiana committed to expend no less than 25% of its total program costs for the implementation of its EE Plan through contracts with Indiana-based businesses. In response to reports of a shortage of skilled labor resources in Indiana to promote energy efficiency, Duke Energy Indiana committed to provide \$250,000 in targeted grants toward the funding and development of specialized post-secondary education programs with various Indiana institutes of higher education. The Company also agreed that future revenues from carbon emission allowances resulting from save-a-watt programs will be credited to those jurisdictional customers that funded the related expenses. In addition, Duke Energy Indiana agreed to provide the OUCC \$100,000 to acquire an independent consultant to assist in evaluating the EM&V results. Finally,

the Company agreed to credit the fully-installed cost of existing demand response equipment back to customers, equally spread out over the term of the agreement.

Attached to the Settlement Agreement is Exhibit B, a table that lists Duke Energy Indiana's initial position, the OUCC concerns and recommendations and the resulting compromise as memorialized in the settlement.

(1) Testimony in Support of Settlement Agreement with the OUCC.

Duke Energy Indiana submitted the testimony of Messrs. Stanley, Schultz, and Farmer in support of the Settlement Agreement. Mr. Stanley testified regarding the settlement terms and conditions, as well as Exhibit B to the Settlement Agreement. He stated that in his opinion the Settlement Agreement is in the public interest because it provides increased opportunities for customers to participate in energy efficiency programs and offers the Company an opportunity to be indifferent to the bias of supply-side investments.

Mr. Stanley explained that the Settlement Agreement continues several core concepts embodied in the Company's Verified Petition and ensuing testimony and exhibits, such as providing an incentive to the Company and its customers to be as aggressive as possible in developing energy efficiency programs. The Settlement Agreement continues the basic premise that the Company will only get paid for implementing programs that produce verifiable results and continues to reflect that compensation for successful implementation of energy efficiency programs will be predicated on a discount to the avoided costs of a power plant to place energy efficiency on a level playing field with supply-side resources. Mr. Stanley stated that the Settlement Agreement reflects the general premise that the utility assumes the risk based upon its actual performance for recovery of its energy efficiency program costs as well as any management incentive.

Mr. Stanley explained that the Settlement Agreement contained a number of modifications to the original proposal that provides customer protections, such as performance targets, with the Company eligible for a higher level of incentive based on how well the Company performs in achieving verified energy and capacity savings; however, the incentive is capped based on achievement of those performance targets. In addition, customers are protected by a rate-impact cap such that customers who choose not to participate in the Company's energy efficiency programs will not experience a significant rate increase as a result of the Settlement Agreement's implementation.

Mr. Stanley testified that the Settlement Agreement satisfies the Alternative Utility Regulation Statute's goals and purposes. Mr. Stanley stated that technological improvements allow for more sophisticated energy efficiency programs as well as for more accurate estimating of customer usage as proposed in the Company's EM&V plan. The Settlement Agreement provides the State, the Company, and its customers with many benefits, including a rate impact cap, a commitment to contract with Indiana businesses to assist in program implementation, and a commitment to provide \$250,000 in targeted grants to post-secondary institutions for specialized energy efficiency education programs. Mr. Stanley explained that the implementation of the Settlement Agreement's terms will promote energy utility efficiency because it will encourage the Company to invest in all cost-effective energy efficiency in its service territory. As to the final statutory requirement, the approval of the Agreement will allow

Duke Energy Indiana to effectively compete with other providers of functionally similar energy services or equipment.

Mr. Schultz explained that the Settlement Agreement takes Duke Energy Indiana's initial proposal and adds a number of customer benefits, such as rate impact certainty, performance targets, and associated earnings caps. Furthermore, he stated that the Settlement Agreement contains a number of customer-oriented policy objectives of the OUCC, such as optimizing demand response program compatibility with the Midwest ISO demand response options, using the TRC test and including management incentives as a component of direct costs. The Settlement Agreement makes the Company indifferent to the pursuit of energy conservation or DR programs by eliminating the subsidization of conservation programs by DR programs. Mr. Schultz stated that customers will be shielded from escalating avoided costs by adding a wholesale market element to the calculation of avoided costs and freezing the avoided cost component at 2008 levels. Another safety valve for customers is that the Settlement Agreement adds rate impact certainty for customers through an initial revenue requirements calculation based on achievement of \$260 million in avoided costs, and by limiting rate impact to the RS rate class to a maximum rate increase from implementation of the save-a-watt programs to 3% over the four-year term of the Settlement Agreement. Mr. Schultz also explained that Duke Energy Indiana agrees to financially assist the OUCC with the required EM&V aspects of the proposal. The Company will also refund over \$6.2 million for previously collected Power Manager costs to avoid double counting such costs and committed that any future carbon-related emission allowances created through the save-a-watt programs during this four-year term will be credited to customers.

Mr. Schultz testified that the Settlement Agreement is consistent with Duke Energy's overall energy efficiency vision of creating a regulatory model for energy efficiency that encourages utilities to invest in energy efficiency just as the existing regulatory model encourages investment in supply-side resources. He also stated that the primary features of the initial proposal remain intact.

Mr. Schultz explained that the Settlement Agreement compresses the revenue requirements and cost recovery associated with implementation of programs over the four-year term, with cost recovery continuing through the sixth year as necessary. He stated that the agreed to program portfolio is similar to the initially proposed program portfolio, with the exception that the research programs have been excluded from the initial program portfolio. The Settlement Agreement recognizes that research programs will be pursued during the four-year term, but any such programs must be presented to the Advisory Committee for consideration first. He stated that the Settlement Agreement also recognizes the need for Commission approval for any new programs and any modifications that would result in a change in rates.

Mr. Schultz testified that there are two modifications to the basic calculations of avoided capacity and energy costs as initially proposed. Avoided capacity costs will be based on the current as-filed QF rate with an annual inflation factor, but will not be otherwise updated during the term of the Settlement Agreement unless the annual filed QF capacity rate changes by more than 25%. He stated that the parties to the Settlement Agreement agreed to work toward the development of a methodology to blend market forces in with the filed QF rate for future

calculations of the avoided capacity costs. Mr. Schultz explained that the calculation of the avoided energy costs will be the same as initially proposed by the Company, that is, the avoided energy costs will be based on the actual avoided energy costs per the Company's IRP.

As a result of the negotiation process, there will be separate avoided cost percentages for demand response and energy conservation programs, to ensure that the Company will be indifferent to implementation of either kind of program relative to overall incentive received. Mr. Schultz testified that the parties agreed to lower the percentages to 75% (avoided capacity costs) for demand response achievements and to 60% (NPV avoided lifetime capacity and energy costs) for energy conservation programs.

Mr. Schultz explained that the Settlement Agreement contains both performance targets and earnings caps, as additional assurances for customers. He stated that the targeted savings achievement of \$260 million due to programs implemented during the four-year term of the agreement is based on the stated targeted MW and cumulative MWh savings. Mr. Schultz testified that the Settlement Agreement contains varying levels of earnings caps based upon varying levels of performance. He explained that the return on program costs will simply be a calculation of the percent return on investment on portfolio program costs.

Mr. Schultz stated that addressing the throughput incentive was an important policy issue for the OUCC. Accordingly, Duke Energy Indiana agreed that it would propose in an alternate proceeding, a cost recovery mechanism that addresses the throughput incentive.

Regarding EM&V, Mr. Schultz stated that the Settlement Agreement essentially adopted the Company's proposed measurement and verification protocols, as stated in its direct testimony. He testified that the Settlement Agreement contains two additional requirements in this area: first, the results of the measurement and verification process at the end of the four-year term will be used to determine the actual MW and MWh impacts achieved, and will be submitted to the Commission for such purpose in any true-up proceeding; second, reports of participation, along with any measurement, verification, and evaluation reports, will be provided to the Commission and parties annually as originally proposed. In addition, Duke Energy Indiana will provide the OUCC with \$100,000 to acquire an independent third-party consultant to assist in evaluating the Company's EM&V studies.

Mr. Schultz testified that the Settlement Agreement creates an Advisory Committee, consisting of Duke Energy Indiana, the OUCC, and the Commission if it so desires, to collaborate with Duke Energy Indiana on its program development and implementation. He stated that specific tasks assigned to the Advisory Committee include the design of a methodology to evaluate the performance of the energy efficiency programs, collaborate on new program ideas, review and approve modifications to existing programs, and review the EM&V process. The Settlement Agreement requires that free ridership and MW and MWh savings will be updated as part of the EM&V process in evaluating the continued cost-effectiveness of existing programs.

Mr. Schultz stated that the Company agreed with the OUCC that the Company's demand response programs needed to be tailored to take advantage of Midwest ISO's markets if possible.

Accordingly, the Settlement Agreement reflects Duke Energy Indiana's commitment to offer DR programs that will be compatible with the various Midwest ISO market requirements for demand response resources. Mr. Schultz also testified that the Company's DR programs that qualify under the Midwest ISO's Module E resource adequacy requirements, or that are otherwise deemed to be qualified planning resources by the Commission, will be eligible for Rider EE recovery; conversely, DR programs that do not meet the Midwest ISO's Module E requirements will be recoverable under Duke Energy Indiana's Rider 70, with revenues and charges to and from the Midwest ISO relative to those programs allocated in FAC, RTO, and Rider 70 proceedings, as appropriate.

Mr. Schultz concluded his testimony by stating his belief that the Settlement Agreement is in the public interest because it delivers \$260 million of avoided future generation costs, which is a dramatic increase in results from energy efficiency for Indiana. At the same time, through negotiation and compromise, the Settlement Agreement contains a number of customer and rate protections, such as a term limit, performance targets and earnings caps, and rate impact caps.

Mr. Farmer presented testimony and exhibits regarding the jurisdictional revenue requirement and rate impacts, as well as accounting issues. He presented an exhibit that showed the jurisdictional revenue requirement, based on the terms and provisions of the Settlement Agreement, are less than the Company's proposal, on both an annual and cumulative basis over the four-year recovery period. His exhibit showed the jurisdictional revenue requirement that will be billed customers during the four-year recovery period based on the provisions of the Settlement Terms is \$25.7 million less than the revenue requirement that would have been billed under the Company's original proposal as modified in the Company's rebuttal testimony.

Mr. Farmer presented an exhibit that provided an estimate of the change in rates pursuant to the Settlement Agreement, which showed that rates will increase by less than 2% during the first year and less than 3% during the fourth year. Mr. Farmer pointed out that customers who participate in programs offered by the Company will likely, depending on the level of participation, reduce their net bill below the level that would have been incurred had the Company's energy efficiency programs not been in place. Customers who do not participate in programs offered by the Company will benefit to the extent the Company's EE Plan lowers the marginal cost of energy and capacity below the level that would have been incurred had the Company not been able to realize avoided cost savings. Mr. Farmer testified that the monthly bill of a typical residential customer using 1,000 kilowatt-hours will increase by \$1.44 or approximately 1.87% during the first year of the four-year cost recovery period and that the same customer's bill would increase by \$1.97 or approximately 2.56% in the last year of the four-year recovery period.

Mr. Farmer testified that lost revenues, in the amount of \$28.6 million, will be recovered via Rider EE and will be subject to adjustment (either up or down) based on the level of verified MW and MWH reductions actually realized. He explained that the recovery of lost margins applicable to energy efficiency 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 due to approval of a decoupling or alternative recovery mechanism or an order in a general rate proceeding that provides for the recovery of lost margins.

Mr. Farmer explained that the true-up process will occur at the end of the four-year term, at which time the amounts due the Company based on the terms of the Settlement Agreement will be compared to revenues collected from customers. Any difference will either flow through to or be collected from customers over the ensuing two years. Mr. Farmer explained that the true-up process will capture the effects of a number of reconciling items, including the difference between revenues billed customers based on 85% of targeted energy efficiency program savings and the revenues due the Company based on verified conservation and demand response avoided cost savings actually realized. In addition, the true-up process will capture the difference between lost revenues billed customers and the recovery of lost revenues actually due the Company based on verified MW and MWH savings. Finally, the true-up process will include calculations that ensure that the level of compensation recovered by the Company does not exceed: (1) \$260 million of total avoided cost savings used to determine compensation levels, (2) a maximum increase of 3% for the recovery of energy efficiency costs applicable to retail customers taking service under Rate Schedule RS, and (3) predetermined levels of after-tax earnings applicable to the energy efficiency program as set out in the Settlement Agreement.

Mr. Farmer emphasized that the Settlement Agreement does not guarantee or ensure that the Company will realize or achieve the earnings levels set out in the Settlement Agreement because the Company 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 the Company will not result in a management incentive or cover the costs of energy efficiency programs. At the end of the four-year period, the after-tax earnings level will be divided by actual program costs incurred in order to determine the percentage return on actual program costs. Mr. Farmer testified that the Company will compare the rate of return on actual program costs produced by this calculation to the management incentive cap that is provided for in the Settlement Agreement, taking into consideration the percentage of avoided cost savings actually realized relative to the \$260 million of targeted avoided costs savings. 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. However, if the rate of return on actual program costs incurred exceeds the level provided for in the Settlement Agreement, then the excess earnings level, grossed-up for applicable taxes, will be refunded to customers.

Mr. Farmer concluded his testimony by explaining that the Company was no longer requesting deferral of program costs. He stated that accounting rules and regulations will require that the Company monitor, on an ongoing basis, the difference between financial results applicable to the energy efficiency programs that are expected to be ultimately realized based on the Settlement Agreement and the financial results recorded on the Company's books that result from the recovery of costs via Rider EE. The Company will record either a regulatory asset or liability. Mr. Farmer explained that, in order to recognize a regulatory asset, accounting rules require that orders from the utility's regulatory commission must allow for the automatic recovery of amounts due the Company. Mr. Farmer requested that the Commission explicitly provide assurance that future rates may be adjusted to recover the amount owed the Company pursuant to the terms of the Settlement Agreement.

(2) **OUCC Testimony in Support of Settlement Agreement.** Ms. Soller⁸ recommended approval of the Settlement Agreement based in part on nine key policy elements and specific benefits achieved through the settlement:

- (1) the Duke Energy Indiana and OUCC collaborative effort to remove the QF rate component (which the OUCC believes does not accurately or adequately reflect utility business decisions to purchase capacity, does not recognize the value of capacity in electricity markets and may over-value capacity) and replace it with a market-based component to calculate avoided costs for program cost/benefit analysis;
- (2) reducing the cost recovery period, including lost revenues, from 20 years to 6 years (4 vintage years of program implementation and limiting lost revenue recovery to only 3 years following each vintage year). This approach simplifies the process, minimizes ratepayer costs and should make it easier to audit Rider EE revenues;
- (3) an opt-out provision for large customers and additional protections for residential ratepayers, including a 3% overall rate impact limit and over-collected amounts repaid to customers with 6% interest;
- (4) creating an Advisory Committee, which may include the Commission if it chooses, to collaborate on program development and further energy efficiency for Duke Energy Indiana customers. This process is expected to optimize regulatory resources and expedite energy efficiency implementation similar to what has occurred through successful gas utility collaboratives;
- (5) Duke Energy Indiana's commitment to address the value of demand response in the Midwest ISO environment, including a credit of \$1,023,000 in PowerShare[®] expenses currently included in base rates as a credit in Rider EE;
- (6) reduced environmental impacts in the form of fewer carbon emissions, plus an agreement that if future carbon legislation awards credits for successful energy efficiency programs, these credits will flow through to ratepayers (who are funding this initiative);
- (7) Duke Energy Indiana's commitment to support Indiana-based businesses by spending at least 25% of its program costs with them;
- (8) Duke Energy Indiana's commitment to fund energy efficiency post-secondary education for technicians and contractors, increasing public interest in this area of employment and improving implementation results that are sometimes less than 100% because of a lack of field labor; and
- (9) a one-time credit of \$6.2 million to reflect costs of Duke Energy Indiana's Power Manager program, which was fully-funded by ratepayers.

Dr. Polito also filed testimony supporting the Settlement Agreement. He testified that the Settlement Agreement contained several elements that balance the parties' interests and address several key issues identified by the OUCC's economic analysis including:

- (1) A 4-year limited term pilot program with a firm expiration date, subject to the remaining conditions set forth below. This limits both parties' exposure to unintended consequences that sometimes can occur with a novel regulatory proposal.
- (2) Limiting management incentives by:

⁸ At hearing, Ms. Soller's settlement testimony was adopted by OUCC witness Andrew Satchwell.

(a) removing the Advanced Power Manager Program (a cause of excessive returns according to Dr. Polito's initial analysis), and

(b) including a "return cap" that limits the Company's return to between 5-15% on program costs based on Duke Energy Indiana successfully reaching targeted energy conservation and demand response savings levels. Dr. Polito opined that this return is generally consistent with a return that may prevail in a competitive market. He noted that even if the Company does reach the return cap, the Settlement Agreement provides that ratepayers receive the substantial majority of energy efficiency avoided cost savings. He also noted that the Settlement Agreement does not guarantee that Duke Energy Indiana will actually earn this incentive, only that Duke Energy Indiana has an opportunity to earn it and that the combination of these elements work to no longer shield Duke Energy Indiana from the risk of nonperformance.

(3) Improved cost-effectiveness based on requiring that the Company's overall energy efficiency program portfolio to be cost-effective when evaluated using the TRC test and including management incentives as a component of direct costs. As filed, Petitioner did not include management incentives as a direct cost component, artificially inflating program cost effectiveness.

(4) Reduced ratepayer risk by fixing avoided costs to a pre-established level, shielding ratepayers from supply-side risks. If avoided costs do change by more than an agreed upon percentage, the avoided costs can be updated for the purposes of determining portfolio cost-effectiveness, but the Settlement Agreement also requires recalculating certain related parameters so that the proposal remains consistent with the return cap.

(5) Reduced risk of utility over-collection. Revenues collected in excess of that allowed under the Settlement Agreement are returned to ratepayers plus an additional 6% interest that compensates ratepayers for the time value of their money. As filed, Petitioner would refund the over-collection without interest. Asymmetrically, ratepayers are not required to compensate Duke Energy Indiana for the time value of its money in the event Duke Energy Indiana does not collect on a timely basis.

(6) Including both a pre-determined, not-to-exceed avoided cost savings goal and a limit to the rate impact to non-participating customers of no more than a 3% increase over the term of the agreement.

(7) Reduced regulatory complexity by eliminating the Company's unnecessarily complex process to reshape the stream of avoided energy and capacity cost savings.

(8) Improved EM&V process, including shareholder-funding of up to \$100,000 to offset the costs of evaluation, measurement and verification activities, incurred by the OUCC on behalf of ratepayers. The Settlement Agreement also adds a procedure allowing the OUCC to formally contest Duke Energy Indiana's EM&V activities in a hearing before the Commission.

(9) A framework for resolving the throughput incentive issue that allows Company profits to increase with the increasing sales of electricity. As filed, the save-a-watt model offered no change to that aspect of the existing form of regulation. Duke Energy Indiana must also propose, in a subsequent proceeding, a cost recovery mechanism that addresses both:

(a) the financial incentive to increase retail sales between rate cases under the existing regulatory framework, and

(b) the financial disincentive to invest in energy efficiency or otherwise decrease the retail sales of electricity between rate cases under the existing regulatory framework.

(10) Creating separate avoided cost percentages for demand response (75%) and energy conservation (60%) programs, both subject to the earnings cap, intended to make the Company indifferent relative to profitability. As originally filed, the Company proposed avoided cost-based compensation at 90% of both energy conservation and demand response programs with no earnings cap.

(3) CAC Testimony in Opposition to Settlement Agreement. The CAC presented the testimony of Messrs. Hornby and Gilligan in opposition to the Settlement Agreement. Mr. Hornby stated his belief that the Company is proposing an unreasonably high performance target for an unreasonably low level of energy conservation. He also expressed his concern that the value-of-service component may limit the Company's ability to respond easily to unexpected changes in market conditions. He recommended that the Commission not approve the Settlement Agreement and reiterated his recommendations from his direct testimony.

Mr. Hornby expressed his belief that the proposed portfolio of programs was heavily weighted towards DR rather than energy conservation programs. He argued that the Settlement Agreement provides for a low level of incremental reductions in energy (kWh) use relative to the levels being achieved by the country's leading utilities. Mr. Hornby opined that the Settlement Agreement creates a hybrid cost-of-service/value of service approach to energy efficiency. Mr. Hornby complained that neither the Company nor the OUCC witnesses provided explicit support for the management incentive proposed in the Settlement Agreement.

Mr. Hornby testified regarding shareholder incentives in California and New York. He stated that the California Commission emphasized estimating the level of shareholder incentive that would produce earnings from conservation equivalent to earnings from supply. He stated that the New York Commission approved a performance-based shareholder incentive expressed as a pre-tax amount equivalent to a percentage of program costs. Mr. Hornby testified that it was difficult for him to compare the management incentive under the Settlement Agreement to the types of shareholder incentives approved in other jurisdictions.

Mr. Hornby concluded his testimony by stating his belief that the value of service component may constrain Petitioner's ability to respond to changes in market conditions because there is no guarantee that the management incentive compensation levels will continue to ensure that the Company pursues all cost-effective conservation if market conditions change dramatically. He reiterated his recommendation that the Commission should not approve the Settlement Agreement, but instead should direct the Company to seek the input of stakeholders regarding an expansion of the breadth of its energy conservation programs under its existing ratemaking framework, and an increase in the aggregate budget for those programs.

Mr. Gilligan testified that he believed the energy efficiency targets in the Settlement Agreement are inadequate and are a fraction of the targets that have recently been established for new energy efficiency programs in neighboring states. He stated that the target for energy efficiency in neighboring states for 2012 is 1% of retail electricity sales, which is approximately

four times the level that Duke Energy Indiana is proposing to reach in 2012, pursuant to the Settlement Agreement.

Mr. Gilligan recommended third-party administration of energy efficiency as a viable alternative to the Company's proposal because it is being utilized successfully in other states. Mr. Gilligan testified that utility administration can offer a simpler regulatory structure, faster program start-up, substantial historical knowledge of customer energy use patterns, and personal relationships with the energy and facility managers in large commercial, industrial and institutional customers. He stated that the advantage to third-party administration is that it can offer administrative cost savings with lower or no incentives as well as have a single focus on energy efficiency. Mr. Gilligan stated that he did not recommend one administrative model over the other, as his experience is that either utility administration or third-party administration can be successful.

Mr. Gilligan recommended two modifications to the EM&V process. He recommended that third-party consultants work under contract to the Commission and that the Commission appoint an advisory panel that is representative of the program stakeholders and includes Commission staff to review the EM&V program, protocols and reports.

(4) Duke Energy Indiana Rebuttal Testimony Regarding Settlement Agreement. In rebuttal to the CAC's testimony, Mr. Schultz stated that the Company's EE Plan represents a significant increase in dollars invested and savings achieved for its customers. As to Mr. Hornby's belief that the management incentive is too high, Mr. Schultz explained that a major difference between the Company's EE Plan and other energy efficiency offerings is that the Company is not guaranteed a certain level of cost recovery; if the Company does not achieve energy efficiency savings, the Company does not get paid. As to Mr. Hornby's comparison of shareholder incentives in California, Mr. Schultz stated that it is unclear how Mr. Hornby normalized for the decoupling rate mechanism in place in California today that fully refunds all lost margins without limitation as to duration against Duke Energy Indiana's proposed limited three-year lost margin recovery. As to comparisons with New York, Mr. Schultz noted that even with very experienced program administrators and solid energy efficiency programs, the state was only able to achieve energy efficiency results of 0.2% of sales. In comparison, Mr. Schultz testified that Duke Energy Indiana is projecting cumulative results of over 1% of sales by 2012.

Mr. Schultz testified that the Company will have the flexibility to respond to changes in market conditions under the Settlement Agreement because the Company's EE Plan is a pay-for-performance compensation model that actually requires the Company to respond to market indicators to maximize its energy efficiency impacts, and thus its earnings potential. Mr. Schultz explained that the cost plus shared savings model that Mr. Hornby recommends is premised on a "spend and recover" philosophy; whereas, the Company's proposal is a "perform and recover" model.

Mr. Schultz agreed with Mr. Hornby that there is a need for increased energy efficiency programs in Indiana and stated that the Settlement Agreement will allow the Company to make significant progress in furtherance of that goal. Mr. Schultz disagreed that a third-party administrator will produce the greatest results for customers at the lowest cost. He stated his belief that a third-party administrator is not in the best interest of consumers or the Company

because it has the potential to stifle innovation and to increase the costs of program development and implementation. Mr. Schultz testified that utilities are in the best position to provide customers with cost-effective energy efficiency because utilities have the expertise, infrastructure and customer relationships necessary to be successful.

Dr. Stevie presented testimony rebutting Mr. Gilligan's concerns regarding the proposed EM&V of the Company's programs. Specifically, Dr. Stevie stated that Mr. Gilligan's proposed modifications are unnecessary. As to Mr. Gilligan's recommendation that the EM&V consultant work under contract to the Commission, Dr. Stevie testified that the Commission has the option to participate as a member of the Advisory Committee. In addition, the Commission has the right to review the EM&V process and review the results and interim reports on an annual basis. He concluded that micro-management of the Company on EM&V is unnecessary because the Settlement Agreement provides an adequate framework to ensure the EM&V work is independent.

In response to Mr. Hornby's testimony that there is no support for the management incentive amount, Mr. Farmer prepared an exhibit designed to provide a sense of magnitude as to the net savings that will flow through to customers under the Settlement Agreement based on a wide range of potential achievement levels. As an example, Mr. Farmer stated that assuming the Company achieves its avoided cost savings target of \$260 million dollars and assuming the Company spends \$107.4 million to achieve this level of attainment, the maximum amount of after-tax profit that would be earned by the Company is \$16.1 million over the four-year term of the Settlement Agreement. Mr. Farmer testified that his exhibit demonstrated that the majority of revenues collected by the Company will be used to fund the payment of program costs and a relatively small amount will flow through to earnings. Mr. Farmer also testified that the estimated avoided cost savings realized by customers is substantial across all levels of achievement. He stated that the customer portion of net avoided cost savings tops out at \$122.5 million and at the lowest attainment level, customers receive \$52.6 million in savings.

Mr. Farmer testified that the Company's rate recovery plan was developed with the purpose of providing a revenue stream that would allow the Company to recover its costs plus an incentive. He stated that at the end of the four-year recovery period, the Company will compare revenues billed customers to the revenue level that would be produced by recovering actual program costs incurred plus a return on actual program costs. Mr. Farmer explained that the two variables that determine the maximum amount of revenues that the Company will ultimately be allowed to recover (*i.e.*, program costs and an incentive) will both meet the fixed, known and measurable standard.

C. The Opt-Out Settlement. On November 3, 2008, Duke Energy Indiana submitted a settlement agreement entered into with Nucor, SDI, Kroger, and the OUCC (together "the Opt-Out Settling Parties"). The Opt-Out Settlement, provided that large industrial and commercial customers with an aggregated annual maximum peak demand greater than 25,000 kW may opt out of the energy conservation and/or demand response components of Rider EE. To meet this threshold, a customer may aggregate the load of the Duke Energy Indiana accounts of its affiliates. A customer who meets this threshold may choose to opt out for select

accounts/locations or all accounts, at its sole election. A customer cannot opt out of individual programs.

The Opt-Out Settlement provides that a customer may opt-out of the demand response component of Rider EE for the term of the agreement. If a customer opts out, that customer will not be charged the demand response component of Rider EE. A customer must opt-out of demand response within 60 days following the approval of the order in this proceeding. If the customer does not opt-out of the demand response component of Rider EE within this 60 day period, the customer will be billed Rider EE charges for the term of the agreement.

The Opt-Out Settlement also provides that a customer may opt-out of the conservation component of Rider EE if they meet certain self-certification requirements. Duke Energy Indiana will collect and maintain the self-certifications for the term of the program and make them available to the Commission and the OUCC at their request. A customer may opt-out of the energy conservation component of Rider EE for each vintage year with lost margin recovery occurring for two additional years. Customers who meet the opt-out threshold have the flexibility to opt-out and back in the energy conservation component of Rider EE. Once a customer opts out, they will be out until they elect to opt back in; however, a customer must elect to opt-out, or back in, no later than 60 days prior to the beginning of a vintage year. The terms of the Opt-Out Settlement provide that a customer who elects to opt-out of the energy conservation component foregoes participation in the true-up process at the end of year four.

The Opt-Out Settlement also provides that the customer will not be charged for equipment necessary for demand response or conservation programs if the customer provides such equipment. The customer is responsible for installation charges, if applicable.

The final provision of the Opt-Out Settlement is a commitment by Duke Energy Indiana that it will not seek recovery of any demand response costs associated with future custom demand response large customer special contracts under Rider EE. Duke Energy Indiana reserved the right to request recovery of any demand response associated costs under such contracts in its Rider 70 or other proceedings. Duke Energy Indiana also committed that if any future custom demand response special contracts for large customers do not meet the Midwest ISO's Module E Resource Adequacy requirements or approval by the Commission as a planning resource, then the Company will not seek recovery of any capacity payments associated with demand response under such contracts in Rider 70 or elsewhere.

(1) **Duke Testimony in Support of the Opt-Out Settlement.** Mr. Schultz explained that the Settlement Agreement with the OUCC contemplated that there would be further discussions with other parties around opt-out provisions and that the Opt-Out Settlement satisfies that contemplation. The Opt-Out Settlement makes modifications to the opt-out provisions as originally proposed in direct testimony and provides for the treatment of large special contract customers demand response impacts and costs.

Mr. Schultz testified that the Company's proposed EE Plan had an opt-out for customers with 5 MW of load for conservation programs but did not contain an opt-out provision for demand response programs. He stated that the Opt-Out Settlement embodies the Opt-Out Settling Parties' agreement that the Company's EE Plan should be modified to include an opt-out

for the demand response component of the plan, limited to large customers with an aggregated annual maximum peak demand greater than 25 MW.

Mr. Schultz testified that a customer who is eligible to opt-out can choose to opt-out for some or all of its accounts or locations. He stated that a customer is not allowed to opt-out of individual programs encompassed by the Company's Rider EE. An eligible customer must opt-out within 60 days of the Commission's Order in this proceeding and remain opted out for the term of the Company's EE Plan.

Mr. Schultz explained that the Opt-Out Settlement modified the initial proposal from 5MW to 25 MW aggregated annual maximum peak demand to meet the threshold requirement to opt-out. He testified that a customer eligible to opt-out may choose to opt-out for some or all of its accounts or locations, but not individual programs. Mr. Schultz testified that, in addition to meeting the 25 MW threshold requirement, in order to opt-out of the energy conservation component of Rider EE for a specific facility, a customer must self-certify or attest that it has performed or had performed an energy audit or analysis and has implemented or has plans to implement the measures identified for installation in such audit or analysis.

Mr. Schultz testified that an eligible customer may opt-out of the energy conservation component of Rider EE for each vintage year of the program because the Settlement Agreement with the OUCC provides that energy conservation programs are fully paid for in the vintage year in which they occur, while lost margin recovery will occur for an additional two years. He explained that this structure allows for more flexibility on energy conservation opt-out because eligible customers may opt-out one year and decide to opt back in the next year. Mr. Schultz stated that once an eligible customer opts out of the energy conservation component of Rider EE, the customer will remain out for the remainder of the EE Plan, unless the customer elects to opt back in and that such election must take place no later than 60 days prior to the beginning of a vintage year. He also testified that a customer who elects to opt-out of the energy conservation component foregoes participation in the true-up process at the end of year four of the Company's EE Plan; a customer must participate all four years to be included in the true-up process.

Mr. Schultz testified that the Settlement Agreement with the OUCC contemplated future custom demand-response programs for its large customers and stated that the Company would seek recovery of costs associated with such future demand response contracts either under Rider EE or under the Company's Rider 70. Mr. Schultz stated that the Opt-Out Settlement modifies that term through Duke Energy Indiana's commitment that it will not seek recovery of any demand response costs associated with these future large customer custom demand response special contracts under Rider EE. As such, the demand response impacts of these contracts will be omitted from the EE Plan and shall have no effect on Rider EE. Mr. Schultz testified that the Company has reserved the right to request recovery of demand response costs associated with these large customer special contracts in its Rider 70 or other proceedings. He stated that Duke Energy Indiana agreed that if any future custom demand response special contracts for large customers do not meet the Midwest ISO's Module E Resource Adequacy requirements or approval by the Commission as a planning resource, then the Company will not seek recovery of any capacity payments associated with demand response under such contracts.

Mr. Schultz explained that if equipment is required on the customer side of the meter for demand response or energy conservation programs covered by the Settlement Agreement, and the customer provides such equipment, the Company will waive charges associated with the equipment except applicable installation charges. He stated the reason for this provision is that customers may have already invested in load-management equipment that is sufficient to meet the needs of Duke Energy Indiana's programs and such customers should not have to pay for additional equipment if the customer-owned equipment meets the requirements of the particular program.

Mr. Schultz stated his belief that the Opt-Out Settlement is in the public interest because it provides a reasonable compromise position to address two open items from the Settlement Agreement with the OUCC regarding opt-out and custom demand response programs considered in special contracts. Mr. Schultz stated that the Company is confident that large customers will participate in energy conservation programs with the more flexible terms, even though the more flexible energy conservation opt-out terms are more difficult for the Company to administer. He reiterated that the Company is taking the risk if large customers do not participate in energy conservation programs, because the Company is only compensated for the energy and demand savings it achieves. Mr. Schultz stated that the treatment of large special contracts is in the public interest because those customers have the ability to manage their operations in a way to provide unique electricity benefits.

Mr. Schultz explained that, as a result of the Opt-Out Settlement, the Company must recognize that some subset of its customers will opt-out and that Duke Energy Indiana needs to focus its efforts on energy conservation measures and on the demand response measures that remain in Rider EE. He testified that the original targets from the Settlement Agreement with the OUCC do not need to change as a result of this new Opt-Out Settlement because the Company plans to target the same avoided costs savings for the four-year period with a reorganized portfolio to achieve these results in a different way. Mr. Schultz stated that the Company is not proposing any changes to the rate factors in Rider EE based on the Opt-Out Settlement because there are many different ways to achieve the same avoided cost results (*i.e.*, approximately \$260 million of avoided future generation costs).

Mr. Schultz concluded his testimony by stating that the Opt-Out Settlement is in the public interest because the Company's proposal will provide substantial demand impacts and the opportunity for energy impacts will be substantially increased.

(2) OUCC Testimony in Support of the Opt-Out Settlement. Dr. Polito specifically addressed the Exhibit A, Section I, Subsection 5 of the Opt-Out Settlement, noting that it requires that Duke Energy Indiana's overall energy efficiency program portfolio be cost-effective when evaluated using the TRC Test and include management incentives as a component of direct costs. He described how the TRC expresses the benefits of a demand side or energy efficiency program, as measured by avoided costs, relative to the costs of the program. By including management incentives as a TRC direct cost component, a TRC ratio greater than one (1) indicates the benefits of a demand side or energy efficiency program exceed its costs, even with incentives, and that implementing the program is a cost-efficient use of resources that creates value.

(3) **CAC Testimony in Opposition to the Opt-Out Settlement.** Grant Smith, Executive Director of CAC, testified against the Opt-Out Settlement, stating his concern that energy efficiency targets will not increase as a result of the Opt-Out Settlement. He testified that there should be significant quantities of energy efficiency that can be achieved in the large customer sector because, nationwide, industry accounts for about 33% of the energy consumed.

Mr. Smith described the barriers to large customer investments in energy efficiency, including the limit of different planning horizons; misunderstanding the value of efficiency as compared to other energy practices; lack of staff and management awareness of energy uses and costs; lack of cross-department cooperation; accounting practices that treat plant-wide energy use as an overhead cost, allocating it across departments in a manner that doesn't identify the causes of the usage; restrictive budgets; and lack of resources. Mr. Smith stated that the CAC has generally favored expanding efficiency programs and responsibility to all customer classes.

Mr. Smith stated his general opposition to aggregating load to opt out because the ability to aggregate does not make participation a function of the type of facility or the way it uses energy but how many locations or facilities are controlled by the parent company. Mr. Smith disagreed with Mr. Schultz that the Company is taking the risk if large customers do not participate in energy conservation programs and stated his belief that the real risk is that the Company will not achieve meaningful reductions in energy and demand and therefore customer bills will not be reduced.

Mr. Smith testified that he is opposed to self-certification as a qualifier to opt-out because self-certification provides no standards for determining if the energy audit is sufficiently robust to identify all cost-effective energy savings. He also expressed his concern that the self-certification process does not require actual investments but only plans to invest in energy efficiency. Finally, Mr. Smith stated that self-certification fails to establish objective criteria upon which to base a decision that the large customers' plans or efforts actually identify all the cost-effective investments.

Mr. Smith stated that allowing some customers to opt-out removes a whole segment of users from the utility planning aspect of energy efficiency and makes the utility and the State a passive observer of investments rather than an active participant. Mr. Smith recommended that the Commission not approve any opt-out provision for energy efficiency measures. To the extent an opt-out is allowed, Mr. Smith opined that it should be based on the character of facility and its uses, not on the size of the parent or controlling company.

(4) **Duke Energy Indiana Rebuttal Testimony Regarding the Opt-Out Settlement.** Mr. Schultz responded to the CAC's concerns that the opt-out provision agreed to by the Opt-Out Settling Parties (1) will not achieve all cost-effective energy efficiency from a utility planning and customer perspective; (2) is not based on the character of the facility and its uses; and (3) will not result in any risk to the Company if large customers do not participate in energy conservation programs. Mr. Schultz reiterated the Company's belief that commercial and industrial customers have a unique ability to undertake self-directed energy efficiency initiatives.

Mr. Schultz stated his belief that the opt-out compromise reached by the Opt-Out Settling Parties is consistent with the policy decisions to recognize the energy efficiency achievements of

larger customers made by other states in which Duke Energy has regulated utilities, such as Kentucky and North Carolina.

Mr. Schultz responded to Mr. Smith's assertion that the Opt-Out Settlement fails to provide for all cost-effective energy efficiency from a utility planning and customer perspective by explaining that the compromise provisions of the Opt-Out Settlement continue to provide customers with the benefit of efforts to implement cost-effective energy efficiency. Mr. Schultz stated that it is in the customer's own financial best interest to ensure that the energy analysis performed on its facilities covers all applicable cost-effective energy efficiency measures.

Mr. Schultz explained that the Company agrees with Mr. Smith's assertion that businesses are often focused on investments that provide quick pay-backs. In response to this concern, eligible customers will now be able to opt-in and out of the Company's portfolio of energy conservation programs on a vintage-year basis based on a commercial or industrial customer's belief that Duke Energy Indiana's energy efficiency programs could benefit its operations.

In response to Mr. Smith's criticism of allowing customers to aggregate the load of multiple accounts to meet the opt-out threshold, Mr. Schultz explained that it is the experience of the Company that most individual customer locations of national or regional accounts fall under common management and receive coordinated attention to energy efficiency initiatives. Furthermore, Mr. Schultz stated that it is not practical to condition opt-out eligibility on subjective determinations of how a customer uses energy.

Mr. Schultz responded to Mr. Smith's argument that Duke Energy Indiana is not assuming risk if large customers do not participate by stating that Duke Energy Indiana is assuming this risk because the Company will incur marketing and administrative costs to develop, promote, and deliver its energy efficiency programs. He stated that under the save-a-watt model, the Company may not recover enough through Rider EE to cover its costs if customers opt out.

D. The Amended Opt-Out Settlement. On January 15, 2009, Duke Energy Indiana submitted the Amended Opt-Out Settlement entered into with the DEI-IG and Wal-Mart, in which the previous settling parties consented to the terms and conditions stated therein. The substantive provisions of the Amended Opt-Out Settlement reduced the aggregate amount eligible for opt-out from 25 MW to 5 MW, with a customer able to aggregate the accounts of its affiliates to meet the opt-out threshold. Consistent with the Opt-Out Settlement, a customer who chooses to opt-out may choose to opt-out for select accounts/locations or all accounts, but not opt-out of individual programs.

In addition to the terms and conditions in the Settlement Agreement with the OUCC and the Opt-Out Settlement, the Amended Opt-Out Settlement provides that once an eligible customer opts-out of the Company's demand response programs, they will not be permitted to opt back in for the four-year term of the Settlement Agreement. As to Duke Energy Indiana's conservation program offerings, opt-out decision-making will occur only once per year during an enrollment period for the first 60 days following approval of the final order in this proceeding. Thereafter, there will be an annual enrollment/opt-out period that ends 60 days prior to the

beginning of the subsequent vintage year for the conservation component. To re-enroll, a customer who has opted-out will need to notify the Company of its intention in writing to opt-in during the annual enrollment period.

The self-certification requirement to opt-out of Duke Energy Indiana's conservation programs remains, with the addition that a customer can attest that it will have an energy analysis performed within the next six months. Duke Energy Indiana agrees to treat the self-certifications as confidential documents and will provide them to the OUCC and Commission upon request, subject to confidentiality restrictions.

The other substantive change made by the Amended Opt-Out Settlement concerns grandfathering PowerShare[®] CallOption customers. Existing PowerShare[®] CallOption customers with 5 MW and above who have the option to opt-out of Rider EE shall be grandfathered at their existing level of participation in PowerShare[®] CallOption to continue under Rider 70, subject to the existing PowerShare[®] CallOption being modified to comply with Midwest ISO's resource adequacy requirements. Attachment No. 1 to the Amended Opt-Out Settlement lists the grandfathered customers and MW amounts. Any MW of PowerShare[®] CallOption beyond the specific customer and MWs grandfathered and any conversion of existing PowerShare[®] CallOption to a new PowerShare[®] product offering will be treated as part of Rider EE, as long as the program meets the Midwest ISO's resource adequacy requirements.

The Amended Opt-Out Settlement states that the amount of PowerShare[®] expense included in base rates today will remain in base rates and continue to be annually reconciled with the amount of PowerShare[®] expense that continues to be recovered under Rider 70. The grandfathered PowerShare[®] CallOption will count towards Duke Energy Indiana's avoided cost target as stated in the Settlement Agreement with the OUCC; the net effect of which is that the Rider EE targeted avoided cost savings target may be adjusted to no less than \$250.7 million to reflect these Rider 70 grandfathered MWs described above for purposes of determining the application of the capped rate of return on program costs.

The Amended Opt-Out Settlement states that Duke Energy Indiana shall label its save-a-watt program as a trial program and that the revenues and expenses associated with Rider EE shall be included in the FAC earnings and expense tests.

(1) Testimony in Support of the Amended Opt-Out Settlement. Mr. Schultz provided details regarding the grandfathering provisions and explained why he believes the Amended Opt-Out Settlement is in the public interest and Mr. Farmer testified regarding the FAC earnings and expense tests.

Mr. Schultz testified that if all of the grandfathered PowerShare[®] CallOption MWs remain in Rider 70, those MWs will still produce avoided cost savings of up to \$9.3 million. He explained that the Amended Opt-Out Settlement reflects a cost recovery construct for these avoided cost savings. Mr. Schultz stated that these savings, together with the Rider EE programs, may still allow Duke Energy Indiana to achieve its avoided cost goal of \$260 million; the net effect is that the Rider EE avoided cost savings target may be adjusted to no less than \$250.7 million to reflect these Rider 70 grandfathered MWs for purposes of determining the

application of the capped rate of return on program costs contained in the Settlement Agreement with the OUCC.

Mr. Schultz described the modifications to the self-certification language. He testified that to opt-out of the energy conservation component of the Rider EE for a specific facility, a customer must self-certify that it has performed or intends to perform an energy audit or analysis and has implemented or has plans to implement energy efficiency measures. Mr. Schultz testified that there are no changes to the lost margin recovery.

Mr. Schultz testified that he believes the Amended Opt-Out Settlement is reasonable because it is in the public interest that customers pursue energy efficiency projects either with Duke Energy Indiana or independently. Mr. Schultz stated that Duke Energy Indiana is committed to work with all customers to accomplish their energy efficiency goals. He explained that Duke Energy Indiana has always recognized that larger commercial and industrial customers may undertake energy efficiency measures on their own and may not need or want the assistance of utility-sponsored programs. The Amended Opt-Out Settlement opens up a significant amount of energy efficiency potential that does not exist for Duke Energy Indiana commercial and industrial customers today because currently, all commercial and industrial customers above 500 kW are automatically excluded from utility sponsored energy efficiency efforts. The terms of the Amended Opt-Out Settlement require customers to take an affirmative action to opt-out of the EE Plan, significantly increases the opt-out threshold to customers larger than 5 MW, and require self-certification for opting out of energy conservation programs.

Mr. Schultz stated that all of the settlement agreements in this proceeding maintain incentives for the Company to pursue energy efficiency and maintain a pay-for-performance model, based on independently verified results, with a number of customer and rate protections, such as a term limit, performance targets and earnings caps, and rate impact caps. He concluded that the modifications proactively address certain important policy issues, including compatibility between utility and the Midwest ISO markets for demand response resources; inclusion of wholesale market forces in the future calculation of avoided capacity costs; and utilities' natural throughput incentive.

Mr. Farmer submitted testimony regarding the term of the Amended Opt-Out Settlement that provides that revenues and expenses from save-a-watt be included in the FAC earnings and expense tests. He explained that the Company will include expenses recorded on the Company's books and records on an "as incurred" basis in both the earnings and expense tests and stated that the effect on the income statement associated with any regulatory asset or liability recorded on the Company's books and records will be included in the FAC tests.

Mr. Farmer stated that the Amended Opt-Out Settlement does not provide for an adjustment to the Commission approved jurisdictional operating expense and earning levels included in future FAC levels. Mr. Farmer testified the purpose of the FAC earnings test is to assure customers and the Commission that Company earnings do not exceed authorized levels and asserted that the provisions of the Amended Opt-Out Settlement will ensure that the Company's actual earned return does not exceed a fair and reasonable level.

(2) **Testimony in Opposition to the Amended Opt-Out Settlement.** While Mr. Smith testified that CAC opposed the Amended Opt-Out Settlement, he stated that CAC supports including the revenues and earnings associated with Rider EE in the FAC earnings test. Mr. Smith stated his belief that the Amended Opt-Out Settlement shows that the Company lacks a real and sustaining commitment to energy efficiency and DSM because it reduces the pool of customers for funding such programs. He reiterated the CAC's concern that the energy efficiency targets are modest and that the self-certification process is not sufficiently robust to identify significant energy or demand savings. Mr. Smith alleged that the opt-out provision is discriminatory in that it only allows some customer classes to opt-out and argued that all customers, including residential customers should be allowed to self-certify and opt-out.

Finally, Mr. Smith recommended that the Commission approve a public benefits charge equal to at least one percent of Duke Energy Indiana's retail revenues funded by all customers. He also recommended that the Commission initiate a public proceeding with full stakeholder participation to identify an independent third-party to design and implement energy efficiency programs exclusive to Duke Energy Indiana's service territory.

(3) **Duke Energy Indiana Rebuttal Testimony Regarding the Amended Opt-Out Settlement.** In rebuttal, Mr. Schultz testified that the Amended Opt-Out Settlement appropriately recognizes the unique capabilities of the Company's larger commercial and industrial customers to undertake self-directed energy efficiency initiatives. He stated that the self-certification process provides the information needed to ensure the customer is engaged in or has plans to engage in self-directed energy efficiency while at the same time minimizing the administrative burden to the Company. Mr. Schultz reiterated that the opt-out compromise reached in the Amended Opt-Out Settlement represents a substantial increase in the number of customers who can participate in the Company's programs.

Mr. Schultz responded to Mr. Smith's suggestion that residential customers have the ability to opt-out by stating that he is unaware of any state that currently allows residential customers to opt out of broad scale energy efficiency programs like the ones Duke Energy Indiana has proposed in this proceeding. He explained that a residential customer opt-out is impractical. Mr. Schultz testified that approximately 110 large customers are eligible to opt-out under the terms of the Amended Opt-Out Settlement, which does not create an administrative burden, whereas a residential customer opt-out provision would require changes to the Company's billing systems and significant new administrative systems that could offer, track, verify, and report residential opt-outs.

Mr. Schultz testified that business customers have competitive concerns that may justify an opt-out of utility-sponsored energy efficiency funding, which do not apply to residential customers. A larger business customer that has implemented energy efficiency efforts on its own does not want to subsidize its competitor's energy efficiency efforts through the utility-sponsored programs.

Mr. Schultz disagreed with Mr. Smith's recommendation of a third-party administrator and stated that utilities are better positioned to design and deliver energy efficiency programs to customers. Mr. Schultz pointed to the Company's existing relationships with customers and the contracting advantages for program design and delivery resulting from its presence across

multiple jurisdictions. He stated that there are no advantages to a third-party administrator and that it increases the cost of administration because of the additional layer of management that has to be funded. Mr. Schultz concluded by testifying that Duke Energy Indiana alone has the responsibility to provide reliable electric service to its customers and that the Company considers energy efficiency an important component of the Company's IRP.

10. Commission Discussion and Findings.

A. Standard for Reviewing Settlement Agreements. Settlements presented to the Commission are not ordinary contracts between private parties. *U.S. Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790, 803 (Ind. 2000). Any settlement agreement that is approved by the Commission "loses its status as a strictly private contract and takes on a public interest gloss." *Id.* (quoting *Citizens Action Coalition v. PSI Energy, Inc.* 664 N.E.2d 401, 406 (Ind. Ct. App. 1996)). Thus, the Commission "may not accept a settlement merely because the private parties are satisfied; rather [the Commission] must consider whether the public interest will be served by accepting the settlement." *Citizens Action Coalition v. PSI Energy, Inc.* 664 N.E.2d at 406. Furthermore, any Commission decision, ruling or order, including the approval of a settlement, must be supported by specific findings of fact and sufficient evidence. *U.S. Gypsum, Inc. v. Indiana Gas Co.*, 735 N.E.2d 790 at 795 (citing *Citizens Action Coalition v. Public Service Co.*, 582 N.E.2d 330, 331 (Ind. 1991)). Our policy regarding settlement agreements is also applicable even though fewer than all of the parties are signatories, or if there is a contested settlement as presented herein. Therefore, before the Commission can approve the settlement agreements in this proceeding, we must determine whether the evidence in this Cause sufficiently supports the conclusion that the settlement agreements are reasonable and just and serve the public interest.

B. Review under the Alternative Utility Regulatory Act. Petitioner elected to be subject to the Alternative Utility Regulatory ("AUR") Act upon filing its verified petition in this proceeding. Petitioner is an energy utility that commenced this Cause for the purpose of seeking Commission approval to implement an ARP, pursuant to Ind. Code § 8-1-2.5-6. Section 6(a) of the AUR Act authorizes the Commission to adopt alternative regulatory procedures, establish rates and charges that are in the public interest, and enhance or maintain the value of the utility's energy services or properties. The alternative regulatory plans and practices authorized by the AUR Act include practices, procedures, and mechanisms focusing on the price, quality, reliability, and efficiency of service. Ind. Code § 8-1-2.5-6(a)(1).

C. Commission Order in Phase II of the DSM Investigation. On December 9, 2009, the Commission issued its Phase II Order in Cause No. 42693, *In the Matter of the Commission's Investigation into the Effectiveness of Demand Side Management Programs* ("Phase II Order"). In this Order, the Commission found that jurisdictional electric utilities, of which Duke Energy Indiana is one, are required to offer certain Core DSM programs ("Core Programs"). The Commission specifically found that all customer classes and market segments should participate and opt-out provisions should not be available at this time. The Core Programs are to include the following: (1) Home energy audit program, (2) Low income weatherization program, (3) Residential lighting program, (4) Energy efficient schools program, and (5) Commercial and Industrial program. To implement these programs, electric utilities are required to pursue coordinated marketing, outreach and consumer education strategies on a statewide basis.

The Commission also determined that an Independent Third Party Administrator should be utilized by the electric utilities to oversee the administration and implementation of the Core Programs. In addition, a DSM Coordination Committee is to be formed to address DSM program oversight generally within the State of Indiana. The Commission also found that a single statewide evaluation protocol was necessary in order to track achievement with DSM goals. Consequently, jurisdictional electric utilities are required to contract with an independent entity to conduct the EM&V with respect to the Core Programs.

Finally, the Commission found that the associated ratemaking and cost recovery issues associated with an electric utility's DSM programs should be addressed on a case by case basis in individual utility proceedings.

D. The Proposed EE Plan as Modified by the Settlement Agreements. Based on the evidence presented, Duke Energy Indiana's proposed 4 year EE Plan as modified by the settlement agreements (hereinafter, "EE Plan") contains many of the programs determined by the Commission in its Phase II Order to be Core Programs. As we have already found that these Core DSM programs are required offerings for jurisdictional electric utilities, the Commission approves Duke Energy Indiana's offering of DSM programs that are considered and determined to be Core Programs in accordance with the requirements of the Phase II Order.

Although the specifics of the Core Programs have yet to be determined, it is clear that Duke Energy's EE Plan also includes programs that exceed or go beyond the type of programs contemplated to be Core Programs. In addition, when the specifics of the Core Programs are determined in accordance with the procedure set forth in the Phase II Order, it is possible that additional aspects of Duke Energy Indiana's proposed DSM programs may exceed what is determined to be part of a Core Program. The Commission considers these DSM programs, or portions of DSM programs, that exceed the Core Programs to be "Core Plus Programs" and hereby approves Duke Energy Indiana's offering of these programs consistent with the findings set forth below.

Even though the Commission finds the cost recovery authorized herein to be reasonable at this time to encourage Duke Energy Indiana to make every effort in the implementation and development of cost-effective DSM programs, the Commission notes that it will again have the opportunity to review and consider the reasonableness of program cost recovery, lost revenues or incentives, such as in a proceeding to approve a new DSM program upon expiration of the one approved herein or as part of additional filings required by the Phase II Order. Duke Energy Indiana, in contrast to other Indiana utilities, has been continuously engaged in DSM programs for a number of years. Thus, we assign considerable credibility to its motives and performance. Nonetheless, as expenditure levels increase dramatically as envisioned by the Commission's directive, a better developed mechanism to confirm the appropriateness of the expenditures is required. In the Phase II Order (at pp. 43-44), we noted the critical importance of EM&V, as well as the lack of a consistent approach across similar programs in Indiana. Both the Commission and Indiana utilities are disadvantaged by the lack of a robust EM&V methodology that allows substantiation of the efficacy of the DSM programs, whether Core or Core-Plus Programs. Establishment of the value for money equation is vital to the acceptance and success of the programs and until such EM&V becomes more generally available and accepted, the

Commission intends to proceed, but with an intense focus on this issue in the interim. We fully expect that upon the expiration of the DSM program approved herein and the submission of new programs, either in accordance with the Phase II Order or in a separate proceeding, the Commission will have better tools available to document the program benefits.⁹ Therefore, the Commission finds that Duke Energy Indiana shall be authorized to offer the EE Plan as set forth below.

1. The Settlement Agreements. Duke Energy Indiana's ARP, as presented in its case-in-chief testimony and modified by the Company's rebuttal testimony and the settlement agreements and supporting testimony filed in this proceeding is consistent with the stated purpose of the Commission's rules regarding Guidelines for Demand-Side Cost Recovery by Electric Utilities ("DSM Rules"), found at 170 IAC 4-8-1 *et seq.* More specifically, the Company's proposal is consistent with section 3(a), which states that the Commission's "regulatory framework attempts to eliminate or offset regulatory or financial bias against DSM, or in favor of a supply-side resource, a utility might encounter in procuring least-cost resources."

The Commission finds that the Vectren Settlement Agreement, the Settlement Agreement with the OUCC and the Amended Opt-Out Settlement, as modified herein, satisfy the public interest standards set forth in Ind. Code § 8-1-2.5-5. Based upon the evidence presented in the verified petition, testimony, the settlement agreements, and testimony in support thereof, the Company's ARP, as modified herein, will provide benefits to Duke Energy Indiana and its customers. Customers will benefit by having a choice of participating in Duke Energy Indiana's energy efficiency portfolio of programs. The evidence demonstrates the results are expected to provide increased customer control over increasing costs for electricity and a reduction in overall energy costs. Duke Energy Indiana expects to benefit by an expanded service portfolio that will enable it to more fully utilize its existing resources.

For these reasons, and as discussed more completely in the findings below, the Commission finds that approval of the ARP, as modified herein, meets the public interest and other considerations of Ind. Code § 8-1-2.5-5. We also find that approval of the ARP as modified will enhance or maintain the value of Duke Energy Indiana's services or property consistent with Ind. Code § 8-1-2.5-6(a)(1)(B) and promote efficiency in rendering retail energy services consistent with Ind. Code § 8-1-2.5-6(a)(2)(B).

The Vectren Settlement Agreement is uncontested and no parties raised any concerns regarding the terms contained therein. The Commission further notes that the Vectren Settlement resolves all issues between Duke Energy Indiana and Vectren North in this proceeding, and commits the settling parties to work together in a collaborative manner to promote energy efficiency in their joint service territories. The Commission finds that the evidence demonstrates the Vectren Settlement Agreement is in the public interest as it promotes the efficient use of both natural gas and electricity, is consistent with the Commission's Phase II Order and therefore should be approved.

⁹ We also recognize that the Commission's DSM Guidelines at 170 IAC 4-8 *et seq.* may also require further review for possible revision.

The Settlement Agreement with the OUCC provides a reasonable framework that will allow Duke Energy Indiana to aggressively pursue energy efficiency measures on a four-year pilot basis, yet at the same time provides a measure of protection for customers from the potential of the Company excessively earning on energy efficiency in this time period. The Company's proposal increases energy efficiency spending and impacts. Additionally, the evidence demonstrates that the Settlement Agreement with the OUCC provides for rigorous review of the Company's EM&V plan – an important aspect of ensuring that energy efficiency efforts result in real verified savings. We also disagree with CAC's contention that the Company's ARP contains unreasonable incentives. The Settlement Agreement with the OUCC provides protection to customers in the form of performance-based earnings caps. The evidence demonstrates that the Settlement Agreement with the OUCC, along with the "Other Provisions" of the Amended Opt-Out Settlement as discussed further below, is in the public interest and provides a compromise framework for moving energy efficiency forward in Indiana. The compromise proposal worked out between Duke Energy Indiana and all but one of the consumer groups in this proceeding is a reasonable step toward increasing Duke Energy Indiana's energy efficiency efforts in the State.

The Opt-Out Settlement and the Amended Opt-Out Settlement (together, the "Opt-Out Settlements") primarily set forth a compromise position by certain parties on the issue of which customers should have access to and pay for utility-sponsored energy efficiency. The Opt-Out Settlements provide that customers with aggregated load of 5 MW or higher have the option to opt-out of Petitioner's (i) demand response programs; and (ii) conservation programs upon a self-certification from the customer that they have performed or plan to perform an energy audit and implement energy efficiency programs.

While we recognize that other states have authorized similar opt-out provisions, we find that the Opt-Out Settlements should be rejected for several reasons. As noted by CAC, significant energy efficiency savings should be achievable in the large customer segment due to the fact that industry accounts for approximately a third of the energy consumed nationally. Although we understand that larger customers often undertake energy efficiency measures on their own, CAC also described many barriers to those energy efficiency investments being made by large customers, including restrictive budgets and a lack of resources. In its Phase II Order (at p. 30), the Commission found that Indiana lags other Midwestern states and the nation in the development of DSM programs and that the exclusion of opt-out provisions at this time was appropriate to "ensure that all DSM opportunities are fully pursued and that significant reservoirs of untapped cost-effective energy efficiency potential are not omitted from consideration." The Phase II Order also established an aggressive DSM savings goal of 2% annual cost-effective DSM savings to be achieved within the next ten years. Consequently, the Commission finds that, at least initially, both Core and Core Plus Programs should be available to all market segments, including commercial and industrial customers.

Furthermore, we find the parties' proposed self-certification process to be wholly deficient. At the hearing, Mr. Schultz confirmed that there are no standards or requirements for what qualifies as an energy audit or assessment and no amount of energy or demand savings that need be achieved to opt-out. TR at C-71, C-72. In fact, under paragraph 3.b. of the Amended Opt-Out Settlement, a commercial or industrial customer need only submit a letter indicating that it *plans* to implement energy efficiency measures or *will perform* an energy analysis in order to

opt-out of the energy conservation programs. The Opt-Out Settlements provide no criteria to determine what plans or investments are sufficient to qualify for self-certification, let alone whether they will be as comprehensive or robust as needed or as can be done through a ratepayer sponsored program. While we understand that commercial and industrial customers that make energy efficiency improvements are paying for energy efficiency on their own, the lack of any confirmation or verification to ensure energy analyses or audits are performed and energy efficiency improvements are made undermines Petitioner's overall energy conservation goals. Therefore, the Commission finds the Opt-Out Settlements, except with respect to the "Other Provisions" of the Amended Opt-Out Settlement as discussed further below, are not in the public interest and should be rejected.

The Amended Opt-Out Settlement also includes a term entitled "Other Provisions," which provides that nothing in this Cause is designed to limit what may be determined in the Commission's investigation into RTO demand response programs in Cause No. 43566, Petitioner's ARP is to be considered a trial program and any expenses or revenues associated with the EE Plan will be included in the Company's FAC earnings and expense tests, which provides additional protection from over-earning during the term of the program. The Commission finds these terms are reasonable, in the public interest and should be approved.

Finally, with regard to future citation of the settlement agreements and Order, we find our approval herein should be construed in a manner consistent with our finding *In Re Richmond Power & Light*, Cause No. 40434 (IURC 03/19/97).

Having found that the Vectren Settlement Agreement, the Settlement Agreement with the OUCC, and the "Other Provisions" of the Amended Opt-Out Settlement are in the public interest and should be approved as set forth herein, we now address more fully certain specific components.

2. Administrator of DSM Programs. CAC questioned whether a third-party administrator would be more appropriate to deliver the DSM programs. Based on the evidence presented and consistent with the Phase II Order, we agree with Duke Energy Indiana that in this instance it is capable of providing the Core Plus Programs and has the expertise and the internal organization necessary to manage delivery of these programs. We also note that Duke Energy Indiana will use third-party contractors to deliver many of its programs via a competitive bid process pursuant to the terms of the Settlement Agreement. However, as noted above, in the Phase II Order (at p. 38) the Commission found that jurisdictional utilities "shall contract with an independent third-party entity for the purpose of jointly administering and implementing the Core Programs." Consequently, the Commission encourages Duke Energy Indiana to consider whether efficiencies or other benefits could be realized by utilizing the same independent third-party administrator to oversee or implement any of its Core Plus Programs.

3. Evaluation, Measurement and Verification. The DSM rules at 170 IAC 4-8-4 place specific requirements upon a utility to develop a plan to evaluate its DSM programs. The proposal put forward by Duke Energy Indiana satisfies those requirements. The Company proposes to do five types of evaluation: cost-effectiveness, impact, measurement, verification, and process evaluations. To effectuate these evaluations, Duke Energy Indiana proposes to perform, or have performed, paper and electronic verification, field verification and monitoring, customer satisfaction surveys, and system performance tests. The Settlement Agreement with

the OUCC provides that the results of the EM&V process will be used to determine the actual MW and MWh achieved.

In addition, as noted in the Settlement Agreement with the OUCC, measurement and verification of programs will also be conducted by an independent third-party and that EM&V reports and evaluations will be completed and provided to the Commission annually. The Advisory Committee review function and the audit dollars for the OUCC provided for in the Settlement Agreement with the OUCC also provide the Commission further assurance that Petitioner's independent EM&V plan will be rigorous and subject to significant scrutiny.

The Commission notes that the Phase II Order (at p. 46) requires jurisdictional utilities to seek "proposals from independent entities to conduct EM&V with respect to the Core Programs and additional DSM Programs undertaken by the parties to ensure that the overall savings objectives identified in [the] Order are being met in a timely and cost effective manner." Consequently, we encourage Duke Energy Indiana to consider utilizing the same third-party evaluator selected in accordance with the Phase II Order for its Core Plus Programs.

4. Incentive Structure. The Settlement Agreement with the OUCC provides a performance incentive mechanism that rewards Petitioner for actual energy efficiency savings achieved. The proposed incentive mechanism is based on the performance of the programs measured in terms of their actual energy and demand savings compared to projected energy and demand savings.

The DSM Rules authorize the Commission, when it deems appropriate, to provide incentives "to encourage participation in and promotion of a demand-side management program." 170 IAC § 4-8-7(a). With respect to the Core Programs, the Commission found in its Phase II Order that jurisdictional electric utilities should have a standard group of core DSM programs as part of its basic utility service offering. As the Core Programs are required offerings, we find the structure of the regulatory compact in Indiana provides the necessary incentive to encourage the implementation and administration of such programs.

With respect to the Core Plus Programs, however, the Commission finds that a performance incentive mechanism is appropriate in light of the Commission's DSM Rules, the strengthening national trend toward promoting energy efficiency, the aggressive savings goals contained in the Phase II Order, and the evidence presented in this proceeding. The maximum incentive that can be achieved under the Company's proposal is a 15% return on program costs. Although CAC argued that this incentive structure is too high, CAC failed to demonstrate that the incentives are unreasonable. Mr. Schultz testified that shared savings approaches typically provide for savings in the range of 10% to 25%, and Duke Energy Indiana's maximum target would be equivalent of a 20% shared savings approach. Further, a unique feature of the Company's plan, compared to other incentive structures, such as a return on program costs or even shared savings approaches, is that the Company does not get paid if it does not produce results. The Company must demonstrate measurable savings through independent EM&V analysis, or it is at risk of not recovering its program costs. Additionally, under the Company's proposal, if the energy efficiency results do not materialize as planned and the utility needs to

make up the difference with power purchases, the customer does not pay twice because customers will not be charged for energy efficiency savings that do not occur.

The Settlement Agreement with the OUCC provides for a tiered incentive structure, with maximum amounts based on actual achievements, as measured and verified by an independent third-party. In addition, the Settlement Agreement with the OUCC provides for a number of customer protections to ensure that the Company does not earn an excessive incentive. We find the proposed incentive mechanism for the Core Plus Programs to be reasonable and therefore approve it.

5. Advisory Committee Structure. The Settlement Agreement with the OUCC creates an Advisory Committee, consisting of voting representatives from Duke Energy Indiana and the OUCC. The Settlement Agreement also provides for the Commission to have a representative on the Advisory Committee, either in a voting or non-voting capacity, as well other non-voting members as may be appropriate or desired. The Advisory Committee has numerous responsibilities, including collaboration on program and pilot development and modification, the design of an appropriate methodology to be used to evaluate the performance of the energy efficiency programs, and review the results of all programs and interim EM&V reports on an annual basis.

The Commission has approved advisory committees or oversight boards in gas DSM proceedings and have found them to be an effective mechanism for managing programs and resolving issues. Consequently, the Commission finds the creation of an Advisory Committee to be reasonable and appropriate. However, as noted above, in the Phase II Order (at p. 41-42), the Commission established a DSM Coordination Committee to oversee and address DSM program oversight in the State of Indiana. Therefore, the Commission encourages Petitioner to consider utilizing the DSM Coordination Committee established in the Phase II Order to also oversee its Core Plus Programs in lieu of its proposed Advisory Committee.

6. Compliance Filing. In order to implement the Commission's findings contained herein, Duke Energy Indiana shall make a Compliance Filing in this Cause of the new Standard Contract Rider 66 – Energy Efficiency Revenue Adjustment (“Rider EE”) and all supporting documents incorporating the findings herein. Given the significant alterations made in this Order to Duke Energy Indiana's proposed EE Plan, the Commission finds that upon Duke Energy Indiana's filing of its revised Rider and supporting documentation, the parties to this proceeding shall have ten (10) days to review the filing and notify the Commission of any objections to the filing. If the parties do not raise any objections and the Commission does not otherwise notify Petitioner within ten (10) days of its Compliance filing, the revised Rider will be approved and become effective upon the date of approval.

Regarding Petitioner's existing DSM Rider No. 66, Duke Energy Indiana shall close out the existing Rider No. 66 concurrent with the implementation of the new Rider EE. Duke Energy Indiana shall submit a reconciliation of costs recoverable via the existing DSM rider within six months after the effective date of new Rider EE.

7. **Accounting Provisions.** Petitioner has proposed that revenues and expenses of the Company's energy efficiency plan be included in future FAC earnings and expense test calculations. Mr. Farmer explained that revenues billed retail customers via Rider EE, whether for the recovery of lost margins, the recovery of program costs or the recovery of the management incentive will be included in future FAC earnings test. Mr. Farmer also explained that expenses of the energy efficiency plan recorded on the Company's books and records will be included in both earnings test and expense test calculations. The Company will monitor, on an ongoing basis, any adjustments to rates that might potentially result from the true-up process and will record either a regulatory asset or regulatory liability on its books, subject to guidelines included in promulgated accounting literature, that will quantify the difference between amounts billed customers and amounts ultimately due the Company. Mr. Farmer explained that the income statement effects associated with the recorded regulatory assets or liabilities will be included in the FAC tests. He also explained that accounting rules require that regulatory commissions clearly acknowledge that future rates may be adjusted to reflect the difference between verified amounts due the Company and amounts billed customers before a regulatory asset may be recorded. Finally, Mr. Farmer explained that the Company's initial request to defer program costs is not needed. No party objected to the Company's proposed accounting treatment. This Order explicitly authorizes Duke Energy Indiana to adjust future rates for results that may occur due to the true-up process at the end of the four-year term. Petitioner is authorized to include the income statement effects of a regulatory asset or regulatory liability, whichever is appropriate, in future FAC earnings test calculations.

11. **Petitioner's Request for Confidential Treatment.** Petitioner filed a Motion for Protection of Confidential and Proprietary Information, with Affidavits of Dr. Richard G. Stevie and Ms. Diane L. Jenner, on December 19, 2007. In its Motion, Petitioner indicated a need for confidential treatment for estimates of avoided costs, spreadsheet programs, and performance data developed internally by Duke Energy Indiana.

The Affidavits of Dr. Stevie and Ms. Jenner indicate that such confidential information has actual or potential independent economic value to competitors, the disclosure of the confidential information could provide competitors with an unfair advantage, and Petitioner has taken all reasonable steps to protect the confidential information from disclosure. In a January 2, 2008 Docket Entry, the Presiding Officers made a preliminary finding that such information should be subject to confidential treatment.

In addition, Petitioner filed a Motion for Protection of Confidential and Proprietary Information, with the Affidavit of Dr. Stevie on July 2, 2008. In this Motion, Petitioner indicated a need for confidential treatment for certain detailed cost estimates for Duke Energy Indiana's ARP, which were included in Petitioner's rebuttal testimony and exhibits, some of which were derived from an updated previously filed workpaper of Dr. Stevie and covered by the previous Motion and Docket Entry. Dr. Stevie indicated that such confidential information has actual or potential independent economic value to competitors, the disclosure of the confidential information could provide competitors with an unfair advantage, and Petitioner has taken all reasonable steps to protect the confidential information from disclosure. In a July 9, 2008, Docket Entry, the Presiding Officers made a preliminary finding that such information should be subject to confidential treatment. Based on the foregoing, pursuant to Ind. Code § 5-14-3-4(a)(4), we find that the various detailed cost estimates presented in this proceeding are "trade

secret” and should be afforded confidential treatment. Accordingly, the information is exempted from public disclosure and will be held as confidential by the Commission.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. The Stipulation and Settlement Agreement between the Company and Vectren North dated May 29, 2008, the Stipulation and Agreement between the Company and the OUCC dated August 15, 2008 and the Amended and Restated Stipulation and Agreement dated January 15, 2009 between the Company and DEI-IG, Wal-Mart, Nucor, SDI, Kroger, and the OUCC (which are incorporated herein and attached hereto as Attachment A), are hereby approved as modified in Finding Paragraph 10 above and shall constitute Petitioner’s approved Alternative Regulatory Plan.

2. The Stipulation and Agreement dated October 31, 2008 between the Company and Nucor, SDI, Kroger, and the OUCC is hereby rejected in its entirety.

3. Petitioner’s proposed ratemaking and accounting requests are hereby approved.

4. Petitioner shall place into effect its new Rider EE approved herein, applicable to all bills rendered beginning with and subsequent to the date upon which the new Rider EE is filed with the Commission’s Electricity Division, consistent with Finding Paragraph No. 10.D.7 above.

5. Upon the effective date of new Rider EE, Petitioner shall terminate existing Standard Contract Rider No. 66. Further, Petitioner shall file, in a docketed proceeding, a final true up of the existing Rider 66 within six months of its termination date.

6. Petitioner’s request for confidential trade secret treatment is hereby approved.

7. This order shall be effective on and after the date of its approval.

HARDY, ATTERHOLT, GOLC, LANDIS AND ZIEGNER CONCUR:

APPROVED: FEB 10 2010

I hereby certify that the above is a true and correct copy of the Order as approved.



Brenda A. Howe
Secretary to the Commission

ATTACHMENT A

COPY

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

FILED

MAY 29 2008

VERIFIED PETITION OF DUKE ENERGY INDIANA, INC.)
 REQUESTING THE INDIANA UTILITY REGULATORY)
 COMMISSION TO APPROVE AN ALTERNATIVE)
 REGULATORY PLAN PURSUANT TO IND. CODE § 8-1-2.5-)
 1, ET SEQ., FOR THE OFFERING OF ENERGY)
 EFFICIENCY CONSERVATION, DEMAND RESPONSE,)
 AND DEMAND-SIDE MANAGEMENT PROGRAMS AND)
 ASSOCIATED RATE TREATMENT INCLUDING)
 INCENTIVES PURSUANT TO A REVISED STANDARD)
 CONTRACT RIDER NO. 66 IN ACCORDANCE WITH IND.)
 CODE §§ 8-1-2.5-1 ET SEQ. AND 8-1-2-42 (a); AUTHORITY)
 TO DEFER PROGRAM COSTS ASSOCIATED WITH ITS)
 ENERGY EFFICIENCY PORTFOLIO OF PROGRAMS;)
 AUTHORITY TO IMPLEMENT NEW AND ENHANCED)
 ENERGY EFFICIENCY PROGRAMS, INCLUDING THE)
 POWERSHARE® PROGRAM IN ITS ENERGY EFFICIENCY)
 PORTFOLIO OF PROGRAMS; AND APPROVAL OF A)
 MODIFICATION OF THE FUEL ADJUSTMENT CLAUSE)
 EARNINGS AND EXPENSE TESTS)

INDIANA UTILITY
REGULATORY COMMISSION

CAUSE NO. 43374

STIPULATION AND SETTLEMENT AGREEMENT

Petitioner Duke Energy Indiana, Inc. and Intervenor Indiana Gas Company, Inc. d/b/a
 Vectren Energy Delivery of Indiana, Inc. ("Vectren North") (each a "Party" and collectively
 "Parties"), solely for the purpose of compromise and settlement and having been duly advised by
 their respective staff, experts, and counsel, stipulate and agree to the matters contained herein
 subject to their approval by in a final order of the Indiana Utility Regulatory Commission ("Final
 Order") without changes or conditions unacceptable to either Party hereto. If this Agreement is
 not approved by the Commission and incorporated in the Final Order or if it is approved with
 changes that are unacceptable to either party, the entire Agreement shall be null and void and
 deemed withdrawn, and a new procedural schedule shall be established that will provide Vectren

North with the opportunity to submit evidence on Duke Energy Indiana's petition, proposals and case-in-chief.

I. Terms and Conditions.

1. **Agreement on all matters.** This Agreement resolves all issues in Cause No. 43774 between Vectren North and Duke Energy Indiana.

2. **Commitment to work together going forward.** The Parties agree that customer benefits can arise by the electric and natural gas utilities serving in the same area working cooperatively together on energy efficiency programming, particularly energy efficiency audits and low income offerings as well as the development of advanced metering infrastructure solutions. The Parties agree to begin meeting collaboratively no later than February 1, 2009 to determine whether efficiencies can be gained through joint programs or offerings for conservation and coordinated investment in advanced metering infrastructure. The Parties reserve their rights to propose individual programs, as well as to object to the programs proposed by the other Party at any time.

3. **Duke Energy Indiana's proposal concerning changes to its approved measures or programs.** Duke Energy Indiana agrees that its program flexibility request within a specific program year is limited to the amount it spends on the various approved programs and measures. Duke Energy Indiana agrees not to add new energy efficiency measures or energy efficiency programs without further Indiana Utility Regulatory Commission ("IURC") approval in one of its annual Standard Contract Rider No. 66 true-up proceedings, or a separate proceeding before the IURC. Vectren North retains the right to object to such new measures or

programs in such future proceedings. Duke Energy Indiana agrees not to object to the right of Vectren North to intervene or file testimony in such proceeding.

4. **Revised Description of the Energy Savings Plan Pilot.** Duke Energy Indiana agrees to revise its program description for the proposed Efficiency Savings Plan (Pilot) as follows:

Program: This is a pilot research and development program designed to learn about and develop a financing structure that helps customers overcome up-front capital outlays for energy efficiency equipment financing. This program will allow residential and non-residential customers to install energy efficiency products associated with the approved energy efficiency programs with no up-front payment. The customer would pay for these products through a tariff charge on their Duke Energy Indiana bill. The tariff would be a utility charge that would remain with the facility, not the customer.

5. **Revised Description of Residential Smart Saver® Air Conditioners and Heat Pumps Incentive Program.** This program will provide incentives to customers, builders, and heating contractors (HVAC dealers) to promote the use of high-efficiency air conditioners and heat pumps with electronically commutated fan motors ("ECM"). The program is designed to increase the efficiency of HVAC systems in new homes and for replacements in existing homes.

Eligibility: Owner-occupied residences, condominiums, and mobile homes served by Duke Energy Indiana are eligible for both the air conditioner and heat pump components of this program. If a home is either currently heated by a natural gas furnace, or if natural gas is available at a new home, then a heat pump incentive is available if a heat pump is installed with an ECM as part of a dual fuel system that uses natural gas as the supplemental heat source.

Customer Incentive: Incentives (rebates) will be paid to the builder (new homes) or for existing homes, part to the homeowner and part to the HVAC contractor. The rebate per HVAC unit is \$300.00.

Marketing: This program will be promoted by targeted direct marketing offers to HVAC contractors and homeowners with aging equipment.

Delivery Organization(s): Energy efficient heat pumps and air conditioners will be sold and installed by qualified dealers.

II. Presentation of the Agreement to the Commission.

The Parties agree that this Agreement represents a fair and reasonable resolution of the issues between them in this cause. The Parties shall support this Agreement before the IURC and request that the IURC accept and approve the Agreement without changes or conditions unacceptable to either Party. The Parties further agree that each will prefile testimony in this cause supporting the Agreement.

III. Effect and Use of Agreement.

1. Neither the making of this Agreement nor any of its provisions shall constitute in any respect an admission by any Party in this or any other litigation or proceeding, nor the entry by the IURC of a Final Order approving this Agreement, shall establish any principles or legal precedent applicable to Commission proceedings other than that resolved herein.

2. This Agreement shall not constitute nor be cited as precedent by any person or deemed an admission by any Party in any other proceeding except if necessary to enforce its terms before the Commission, or any state court of competent jurisdiction on these particular

issues. This Agreement is solely the result of compromise in the settlement process and except as provided herein, is without prejudice to and shall not constitute a waiver of any position that any of the Parties may take with respect to any or all of the items resolved herein or in any future regulatory or other proceedings.

3. The evidence to be submitted in support of this Agreement will constitute substantial evidence sufficient to support the Agreement and will provide an adequate evidentiary basis upon which the Commission can make any findings of fact and conclusions of law necessary for the approval of the Agreement.

4. The communications and discussions during the negotiations and conferences which have produced this Agreement have been conducted on the explicit understanding that they are, or relate to, offers of settlement and shall be privileged and confidential, shall be without prejudice to the position of any Party, and are not to be used in any manner in connection with any other proceeding or otherwise.

5. The undersigned Parties have represented and agreed that they are fully authorized to execute the Agreement on behalf of their designated clients who will be bound hereby.

6. The Parties shall support this Agreement, following its approval by the Commission, in the event of any appeal or a request for a stay by a person not a party hereto, giving due regard to resource limitations and other practical considerations.

7. The provisions of this Agreement shall be enforceable by any Party before the Commission, and thereafter in any state court of competent jurisdiction as necessary.

ACCEPTED and AGREED this 29th day of May, 2008.

DUKE ENERGY INDIANA, INC.

INDIANA GAS COMPANY, INC.
d/b/a VECTREN ENERGY
DELIVERY OF INDIANA, INC.

By: Melanie D Price
Melanie D. Price
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100 East Main Street
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By: Robert E. Heidorn *DWM*
Robert E. Heidorn
VECTREN CORPORATION
One Vectren Square
211 N.W. Riverside Drive
Evansville, IN 47708

**STATE OF INDIANA
BEFORE THE
INDIANA UTILITY REGULATORY COMMISSION**

**VERIFIED PETITION OF DUKE ENERGY)
INDIANA, INC. REQUESTING THE INDIANA)
UTILITY REGULATORY COMMISSION TO)
APPROVE AN ALTERNATIVE REGULATORY)
PLAN PURSUANT TO IND. CODE § 8-1-2.5-1, *ET*)
SEQ., FOR THE OFFERING OF ENERGY)
EFFICIENCY CONSERVATION, DEMAND)
RESPONSE, AND DEMAND-SIDE MANAGEMENT)
PROGRAMS AND ASSOCIATED RATE)
TREATMENT INCLUDING INCENTIVES)
PURSUANT TO A REVISED STANDARD)
CONTRACT RIDER NO. 66 IN ACCORDANCE)
WITH IND. CODE §§ 8-1-2.5-1 *ET SEQ.* AND)
8-1-2-42(a); AUTHORITY TO DEFER PROGRAM)
COSTS ASSOCIATED WITH ITS ENERGY)
EFFICIENCY PORTFOLIO OF PROGRAMS;)
AUTHORITY TO IMPLEMENT NEW AND)
ENHANCED ENERGY EFFICIENCY PROGRAMS,)
INCLUDING THE POWERSHARE® PROGRAM IN)
ITS ENERGY EFFICIENCY PORTFOLIO OF)
PROGRAMS; AND APPROVAL OF A)
MODIFICATION OF THE FUEL ADJUSTMENT)
CLAUSE EARNINGS AND EXPENSE TESTS)**

CAUSE NO. 43374

**STIPULATION
AND
AGREEMENT**

August 15, 2008

STIPULATION AND AGREEMENT

This Stipulation and Agreement ("Agreement") is entered into this 15th day of August, 2008, by and between Duke Energy Indiana, Inc. ("Duke Energy Indiana") and the Indiana Office of Utility Consumer Counselor ("OUCC") (together "the Parties").

WHEREAS, the Parties to this Agreement have engaged in extensive, arms' length settlement negotiations in an effort to constructively resolve their differences in this proceeding;

WHEREAS, the Parties believe that this Agreement is sound, it reasonably balances both Duke Energy Indiana's and ratepayers' interests; and is in the public interest;

WHEREAS, the Agreement retains many important features of Duke Energy Indiana's initial Save-a-Watt proposal, such as:

- Compensation to Duke Energy Indiana for successful implementation of energy efficiency programs on the basis of a discount to the "avoided costs" of a power plant, rather than on the basis of what the utility spends on energy efficiency programs;
 - Pay for performance, in that the avoided cost compensation described above is based upon actual energy efficiency savings achieved, measured and verified by an independent third party;
 - The potential for an incentive for Duke Energy Indiana if it effectively and efficiently implements and delivers energy efficiency programs to its customers;
- but,

- Duke Energy Indiana remains at risk, based upon its actual performance, for recovery of its energy efficiency program costs, as well as any management incentive;

WHEREAS, the Agreement also includes a number of provisions that are very important to the OUCC, on behalf on Indiana consumers, such as:

- Performance targets, with Duke Energy Indiana eligible for a higher level of incentive based on how well it performs in achieving energy efficiency results which lead to actual savings for its customers;
- Earnings caps – which vary by performance while limiting the amount of incentive for which Duke Energy Indiana is eligible;
- A rate impact cap – to ensure that during the 4-year term of this agreement, even residential customers who choose not to participate in energy efficiency programs will not experience a significant rate increase as a result of the Save-a-Watt program;
- A financial commitment to contract with Indiana businesses to assist in implementation of the energy efficiency programs; and
- A commitment to provide \$250,000 in targeted grants to post-secondary institutions for specialized energy efficiency education programs.

NOW, THEREFORE, the Parties agree as follows:

1. Scope of Agreement. This Agreement comprehensively resolves all issues between the Parties associated with Duke Energy Indiana's save-a-watt program as filed in Cause No. 43374.

a). Agreement Framework. Attached hereto as Exhibit A is a Term Sheet setting forth specific provisions of the settlement ("Settlement Terms") that is intended by the Parties to resolve all pending issues relating to Cause No. 43374. The terms of the Agreement are effective upon approval by the Indiana Utility Regulatory Commission ("Commission"). Also attached hereto, as Exhibit B, is a chart summarizing (1) Duke Energy Indiana's initial save-a-watt proposal, (2) the major issues raised by the OUCC in their testimony filed in this Cause, and (3) how the Settlement Terms address those issues raised by the OUCC, resulting in a comprehensive compromise that forms the basis for this Agreement.

2. Integration. Approval of this Agreement constitutes approval of the Settlement Terms attached hereto as Exhibit A.

3. Presentation of the Agreement.

a). The Parties shall jointly move to have this Agreement presented to and approved by the Commission.

b). The Agreement, including the Settlement Terms in Exhibit A, is not severable and shall be accepted or rejected by the Commission in its entirety without modification or further condition that may be unacceptable to either Party.

4. Effect and Use of Stipulation and Agreement.

a). The terms of this Agreement, including the Settlement Terms in Exhibit A, represent a fair, just and reasonable resolution by negotiation and compromise. As set forth in the Order in *Re Petition of Richmond Power & Light*, Cause No. 40434 at page 10, as a term of

this Agreement, the Commission must assure the Parties that it is not the Commission's intent to allow this Agreement, or the Order approving it, to be cited as precedent by any person or deemed an admission by any Party in any other proceeding except as necessary to enforce its terms before the Commission, or any court of competent jurisdiction on these particular issues. This Agreement, including the Settlement Terms in Exhibit A, is solely the result of compromise in the settlement process. Nothing contained herein is to be construed or deemed an admission, liability or wrongdoing on the part of either party to this Agreement. Both of the parties hereto have entered into this Agreement solely to avoid further disputes and litigation with the attendant inconvenience and expenses.

b). The evidence presented by the Parties in this Cause, including testimony offered in support of Settlement, constitutes substantial evidence sufficient to support this Agreement and provides an adequate evidentiary basis upon which the Commission can make any findings of fact and conclusions of law necessary for the approval of this Agreement, as filed.

c). The issuance of a Final Order by the Commission approving this Agreement, including the Settlement Terms specified in Exhibit A, without modification shall terminate all proceedings in regard to this Agreement.

d). The undersigned represent and agree that they are fully authorized to execute this Agreement on behalf of their designated clients who will be bound thereby.

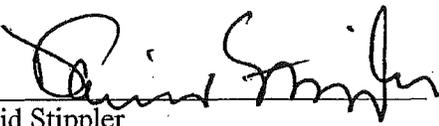
e). The Parties shall not appeal the agreed final Order or any subsequent Commission order to the extent such order is specifically implementing, without modification, the provisions of this Agreement, including the Settlement Terms in Exhibit A, and the Parties shall not support any appeal of any such order by a person not a party to this Agreement.

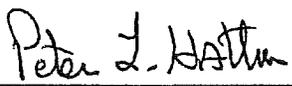
f). The provisions of this Agreement, including the Settlement Terms in Exhibit A, shall be enforceable by any party at the Commission or any court of competent jurisdiction, whichever is applicable.

g). The communications and discussions during the negotiations and conferences which produced this Agreement, including the Settlement Terms in Exhibit A, have been conducted on the explicit understanding that they are or relate to offers of settlement and shall therefore be privileged.

ACCEPTED AND AGREED this 15th day of August, 2008.

By: _____
Jim Stanley
President, Duke Energy Indiana,

By: 
David Stippler
Indiana Office of Utility Consumer Counselor

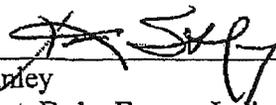
By: 
Peter L. Hatton
Attorney for Duke Energy Indiana

By: 
Randall Helmen
Attorney for the Indiana Office of Utility Consumer
Counselor

f). The provisions of this Agreement, including the Settlement Terms in Exhibit A, shall be enforceable by any party at the Commission or any court of competent jurisdiction, whichever is applicable.

g). The communications and discussions during the negotiations and conferences which produced this Agreement, including the Settlement Terms in Exhibit A, have been conducted on the explicit understanding that they are or relate to offers of settlement and shall therefore be privileged.

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Jim Stanley
President, Duke Energy Indiana,

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David Stippler
Indiana Office of Utility Consumer Counselor

By: _____
Peter L. Hatton
Attorney for Duke Energy Indiana

By: _____
Randall Helmen
Attorney for the Indiana Office of Utility Consumer
Counselor

SETTLEMENT TERMS

A. Initial Programs

RESIDENTIAL CUSTOMER PROGRAMS

- Residential Energy Assessments
- Smart Saver[®] for Residential Customers
- Low-Income Services
- Energy Efficiency Education Program for Schools
- Power Manager

NON-RESIDENTIAL CUSTOMER PROGRAMS

- Non-Residential Energy Assessments
- Smart Saver[®] for Non-Residential Customers
- PowerShare[®] (subject to the conditions set forth in Section L. below)

In addition, research programs may be included to begin pilots with customers to determine the potential impacts of these new programs. However, Duke Energy Indiana agrees not to offer these programs or its the Efficiency Savings Plan in its initial portfolio of programs, but will present the programs to the Advisory Committee for consideration before Duke Energy Indiana offers them as pilot programs.

B. Term

1. The term of the settlement agreement shall be 4 years; however, cost recovery shall continue through year 6 as necessary to enforce its terms.

C. Compensation for Results

2. The Company will be compensated based on its ability to achieve verified MW and MWh reductions that create avoided cost savings on behalf of customers. The Company will retain a percentage of avoided cost savings, as set out below, in order to recover the cost of marketing, implementing and administering energy efficiency programs, impact evaluation studies and to provide the utility with an incentive for the successful

management of energy efficiency programs. Any incentive that may be due the Company will be funded by the avoided cost savings retained by the Company.

2. Total avoided cost savings shall be measured based on actual MW and MWh reductions achieved applicable to energy efficiency programs multiplied by MW and MWh avoided cost rates as described in Section H below. Reductions in MWs and MWhs shall be measured and verified by an independent-third party acceptable to the advisory committee. The percentage of avoided costs will differ for demand response and conservation programs in order to mitigate any bias that may exist between demand response and energy conservation programs from a profitability perspective and so that the Company will be indifferent to the percentage relationship of demand response and conservation programs when determining the optimal mix of programs during the term of the Settlement Agreement. The Company assumes the risk that energy efficiency savings retained by the Company will not cover the costs of marketing, implementing or administering the energy efficiency programs or provide an incentive for the successful management of energy efficiency programs during the period of the Settlement Agreement. The percentage of avoided costs retained by the Company will vary, depending upon the success with which the Company manages its energy efficiency programs as set forth below:

Demand Response % of Avoided Costs	Conservation % of NPV of Avoided Costs
75%	60%

Revenue = Demand Response: 75% of avoided capacity costs +
 Energy Conservation: 60% of NPV of avoided energy costs +
 60% of NPV of avoided capacity costs

Costs = Program costs in year incurred

3. The Company shall use the same value for avoided costs when determining targeted cost savings and actual cost savings.

D. Performance Targets and Earnings Cap

1. The Company shall have the opportunity to earn an incentive for the successful management of energy efficiency programs which shall be tied to performance relative to energy efficiency plan targets. The energy efficiency plan is forecasted to produce total avoided cost savings of \$260 MM (nominal dollars) due to programs implemented during the 4-year term of the agreement. The performance targets are set as a percentage of actual achievement relative to the \$260 MM in targeted cost savings. The performance targets and earnings caps are as follows:

% Target Achievement	Capped Rate of Return on Program Costs
90% to 100%	15%
80% to 89%	12%
60% to 79%	9%
<60%	5%

It should be noted that program cost recovery is not guaranteed. With save-a-watt, the Company assumes the risk that the avoided cost revenues will cover program costs.

2. The total avoided cost savings used to determine compensation levels shall not exceed the targeted total avoided cost level of \$260 MM. In addition, the Company agrees to limit rate impact to the RS rate class to a maximum of 3.0% for the Rider EE (see Table F-2). This rate limit applies to the combined revenue requirement for EE programs under save-a-watt and all associated lost revenues.

Should the Company decide to pursue innovative new program ideas that seem unattainable today to further reduce carbon emissions in the state of Indiana which may cause the Company to exceed the agreed upon limits, it will first seek input from the Advisory Committee and request authority from the IURC to pursue those programs. Based upon recent experience in other energy efficiency initiatives and collaboratives, the OUCC believes the Commission should retain its authority to establish all regulated retail rates, which in this case, may be accomplished by establishing a firm cap.

3. The management incentive, which shall be calculated as an after-tax return on actual program costs incurred, shall not exceed (i.e., shall be capped) at the rates set forth in Section D.1. above. To the extent Company earnings, at the end of the four-year settlement period exceed the capped earnings, such excess earnings shall be refunded to customers. The after-tax return on actual program costs shall be grossed-up for applicable taxes when determining amounts to be returned or recovered from customers.
4. The target achievement of \$260MM (nominal dollars) due to programs implemented during the 4-year term of the agreement is tied to the following targeted MW and cumulative MWh savings:

	Portfolio Impacts at 100% Participation				
	Indiana				
Year	1	2	3	4	Beyond Yr 4
MWh	69,269	146,592	215,334	296,466	1,585,571
MW	317	403	451	496	96

5. The targets submitted in the Company's plan assume 100% participation. Final target discussions should remain open as opt-out provisions and other key issues are discussed with other intervening parties.
6. The estimated relative profitability outcome of various combinations of demand response and conservation programs is shown below for illustrative purposes only. Any incentive ultimately earned by the Company will depend on the Company's ability to achieve actual savings on behalf of customers.

Portfolio ROI Matrix Based on Participation

Indiana		Conservation Participation Levels					
		100%	90%	80%	70%	60%	50%
Demand Response Participation Levels	100%	15.0%	15.0%	12.0%	9.0%	9.0%	5.0%
	90%	15.0%	15.0%	12.0%	9.0%	9.0%	5.0%
	80%	12.0%	12.0%	12.0%	9.0%	8.0%	5.0%
	70%	9.0%	9.0%	9.0%	9.0%	6.0%	3.0%
	60%	9.0%	9.0%	9.0%	7.0%	4.0%	1.0%
	50%	5.0%	5.0%	5.0%	5.0%	2.0%	(2.0%)

7. The carbon offsets generated by the Company's proposal are estimated to be slightly more than 2 million tons

Carbon Tons Offset

Estimated based on 100% Participation Level

Indiana	
Sum of MWh Impacts Over Life of Measures	2,313,233
Carbon Tons Avoided Per MWh	0.97
Total Carbon Offset (tons)	2,243,836

8. The Company agrees that future revenues from carbon emission allowances resulting from save-a-watt programs will be credited to those jurisdictional ratepayers that funded related expenses.

E. Lost Revenues

1. The Company shall recover 100% of the lost revenues via Rider EE. The Company will terminate the recovery of lost revenues for each vintage year of EE installations 3 years following the end of such vintage year to reflect the effect of opportunity sales. The recovery of lost revenues will end in the event that decoupling or an alternative recovery mechanism is implemented or a general rate case is implemented.

Estimated Lost Revenues:

Lost Margins By Vintage								
<i>Estimated based on 85% Achievement and Lost Margins, 3-year term, 4 vintages</i>								
Indiana								
Projected Revenue Requirement Billed	1	2	3	4	5	6	7	Sum Total
First Year Vintage	\$2,076,681	\$2,076,681	\$2,076,681					\$6,230,044
Second Year Vintage		\$2,419,912	\$2,419,912	\$2,419,912				\$7,259,736
Third Year Vintage			\$2,272,914	\$2,272,914	\$2,272,914			\$6,818,743
Fourth Year Vintage				\$2,768,034	\$2,768,034	\$2,768,034		\$8,304,101
Total	\$2,076,681	\$4,496,593	\$6,769,508	\$7,460,860	\$5,040,948	\$2,768,034	\$0	\$28,612,624

F. Revenue Requirements

1. The intent of this design is to recover the full revenue requirements during the 4-year term of this agreement. The Company agrees to forego any “revenue reshaping” and, instead, base cost recovery on avoided costs applicable to the energy efficiency programs. Revenues collected from customers during the term of the agreement will be based on the expected avoided costs to be achieved during the term of this period and an 85% level of achievement. These forecasts and assumptions produce revenue requirements, which shall then be trued up to actual results at the end of the agreement. If the Company over-collects revenues from customers, the amount of over-collection shall be refunded at an annual rate of 6%; if the company under-collects revenues from customer, the amount of under-collections shall be collected with no (0%) annual carrying charge.

2. The initial revenue requirements and estimated percentage increase in overall customer rates calculated based on 85% achievement levels are listed below:

Revenue Requirements:

Total Revenue Requirements							
<i>Estimated based on 85% Achievement</i>							
Indiana	1	2	3	4	5	6	Sum Total
Incremental Energy Savings (MWh)	58,879	65,725	58,431	68,962	0	0	
Incremental Energy as % of 2009-Sales	0.20%	0.22%	0.20%	0.24%	0.00%	0.00%	
Cumulative Energy as % of 2009-Sales	0.20%	0.43%	0.62%	0.86%	0.86%	0.86%	
Retail Sales Forecast (MWh)	29,291,294	29,549,786	29,932,999	30,021,739	30,007,518	30,061,389	
Cumulative Energy Savings (MWh)	58,879	124,603	183,034	251,996	248,946	215,340	
Retail Sales Forecast after EE savings (MWh)	29,232,415	29,425,183	29,749,965	29,769,743	29,758,572	29,846,049	
Estimated Energy Efficiency Revenues	\$28,414,809	\$30,132,063	\$30,324,422	\$33,619,740	\$0	\$0	\$122,491,033
Rate \$/kWh	\$0.00097	\$0.00102	\$0.00102	\$0.00113	\$0.00000	\$0.00000	
Rate Change (based on June 2007 rev)	1.58%	1.68%	1.69%	1.87%	0.00%	0.00%	
Estimated Lost Margins	\$2,076,681	\$4,496,593	\$6,769,508	\$7,460,860	\$5,040,948	\$2,768,034	\$28,612,624
EE Rate \$/kWh	\$0.00007	\$0.00015	\$0.00023	\$0.00025	\$0.00017	\$0.00009	
Rate Change (based on June 2007 rev)	0.12%	0.25%	0.38%	0.42%	0.28%	0.15%	
Total Revenue Requirement	\$30,491,490	\$34,628,656	\$37,093,929	\$41,080,600	\$5,040,948	\$2,768,034	\$151,103,657
Rate \$/kWh	\$0.00104	\$0.00118	\$0.00125	\$0.00138	\$0.00017	\$0.00009	
Rate Change (based on 2007 rev)	1.70%	1.93%	2.07%	2.29%	0.28%	0.15%	

- It is not Duke Energy's intention to charge customers twice for the same demand response equipment. Because the save-a-watt model indirectly compensates the Company for demand response equipment, Duke Energy shall credit the full installed cost of existing demand response equipment back to customers. Such credit will be equally spread out over the term of the agreement. The Company estimates that a total credit shall be in the amount \$6,229,115, of which \$1,557,279 would be credited back to customers in each year.

G. True-Up Process

- Annual amounts billed customers during the term of the four-year pilot program will be fixed based on the values for each year set forth in Section F above. Any difference between amounts billed customers or amounts due the Company based on the terms of the Settlement Agreement, as determined at the end of the settlement period, shall be returned to customers or recovered from customers via Rider EE. Duke Energy Indiana shall not file updates or change the annual jurisdictional revenue requirement levels billed customers during the settlement period, as set out in Section F.2., unless it

becomes apparent that estimated amounts owed customers or amounts owed the Company at the end of the settlement period will be greater than a 1.5% change in the total customer rates in a single year.

2. The true-up process will incorporate the following provisions:

- a. Actual avoided cost savings will be compared to targeted avoided cost savings at the end of year 4 as follows:

$$\text{Actual cost savings/target cost savings} = \% \text{ Target Achievement}$$

- b. The percentage of actual target achievement is used in conjunction with the table in Section D. above to determine the appropriate earnings cap.
- c. The net income based on actual savings is calculated and compared to the applicable earnings cap.
- d. Any difference between the Company's net income and the amount collected from customers based on the initial revenue requirement during the 4-year term will be reconciled between customers and the Company.
- e. If the Company over-collects revenues from customers, the amount of over-collection shall be refunded at an annual rate of 6%; if the company under-collects revenues from customer, the amount of under-collections shall be collected with no (0%) annual carrying charge.

3. Any difference between lost revenues billed customers and lost revenue due the Company based on results of the Measurement and Verification (M&V) study completed at the end of the settlement period will be reconciled and either returned to customers or recovered from customers. Such amount will be refunded or recovered over two years from the date of any such reconciliation with interest accrued on any over or under collected balance as set forth in Section G.2.e. above.

H. Controlling Avoided Costs

1. The settling parties agree to utilize the Company's QF rate as the avoided cost for the cost/benefit analysis of the initial save-a-watt programs during the term of this agreement. However, the parties recognize the need to incorporate a market-based component to the value of avoided costs in the future to more accurately reflect Company business decisions in activities such as purchasing capacity or constructing generation units such as a gas fired combustion turbine.

The settling parties anticipate discussions related to avoided cost values to be a key agenda item in expected technical workshops planned by the IURC in Phase II of its generic DSM proceeding, IURC Cause No. 42693. In the meantime, the settling parties agree to develop a methodology that may serve as a proxy to blend the build and buy options to initiate stakeholder discussions within 90 days of the issuance of a final order in this proceeding. The value derived from such methodology may be used to establish the avoided costs for program cost/benefit analysis and cost recovery for any additional programs offered during term of the settlement agreement and for programs that continue beyond the settlement term.

Given the absence of a capacity market in the MISO footprint and no imminent plans to establish such a market, the methodology will weight the 2008 approved QF rate and a market-based value of capacity based upon data such as, but not limited to, capacity purchases, the value of demand response resources in MISO through its Emergency Demand Response tariff, and the value of Demand Response Resources (DRRs) in the Ancillary Services Market (ASM) which is scheduled to begin in September 2008.

2. If the approved capacity credit of the QF rate changes by more than 25%, the avoided cost will be adjusted to enable modification of the portfolio of programs. Upon modification, the energy efficiency avoided cost percentages will be changed to maintain the relationship between the target achievement and the target management incentives.

I. Program Portfolio Management and Advisory Committee

1. In order to achieve maximum results, the portfolio of energy efficiency programs will be constantly monitored by Duke Energy's program managers and may need to be modified periodically in order to make the programs more successful, more cost-effective, and/or react to market conditions.
2. An Advisory Committee shall be established to collaborate with Duke Energy on its program development and modification.
3. The Advisory Committee shall exist throughout the term of this agreement and shall consist of representatives of Duke Energy and the OUCC with each organization having one vote. Upon approval of the settlement agreement, the Commission shall have the opportunity to have a voting representative if it so chooses. There may be other non-specified non-voting members, such as other settling parties, the Lieutenant Governor's Indiana Energy Group, the Energy Center at Discovery Park, Purdue University and members associated with other Indiana-based universities and national energy efficiency advocates.
4. During the implementation of the programs outlined herein, Duke Energy will work with the Advisory Committee on the design of an appropriate methodology to be used to evaluate the performance of the energy efficiency programs. Additional roles of the

Advisory Committee are to collaborate on new program ideas, review and approve modifications to existing programs, and review the M&V process.

5. Independent measurement and verification of programs, conducted by an independent third-party will be performed according to the schedule agreed to herein to ensure programs remain cost effective. The overall program portfolio must always be cost-effective when evaluated using the total resource cost test and including management incentives as a component of direct costs.
6. The Advisory Committee will review results of all programs and interim M&V reports on an annual basis. This group may request a mid-point review of programs and rates by the Commission should the need arise.
7. Free ridership and MW and MWh savings will be updated as part of the M&V process in evaluating the continued cost-effectiveness of existing programs.
8. The Advisory Committee shall have the ability to approve program modifications as long as the changes do not go outside the guidelines set out in this settlement or result in spending above previously approved levels.
9. Should the Advisory Committee vote and approve modifications to the existing programs, no IURC approval would be needed to implement such modifications.
10. It is anticipated that the IURC will need to approve all new programs and any proposal that results in an increase in rates.
11. Duke Energy Indiana retains the right to raise any program approval concerns with the Commission.
12. The Advisory Committee will meet at least two times a year.

J. Measurement & Verification

1. Reports of actual energy efficiency participation including any measurement, verification and evaluation shall be completed and provided to the IURC and parties to this proceeding annually.
2. The results of the M&V process at the end of the settlement term will be used to determine the actual MW and MWh achieved. The M&V study shall be submitted to the Commission as part of such true-up proceedings set forth in Section G. above.
3. The OUCC retains the right, if necessary, to formally contest the results of the Company's M&V activities in a hearing before the Indiana Utility Regulatory Commission.
4. Duke Energy Indiana will provide the OUCC with \$100,000 to acquire an independent third-party consultant to assist in evaluating the results of the Company's M&V studies. Company shareholders shall provide such funding and the amounts of such funding shall not be considered when determining either program costs or management incentives provided under this agreement.

K. Throughput –

1. Company shall propose, in an alternate proceeding, a cost recovery mechanism that addresses both (1) the financial incentive to increase between rate cases retail sales under the existing regulatory framework, and (2) the financial disincentive under the existing regulatory framework to invest in energy efficiency or otherwise decrease the retail sales of electricity between rate cases. Upon a final order approving this settlement, Duke Energy Indiana agrees to meet with the OUCC and other parties to the settlement agreement to discuss a framework for resolving the throughput issue. No

later than sixty days after the issuance of a final order approving the settlement agreement, either (1) the settling parties shall submit a petition seeking Commission approval of a throughput mechanism, or (2) Duke Energy Indiana shall file its Petition proposing a mechanism to address the throughput issue.

L. MISO Demand Response Resources

1. Duke Energy Indiana is supportive of the Midwest ISO's demand response initiatives and wishes to encourage demand response program participation in this market. As the new rules are developed by Midwest ISO regarding resource adequacy, ancillary services market, and economic value, Duke Energy Indiana commits to offer demand response programs that will be compatible with the various Midwest ISO demand response tariff provisions. Duke Energy Indiana believes it is in a unique position to coordinate customer participation in Midwest ISO demand response initiatives. Duke Energy Indiana believes that a key variable in determining how the Company should be paid for demand response programs by retail customers is whether those programs will count toward the Company's Midwest ISO resource adequacy requirements. Planning resources that qualify under Midwest ISO Module E resource adequacy requirements will be eligible for Save-A-Watt (SAW) recovery.¹ SAW recovery for PowerShare CallOption will not be requested until this program qualifies as a Planning Resource under Midwest ISO Module E requirements or IURC approval if obtained to use this program as a Planning Resource.
2. Economic customer demand response programs could be designed for use in the energy markets including the ancillary service market, participation as emergency demand response resources, or be used by Duke Energy Indiana to reduce load requirements or

¹ The settling parties understand that as proposed, Module E will include provisions for state commissions to approve additional programs to be considered planning resources that reach beyond MISO's minimum requirements. If the IURC approves specific demand response programs under these conditions, the Company may seek IURC authority to recover costs for such programs through Rider EE using the SAW model.

to avoid expected high locational marginal prices. These programs may or may not meet requirements to be Planning Resources. Duke Energy Indiana will recover all program costs for Economic Programs, including the PowerShare Quote Option program, through Rider 70 proceedings. Revenues and charges received from or allocated to Duke Energy Indiana by the Midwest ISO related to such programs would be allocated in FAC, RTO, and Rider 70 proceedings.

3. The Company may develop future custom demand response programs to flexibly respond to the needs of large customers and will evaluate such programs to determine whether they qualify as Midwest ISO Planning Resources or are Economic in nature. The Company may seek cost recovery under SAW or under Rider 70 proceedings as described above. Before presenting such custom demand response programs to the Commission for approval, the Company will first seek input from the Advisory Committee, subject to duly executed confidentiality agreements, and then request authority from the IURC to extend such offerings, which is consistent with the agreement in section D.2. above.

No later than 60 days after (1) FERC final approval of Module E, and (2) after the approval of this settlement agreement, Duke Energy Indiana commits to begin meeting with the OUCC to ensure that its demand response programs receiving Rider EE recovery can be utilized as Midwest ISO Planning Resources. In addition, Duke Energy commits to discuss with the OUCC new demand response programs designed for Midwest ISO ASM participation.

If the Company includes the PowerShare programs in Rider EE (as part of save-a-watt), it will extract the PowerShare program costs from Rider 70, and reduce its requested recovery of any capacity purchases in future Rider 70 proceedings by the amount of the

PowerShare resources to avoid double-recovery. This commitment will continue until both the Midwest ISO and the IURC support the inclusion of price-responsive demand as an adequate resource for planning purposes, or until the end of the settlement term, whichever is sooner.

M. Engagement of Indiana-based firms

Duke Energy Indiana commits to expend no less than 25% of its total program costs during the term of this agreement for the implementation of save-a-watt through contracts with Indiana-based businesses. In like manner, Duke Energy Indiana shall make every effort to employ local vendors where feasible in the marketing, implementing and administering of such energy efficiency programs.

The parties acknowledge reports of a shortage of skilled labor resources in Indiana to promote energy efficiency. The shortage of skilled persons necessary to complete energy efficiency audits, install demand response equipment and effectuate measures promoting energy efficiency has delayed full participation in important programs. The parties believe that focused skills training for energy efficiency technicians and contractors may facilitate increased program participation and overall effectiveness in the future.

In order to address this situation, the Company agrees to provide the sum of \$250,000 to be paid in the form of targeted grants toward the funding and development of specialized post-secondary education programs with various Indiana institutes of higher education.

This payment will be due within 90 days of the issuance of a final order in this proceeding.

EXHIBIT B

Duke Energy Indiana / OUCC Save-A-Watt Settlement

Provision	Exhibit A Reference	Save-a-Watt as proposed by Duke Indiana in Case-in-Chief	OUCC Concerns/Recommendations	Resulting Compromise / Save-a-Watt Settlement Agreement Provisions
Term	B	No definitive term, but proposal included a 4-year term of programs.	The Commission should grant Petitioner the authority to implement the save-a-watt regulatory model only as a term pilot program with a firm expiration date.	4 year pilot program (with true-up, etc. extending beyond as necessary).
Initial EE Programs to be Implemented	A	Residential: <ul style="list-style-type: none"> • Energy Assessments • Smart Saver • Low-Income • K-12 Education • Power Manager Non-Residential <ul style="list-style-type: none"> • Energy Assessments • Smart Saver • PowerShare Research <ul style="list-style-type: none"> • Advanced Power Manager • Efficiency Savings Plan 	The Commission should not authorize the proposed Advanced Power Manager in this Cause since it is not yet fully developed. The Company should exclude from the save-a-watt regulatory model its proposed Advanced Power Manager program.	Residential: <ul style="list-style-type: none"> • Energy Assessments • Smart Saver • Low-Income • K-12 Education • Power Manager Non-Residential <ul style="list-style-type: none"> • Energy Assessments • Smart Saver • PowerShare Potential Research <ul style="list-style-type: none"> • Efficiency Savings Plan (not in initial portfolio of programs, will be discussed by Advisory Committee)
Avoided Cost-Based Compensation to Duke for Results	C	Energy conservation : 90% of actual (independently measured & verified) avoided costs achieved.	Duke must present evidence of actual savings in terms of demand (MWs) and energy (MWhs) that are measured, verified and audited by third party vendors. Results of such studies should form the foundation of cost recovery. Noted that demand response programs are subsidizing energy conservation based on portfolio mix.	Separate avoided cost percentages for demand response and energy conservation programs to make the company indifferent relative to profitability. 60% of actual (independently measured & verified) NPV avoided capacity and energy costs achieved, subject to an earnings cap (described on page 2 below).
	C	Demand response: 90% of actual (independently measured & verified) avoided costs achieved.	DSM savings and related decreases in program costs must be shared equitably between Duke's ratepayers and its shareholders. Duke should limit the proposal to a factor no greater than 66% by which to weight avoided cost savings.	75% of actual (independently measured & verified) avoided capacity costs achieved, subject to an earnings cap (described on page 2 below).

EXHIBIT B

Duke Energy Indiana / OUCC Save-A-Watt Settlement

Provision	Exhibit A Reference	Save a Watt as proposed by Duke Indiana in Case-in-Chief	OUCC Concerns/Recommendations	Resulting Compromise / Save a Watt Settlement Agreement Provisions
Included Elements in Avoided Cost-Based Compensation	C,E	Program costs, "lost revenues," and management incentive – all at risk, based upon achievement of actual, verified results	See discussion of "lost revenues" and "throughput incentive" on page 3 below.	Program costs and management incentive -- both at risk, based upon achievement of actual, independently verified results. "Lost revenues" (for energy conservation programs only) broken out and dealt with separately, (as described on page 3 below).
Avoided Cost Calculation	H	Demand: Based on annual QF rate filed with IURC (i.e., "peaker methodology")	The Company's proposal inextricably links the cost to ratepayers of energy efficiency and utility supply-side costs. This exposes consumers to a risk not previously associated with energy efficiency investments. The Company must provide a method of shielding ratepayers from such risk. Cost recovery of any shareholder incentives based upon avoided costs should be closely linked to actual Midwest ISO market based savings.	Based on current annual QF rate filed with IURC, but set for 4 years with inflation factor. May be modified during term if changes by more than 25%. Agreement to work towards inclusion of market component in avoided cost calculation.
	H	Energy: Based on actual avoided energy costs, per IRP	None.	Based on actual avoided energy costs, per IRP
Performance Targets and Earnings Caps	D	No explicit performance targets; implicit within "pay for performance" nature of avoided cost revenue stream. No earnings caps	Duke's proposal provides the utility with an opportunity for unregulated profit. This profit derives from shareholder incentives that exceed outcomes that may prevail in competitive markets and the magnitude of which shield the Company from the risk of non-performance. Duke shareholder incentives should be tiered based upon actual results. Duke should limit the proposal to a return	Based on targeted plan savings, earnings cap varies based upon performance level achieved as percent of target (see below) <u>% Target</u> <u>CAP</u> 90-100% 15% cap on return on program costs 80-89% 12% cap on return on program costs 60-79% 9% cap on return on program costs <60% 5% cap on return on program costs *Energy conservation – Savings considered over life of measure, e.g., HVAC has 15 yrs of savings *Demand response – Savings are annual

EXHIBIT B

Duke Energy Indiana / OUCC Save-A-Watt Settlement

Provision	Exhibit A Reference	Save a Watt as proposed by Duke Indiana in Case-in-Chief	OUCC Concerns/Recommendations	Resulting Compromise / Save a Watt Settlement Agreement Provisions
Initial Revenue Requirements Calculation	F	Based on 90% of estimated avoided costs at 100% achievement, "shaped" to resemble power plant investment and recovery.	The Company's proposal to reshape revenues is unnecessarily complex. The Company should base revenues on contemporaneous estimates of avoided costs.	Based on 4-year plan to create \$260 MM in (nominal) avoided costs at 85% achievement level; no "reshaping" of revenue requirements.
EE Savings Cap, i.e. limitations on amount of kWh and kW Duke Energy can achieve	D	None; Energy Efficiency is a valuable resource that benefits all customers compared to alternative resources and lowers bills for participants through their reduction in usage.	The Commission should consider a reasonable rate impact for Duke ratepayers based on a holistic review of other pending or active regulatory ratemaking treatments. The Company's proposal exposes ratepayers to an indeterminable rate impact.	Limited to targeted plan savings over the 4-year term and a 3.0% maximum rate increase for residential customers during the 4-year term.
True Up	G	Annual, with adjustment to revenue requirements based on actual compared to targeted avoided cost savings. Over collections refunded to customers with 0% interest.	The utility should shield ratepayers from both the risk and costs of utility over-collection and should return to ratepayers any excess revenues collected plus an additional amount that compensates ratepayers for the time value of their money.	At conclusion of 4-year period, based on actual compared to targeted avoided cost savings, in conjunction with performance targets and earnings caps. Over-collections refunded to customers with 6% interest.
Cost Recovery Period	E	20 years based on life of measure with recovery of and on avoided cost	See discussion of limited term above.	6 years: (4 + true up in year 5) for recovery of avoided cost and full 6 years for recovery of lost revenues.
"Lost Revenue" Recovery Mechanism (loss attributable to fixed cost recovery, for energy conservation	E,K	No explicit lost revenue recovery or decoupling mechanism proposed.	The Company's save-a-watt regulatory model fails to remove the throughput incentive whereby the Company continues to profit from increasing electricity sales.	Direct recovery of 100% of lost revenues resulting from energy conservation programs for 3 (vintage) years. Duke Indiana to propose mechanism to deal with "throughput incentive" in alternate proceeding. Lost revenue recovery mechanism terminated prior to 3 years if/when new base rate case or throughput incentive mechanism implemented.

EXHIBIT B

Duke Energy Indiana / OUCC Save-A-Watt Settlement

Provision	Exhibit A Reference	Save a Watt as proposed by Duke Indiana in Case-in-Chief	OUCC Concerns/Recommendations	Resulting Compromise / Save a Watt Settlement Agreement Provisions
Measurement and Verification	I,J	By independent third party with defined program schedule.	The Company should commit to funding with shareholder dollars all evaluation, measurement and verification activities, including both costs incurred by the Company and by the OUCC on behalf of ratepayers.	Same; plus \$100,000 funding for OUCC Independent M&V consultant. Overall program portfolio must always be cost-effective when evaluated using the total resource cost test and including management incentives as a component of direct costs.
Opt Out Option for Large Customers	N/A	Customers having an aggregate load of 5 MW or more may opt out of participating in save-a-watt conservation programs, provided they self-certify re EE actions taken. Large customers who opt in and participate in conservation programs must stay in save-a-watt for 11 years which represents the useful life of save-a-watt measures installed.	None	Proposed opt-out provisions were not changed in this agreement; however, there are implicit changes due to introduction of the 4 year pilot term applicable to all Duke Indiana customers.
Program Portfolio Management and Advisory Committee	I	Collaborative process with Energy Efficiency stakeholders to provide input to program development and review measurement and verification	An Oversight Board comprised of DSM stakeholder representatives should actively and regularly review specific utility programs, results and, forecasted DSM expenditures.	Potential for three voting members (DEI, OUCC and IURC, if the IURC so chooses to participate) plus non-voting members to shape program modifications.

EXHIBIT B

Duke Energy Indiana / OUCC Save-A-Watt Settlement

<p>MISO DR Compatibility</p>	<p>L</p>	<p>Consistent with current resource planning.</p> <p>Discussed demand response opportunities in MISO, but did not link them to save-a-watt.</p>	<p>The Company's proposal does not follow the intent of the FERC and creates barriers to DR participation in competitive wholesale energy markets.</p> <p>Duke should fully utilize all Midwest ISO market-based options and related revenue sources for DR.</p>	<p>Duke Indiana commits to work to make SAW programs compatible with MISO requirements. DR programs that meet MISO requirements are eligible for SAW; if DR programs do not meet MISO DR requirements (or are otherwise not deemed qualifying resources by IURC), approved programs receive cost recovery treatment under Rider 70. Company may request custom DR programs that meet MISO requirements be placed under SAW or Rider 70.</p>
<p>Provision</p>	<p>Exhibit A Reference</p>	<p>Save a Watt as proposed by Duke Indiana in Case-in-Chief</p>	<p>OUCC Concerns/Recommendations</p>	<p>Resulting Compromise / Save a Watt Settlement Agreement Provisions</p>
<p>Other Provisions</p>	<p>D, F, M</p>	<p>Not applicable</p>	<p>No specific recommendations in testimony</p>	<p>Future revenues from carbon emission allowances resulting from save-a-watt programs will be credited to customers</p> <p>Duke Indiana commits to expend no less than 25% of total program costs through contracts with Indiana-based businesses.</p> <p>Duke Indiana agrees to provide \$250,000 in targeted grants for specialized post-secondary education programs to assist in the training of a skilled labor force in Indiana to promote energy efficiency.</p> <p>Duke will credit customers with \$6.2 MM previously collected to fund Power Manager program split evenly over 4 years to avoid double-recovery.</p>

STATE OF INDIANA
BEFORE THE
INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF DUKE ENERGY)
INDIANA, INC. REQUESTING THE INDIANA)
UTILITY REGULATORY COMMISSION TO)
APPROVE AN ALTERNATIVE REGULATORY)
PLAN PURSUANT TO IND. CODE § 8-1-2.5-1,)
ET SEQ., FOR THE OFFERING OF ENERGY)
EFFICIENCY CONSERVATION, DEMAND)
RESPONSE, AND DEMAND-SIDE)
MANAGEMENT PROGRAMS AND)
ASSOCIATED RATE TREATMENT)
INCLUDING INCENTIVES PURSUANT TO A)
REVISED STANDARD CONTRACT RIDER NO.)
66 IN ACCORDANCE WITH IND. CODE)
§§ 8-1-2.5-1 *ET SEQ.* AND 8-1-2-42(a);)
AUTHORITY TO DEFER PROGRAM COSTS)
ASSOCIATED WITH ITS ENERGY)
EFFICIENCY PORTFOLIO OF PROGRAMS;)
AUTHORITY TO IMPLEMENT NEW AND)
ENHANCED ENERGY EFFICIENCY)
PROGRAMS, INCLUDING THE)
POWERSHARE® PROGRAM IN ITS ENERGY)
EFFICIENCY PORTFOLIO OF PROGRAMS;)
AND APPROVAL OF A MODIFICATION OF)
THE FUEL ADJUSTMENT CLAUSE)
EARNINGS AND EXPENSE TESTS)

CAUSE NO. 43374

AMENDED AND RESTATED

STIPULATION

AND

AGREEMENT

January 15, 2009

AMENDED AND RESTATED STIPULATION AND AGREEMENT

This Amended and Restated Stipulation and Agreement (“Amended Agreement”) is entered into this 15th day of January, 2009, by and between Duke Energy Indiana, Inc. (“Duke Energy Indiana”), Duke Energy Indiana – Industrial Group (“Industrial Group”), Wal-Mart Stores East, LLP (“Wal-Mart”), Nucor Steel, a division of Nucor Corporation (“Nucor”), Steel Dynamics, Inc.-Engineered Bar Products Division (“SDI”), Kroger Company (“Kroger”), and the Indiana Office of Utility Consumer Counselor (the “OUCC”) (together “the Parties”).

NOW, THEREFORE, the Parties agree as follows:

1. Scope of Agreement. This Amended Agreement, along with the August 15, 2008 Stipulation and Agreement entered into between Duke Energy Indiana and the OUCC (“the August 15 Settlement”) and the Stipulation and Agreement entered into between Nucor, SDI, Kroger and the OUCC and filed with the Commission on November 3, 2008 (“Opt-Out Settlement”) (collectively, “the Settlements”), comprehensively resolves all issues between the Parties associated with Duke Energy Indiana's alternative regulatory plan as filed in Cause No. 43374.

a). Agreement Framework. Attached hereto as Exhibit A is a Term Sheet setting forth specific provisions of the settlement (“Amended and Restated Settlement Terms”) that, along with the August 15 Settlement and the Opt-Out Settlement, is intended by the Parties to resolve all pending issues relating to Cause No. 43374 relative to the Parties. The terms of the Amended Agreement are effective upon approval by the Indiana Utility Regulatory Commission (“Commission”).

2. Integration. Approval of this Agreement constitutes approval of the Settlement Terms attached hereto as Exhibit A.

3. Presentation of the Agreement.

a). The Parties will jointly move the Commission for approval of the Settlements in their entirety. This Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, is not severable from either the August 15 Settlement or the Opt-Out Settlement and the Settlements shall be accepted or rejected by the Commission in their entirety without modification or further condition that is unacceptable to any Party, consistent with section 3(c) below.

b). The Parties agree to support or not oppose the approval in their entirety of the August 15 Settlement or Opt-Out Settlement. The Parties agree that Duke Energy Indiana's case-in-chief filing, as modified by the August 15 Settlement, the Opt-Out Settlement, and this Amended Agreement shall be taken together as whole and shall constitute the Company's alternative regulatory plan. Nucor, SDI, Kroger, the Industrial Group, and Wal-Mart agree not to offer for admission into the record their respective testimonies and exhibits previously filed in this proceeding regarding the Settlements (*i.e.* testimony filed on October 27, 2008 and December 19, 2008). The Parties may, if they choose, file additional testimony in support of this Agreement.

c). If the Order of the Commission in this proceeding modifies or conditions the August 15 Settlement, only the parties to the August 15 Settlement may decide to accept or reject such modification or condition. If the Order of the Commission modifies or conditions of the Opt-Out Settlement, only the parties to the Opt-Out Settlement may decide to accept or reject such modification or condition. If the Order of

the Commission in this proceeding modifies or conditions approval of this Amended Agreement, only the Parties to this Amended Agreement may decide to accept or reject such modification or condition.

4. Effect and Use of Stipulation and Agreement.

a). The terms of this Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, represent a fair, just, and reasonable resolution by negotiation and compromise. As set forth in the Order in *Re Petition of Richmond Power & Light*, Cause No. 40434 at page 10, as a term of this Amended Agreement, the Commission must assure the Parties that it is not the Commission's intent to allow this Amended Agreement, or the Order approving it, to be cited as precedent by any person or deemed an admission by any Party in any other proceeding except as necessary to enforce its terms before the Commission, or any court of competent jurisdiction on these particular issues. This Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, is solely the result of compromise in the settlement process. Nothing contained herein is to be construed or deemed an admission, liability, or wrongdoing on the part of Duke Energy Indiana. Each of the parties hereto has entered into this Amended Agreement solely to avoid further disputes and litigation with the attendant inconvenience and expenses.

b). The evidence presented by the Parties in this Cause constitutes substantial evidence sufficient to support the August 15 Settlement, the Opt-Out Settlement and this Amended Agreement and provides an adequate evidentiary basis upon which the Commission can make any findings of fact and conclusions of law

necessary for the approval of both the August 15 Settlement, the Opt-Out Settlement and this Amended Agreement, as filed.

c). The issuance of a final Order by the Commission approving the August 15 Settlement, the Opt-Out Settlement, and this Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, without modification shall terminate all proceedings in regard to these Agreements.

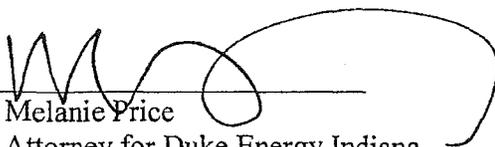
d). The undersigned represent and agree that they are fully authorized to execute this Amended Agreement on behalf of their designated clients who will be bound thereby.

e). The Parties shall not appeal the agreed final Order or any subsequent Commission order to the extent such order is specifically implementing, without modification, the provisions of the August 15 Settlement, the Opt-Out Settlement, and this Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, and the Parties shall not support any appeal of any such order by a person not a party to this Amended Agreement.

f). The provisions of this Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, shall be enforceable by any party at the Commission or any court of competent jurisdiction, whichever is applicable.

g). The communications and discussions during the negotiations and conferences that produced this Amended Agreement, including the Amended and Restated Settlement Terms in Exhibit A, have been conducted on the explicit understanding that they are or relate to offers of settlement and shall therefore be privileged.

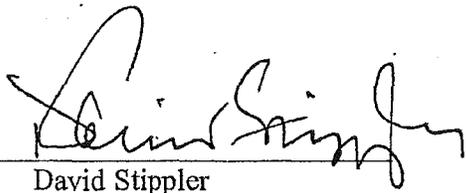
ACCEPTED AND AGREED this 15th day of January, 2009.

By: 
Melanie Price
Attorney for Duke Energy Indiana

By: 
Kurt Boehm
Attorney for Kroger

This sheet is a signature page to the Amended Settlement in Cause No. 43374.

By:



David Stippler
Indiana Office of Utility Consumer Counselor

This sheet is a signature page to the Amended Settlement in Cause No. 43374.

By:

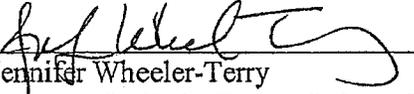


Peter Matheis
Attorney for Nucor

This sheet is a signature page to the Amended Settlement in Cause No. 43374.

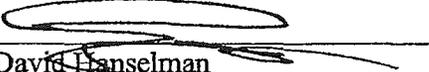
By: 
Damon Xenopoulos
Attorney for SDI

This sheet is a signature page to the Amended Settlement in Cause No. 43374.

By: 
Jennifer Wheeler-Terry
Attorney for Duke Energy Indiana Industrial Group

This sheet is a signature page to the Amended Settlement in Cause No. 43374.

By:


David Hanselman

Grace Wung

Attorneys for Wal-Mart Stores of the East, LP

This sheet is a signature page to the Amended Settlement in Cause No. 43374.

AMENDED AND RESTATED SETTLEMENT TERMS

These settlement terms reflect an amendment to the Stipulation and Agreement filed with the Indiana Utility Regulatory Commission on November 6, 2008 among Duke Energy Indiana, Inc. ("Duke Energy Indiana" or "Company"), the Indiana Office of Utility Consumer Counselor ("OUCC"), Nucor Steel, a Division of Nucor Corporation ("Nucor"), Steel Dynamics, Inc.-Engineered Bar Products Division ("SDI"), and Kroger Company ("Kroger") (the "Initial Parties"). The Initial Parties consent to the Amended and Restated Stipulation and Agreement, including these Amended and Restated Settlement Terms. (collectively referred to as "the Parties") agree as follows:

The Stipulation and Agreement entered into with the Indiana Office of Utility Consumer Counselor ("OUCC") and filed with the Indiana Utility Regulatory Commission on August 15, 2008 in Cause No. 43374 contemplated that there would be further discussions, specifically around opt-out provisions, with other parties. Specifically, Paragraph D5 states that "[f]inal target discussions should remain open as opt-out provisions and other key issues are discussed with other intervening parties." In furtherance of the spirit of the August 15 Settlement, the Initial Parties and the Industrial Group and Wal-Mart Stores East, LP (collectively referred to as "the Parties") agree as follows:

A. Opt Out for Large Customers

1. Eligibility. The Parties agree that a large industrial and commercial customer in Indiana may opt out of the energy conservation and/or demand response components of the Company's proposed Standard Contract Rider No. 66 ("Rider EE") if the customer's aggregated annual maximum peak demand is greater than 5,000 kW.
 - a. A customer may aggregate the load of the Duke Energy Indiana accounts of its affiliates to meet this opt out threshold. For purposes of this provision, an "affiliate" shall be defined as any business entity of which 50% or more is owned or controlled, directly or indirectly, by the customer.
 - b. If a customer qualifies to opt out of the Company's Rider EE, the customer may choose to opt out for select accounts/locations or all accounts, at its sole election. However, the customer cannot opt out of individual programs.
 - c. In order to ensure a manageable administrative process, opt-out decision-making will be limited for demand response and conservation as detailed in sections A.2 and A.3, respectively.
2. Demand Response Programs.
 - a. A customer may opt out of the demand response component of Rider EE for the term of the Company's proposed Rider EE. The demand response component of Rider EE will not be charged to customer accounts or locations that opt out of demand response during said term. A customer must opt out of demand response within 60-days

following the approval of the order in this proceeding. Once an eligible customer has opted-out of the demand response component of Rider EE, they will not be permitted to opt-back-in for the initial term of Rider EE. If the customer does not opt out of the demand response component of Rider EE within this 60 day period, the customer will be billed Rider EE charges for the term of this Agreement.

- b. There is no customer certification required to opt out of the demand response component of Rider EE.
3. Energy Conservation Programs.
- a. In order to ensure a manageable administrative process, opt-out decision-making will occur only once per year during an enrollment period for the conservation component of Rider EE. A customer must choose to opt out of the conservation component during the first sixty days following approval of the final order in this proceeding. Thereafter, there will be an annual enrollment/ opt-out period that ends 60 days prior to the beginning of the subsequent vintage year for the conservation component. During the enrollment/ opt-out period, qualifying customers may designate which of their accounts will opt-out (or opt back-in) of energy conservation programs. Once a customer has chosen to opt-out of the conservation component, they will not be entitled to (re)enroll unless they notify the Company of their intention in writing to opt-in during the annual enrollment period.
 - b. At the time of the election to opt out of the energy conservation component of Rider EE, the customer must self-certify that, within the last three years it has performed or had performed an energy audit or analysis or within the next six months will perform an energy audit or analysis and has implemented or has plans for implementing energy efficiency measures. Duke Energy Indiana will collect and maintain the self-certifications for the term of the program and treat such certifications as confidential customer information. Duke Energy Indiana will make the self-certifications available to the Commission and the OUCC at their request for informational purposes and subject to confidentiality restrictions. The affected customer will also be notified.
 - c. A customer may opt out of the energy conservation component of Rider EE for each vintage year. Energy conservation programs are fully paid for in the vintage year in which they occur. Lost margin recovery will occur for two additional years. For example, a large customer who participates in vintage year 1, could opt-out of vintage years 2, 3 and 4. The customer would pay the energy conservation component of Rider EE in vintage year 1 and lost margins associated with year 1 in the first year. The customer would continue to see EE Rider charges in years 2 and 3 to collect vintage year 1 lost margin recovery for years 2 and 3. The customer would not incur any charges for the energy conservation component or lost margins associated with vintage years 2 or 3.
 - d. The vintage year approach provides customers with greater flexibility to opt out and back in to Duke Energy Indiana's energy conservation component of Rider EE. For example, a customer who opts out of vintage year 1 and 2 may opt in for vintage year 3. The vintage year approach should make it easier for large customers to participate in energy conservation programs.
 - e. Once a customer opts out, they will be out until they elect to opt back in.

- f. A customer must elect to opt-out, or back in, no later than 60-days prior to the beginning of a vintage year.
 - g. If a customer elects to opt out of energy conservation component, they forego participation in the true up process at the end of year four. In other words, a customer must participate all four years to be included in the true up process.
4. **Customer Equipment.** If equipment is required on the customer side of the meter for demand response or energy conservation programs covered by the August 15 Agreement, and the customer provides such equipment, the Company agrees to waive any charges for the equipment. If the Company installs such equipment on the customer's behalf, the Company will charge the cost of installation to the customer. The equipment requirements, and determination of customer equipment meeting those requirements will be determined by the Company at its sole discretion.

B. Treatment of Future Custom Demand Response Special Contracts for Large Customers

1. Duke Energy Indiana commits at this time it shall not seek recovery of any demand response costs associated with future custom demand response special contracts (*i.e.*, non-tariff contracts) under Rider EE (for example, contracts currently being negotiated with SDI and Nucor). In other words, the demand response impacts of these contracts will be omitted from the save-a-watt model and shall have no effect on Rider EE. The Company reserves the right to request recovery of any demand response associated costs under such contracts in its Rider 70 or other proceedings.
2. Duke Energy Indiana further agrees that if any future custom demand response special contract for large customers (*i.e.*, a non-tariff contract) does not meet the Midwest ISO's Module E Resource Adequacy requirements or approval by the Commission as a planning resource, then the Company will not seek recovery of any capacity payments associated with demand response under such contracts (in Rider 70 or elsewhere).

C. Grandfathering PowerShare CallOption

1. Existing customers, 5MW and above who have the option to opt out of Rider EE, shall be grandfathered at their existing level of participation in PowerShare CallOption to continue under the existing cost recovery structure (*i.e.*, Rider 70) subject to the existing PowerShare CallOption being modified to comply with Midwest ISO's resource adequacy requirements. See Confidential Attachment No. 1 for the grandfathered customers and MW amounts. Any MW of PowerShare CallOption beyond the specific customer and MWs grandfathered and any conversion of existing PowerShare Call Option to a new PowerShare product offering will be treated as part of Rider EE, as long as the program meets the Midwest ISO's resource adequacy requirements.
2. Rate recovery associated with the grandfathered demand response load will continue under Rider 70 as it does today. Additionally, the amount of PowerShare expense included in base rates today will remain in base rates and continue to be annually reconciled (trued-up) with the amount of PowerShare expense that continues to be recovered under Rider 70 (*i.e.*, expenses associated with PowerShare QuoteOption and grandfathered PowerShare CallOption).

3. The grandfathered PowerShare CallOption MWs will still produce avoided cost savings up to \$9.3 million, and therefore, together with Rider EE programs may allow Duke Energy Indiana to achieve its avoided cost goal of \$260 million. The net effect is that the Rider EE targeted avoided cost savings target may be adjusted to no less than \$250.7 million to reflect these Rider 70 grandfathered MWs described above for purposes of determining the application of the capped rate of return on program costs contained in the Settlement Agreement filed on August 15, 2008.

D. Other Provisions

1. The Parties acknowledge that issues regarding participation in RTO demand response programs are pending in Cause No. 43566, and the parties do not intend anything in the settlement agreement filed in this proceeding to limit what may be determined in Cause No. 43566. Likewise, none of the Parties, by entering into the settlement agreement in this proceeding, has acquiesced in or waived any position with respect to any other proceeding, including such proceedings that Duke Energy Indiana has committed to initiate as part of settlement agreements in this proceeding.
2. Duke Energy Indiana shall label save-a-watt as a trial program.
3. The revenues and expenses associated with the save-a-watt program (Rider EE) shall be included in the FAC earnings and expense tests.