

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF INDIANA)
MICHIGAN POWER COMPANY ("I&M") FOR)
THE TIMELY RECOVERY OF LOST)
REVENUES PURSUANT TO 170 IAC 4-8-6 AND)
SHAREHOLDER INCENTIVES PURSUANT TO)
170 IAC 4-8-7 RELATED TO I&M'S DEMAND-)
SIDE MANAGEMENT AND ENERGY)
EFFICIENCY PROGRAMS AND FOR)
APPROVAL OF MODIFICATION OF THE)
FUEL ADJUSTMENT CLAUSE EARNINGS)
TEST IN ACCORDANCE WITH IND. CODE §§)
8-1-2.5-1 ET SEQ. AND 8-1-2-42(a).)

CAUSE NO. 43827

APPROVED: SEP 22 2010

BY THE COMMISSION:

David E. Ziegner, Commissioner
Aaron A. Schmoll, Senior Administrative Law Judge

On November 16, 2009, Indiana Michigan Power Company ("Petitioner," "Company" or "I&M") filed a Petition with the Indiana Utility Regulatory Commission ("IURC" or "Commission") for the timely recovery of lost revenues and shareholder incentives related to I&M's Demand-Side Management and Energy Efficiency Programs and for approval of modification of the Fuel Adjustment Clause ("FAC") earnings test. I&M filed its direct testimony and exhibits on November 16, 2009.

On January 20, 2010, the Commission conducted a Prehearing Conference and Preliminary Hearing in this Cause. Petitioner and the Office of Utility Consumer Counselor ("OUCC") appeared and participated at the Prehearing Conference. On January 27, 2010, the Commission issued its Prehearing Conference Order establishing the schedule and other procedural requirements for this Cause.

On March 15, 2010, the Office of Utility Consumer Counselor ("OUCC") filed its direct testimony and exhibits. On April 12, 2010, I&M filed its rebuttal testimony and exhibits. On April 28, 2010, I&M filed a Notice of Settlement and Agreed Motion for Modification of Procedural Schedule, which was granted by Docket Entry dated April 30, 2010. On May 7, 2010, I&M submitted the Parties' Stipulation and Settlement Agreement ("Settlement"). Also on May 7, 2010, the Parties filed supplemental testimony and exhibits in support of the Settlement.

Pursuant to notice given and published as required by law, proof of which was incorporated into the record of this Cause by reference and placed in the official files of the Commission, a public hearing was held on May 14, 2010 at 11:00 a.m. in Room 224, National City Center, 101 W. Washington Street, Indianapolis, Indiana. Petitioner and OUCC participated in the hearing. No members of the general public appeared. At the hearing, the Commission accepted into the record Petitioner's Direct, Rebuttal, and Supplemental testimony and the OUCC's testimony in support of settlement. Also admitted into evidence without objection were I&M's responses to questions posed

in Docket Entries dated May 10, 2010 and May 12, 2010 and the OUCC's response to a question posed in the May 12th Docket Entry. No other party or members of the general public appeared.

The Commission, based upon the applicable law, the evidence herein, and being duly advised, now finds as follows:

1. **Notice and Jurisdiction.** Proper notice of the public hearing in this Cause was published as provided by law. Petitioner is a public electric generating utility and is subject to the jurisdiction of the Commission. This Commission has jurisdiction over Petitioner and the subject matter of this proceeding in the manner and to the extent provided by the laws of the State of Indiana.

2. **Petitioner's Organization and Business.** I&M is a corporation organized and existing under the laws of the State of Indiana, with its principal offices at One Summit Square, Fort Wayne, Indiana. I&M has corporate power and authority, among other things, to engage in generating, transmitting, distributing and selling electric energy within the States of Indiana and Michigan. I&M is a "public utility" within the meaning of Ind. Code § 8-1-2-1 and is lawfully engaged in the provision of electric services under duly acquired indeterminate permits and franchises within Indiana. I&M is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana.

3. **Background.** In accordance with the Commission's March 4, 2009 Order in Cause No. 43306 ("43306 Order"), I&M and various other parties (Citizens Action Coalition, the City of Ft. Wayne, the I&M Industrial Group and the OUCC) submitted a Stipulation and Settlement Agreement in Cause No. 43769 ("43769 Settlement"), which requested Commission approval and authorization for I&M to implement specified programs (collectively referred to herein as the "DSM Phase I Programs") for a two-year term and to timely recover the direct and indirect costs thereof as set forth in the 43769 Settlement. The 43769 Settlement also provided that the direct and indirect costs incurred for the DSM Phase I Programs shall be recovered through I&M's Demand-Side Management / Energy Efficiency (DSM/EE) Program Cost Rider approved in accordance with the 43306 Order. The 43769 Settlement also stated that I&M could seek Commission approval of lost revenues and DSM incentives in a separately docketed proceeding, with no party waiving any objection thereto. The Commission approved the 43769 Settlement on March 17, 2010.

4. **Petitioner's Original Request.** I&M seeks Commission authority to timely recover lost revenues and shareholder incentives for its DSM Phase I Programs, relating to the time of their implementation. I&M is also requesting accounting authority to implement the requested recovery of net lost revenues and Shared Savings. In addition, I&M requests that such incentives, if obtained, be excluded from its FAC earnings tests in order to preserve the intention of creating and retaining an incentive opportunity. To ensure the incentives can be retained, I&M proposes that its authorized net operating income for purposes of the FAC earnings test be adjusted by the amount of the actual incentive earned.

5. **Summary of Evidence of the Parties.**

A. **Petitioner's Testimony.** I&M Witness William K. Castle described the calculation of "net benefits" that are expected to result from the DSM Phase I Programs. Mr. Castle explained that net benefits are, generally, the benefits of a program less the cost. He stated that in Cause No. 43769 he described the benefits and costs as a ratio: benefits/costs. He noted that net

benefits are really a restatement of the cost effectiveness test results as a difference of the benefits and costs. He stated that as in the calculation of the utility cost effectiveness test described in his testimony supporting the 43769 Settlement the benefits are the present value of avoided capacity and energy over the lives of the measures in the programs. The costs consist of the actual utility program costs. Mr. Castle stated the expected utility net benefit from the Year 1 programs is \$4.67 million, and \$6.41 million for the Year 2 programs. See Exhibit WKC-1.

Mr. Castle stated that he utilized the same assumption for avoided costs, discount rate, program impact and costs, and all other relevant factors. Mr. Castle stated that his calculation of the utility net benefits of the DSM Phase I Programs did not include I&M's proposed Shared Benefit or Program Incentives. He stated that including performance incentives based on a shared savings for the purposes of determining cost-effectiveness is not standard industry practice.

Mr. Castle stated the proposed portfolio of programs is cost-effective even when performance incentives are included as costs. He showed the recalculation of the Total Resource Cost ("TRC") scores when performance incentives are included as part of Administrative costs. See Exhibit WKC-2. He stated the portfolio of programs has an average TRC score of 1.2, when including performance incentives.

I&M Witness Jeffrey L. Brubaker addressed the accounting to be employed for I&M to properly account under Accounting Principles Generally Accepted in the United States of America ("GAAP") and the FERC Uniform System of Accounts ("USofA") for net lost revenues and shared savings included in I&M's proposed changes to the rates under the proposed DSM/EE Program Cost Rider.

Mr. Brubaker stated that I&M is requesting to record a regulatory asset and recognize revenues for net lost revenues and shared savings in the accounting period that the revenues are actually lost. In order to record a regulatory asset for net lost revenues and shared savings which are not an incurred cost, the requirements of Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 980-605-25, formerly Emerging Issues Task Force (EITF) Issue No. 92-7, *Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs* must be met. FASB ASC 980-605-25 addresses the recognition of revenues from alternative revenue programs including programs that adjust billings to compensate the utility for demand side management initiatives. He stated that I&M is not currently recording a regulatory asset to recognize the additional net lost revenues and shared savings to be billed in the future. However, if the proposed changes to the rates under the DSM/EE Program Cost Rider are approved as filed, I&M will record a regulatory asset and recognize revenues for the net lost revenues and shared savings in the accounting period that the revenues are lost and the shared savings are realized.

Mr. Brubaker stated that in accordance with FASB ASC 980-605-25, I&M can recognize such additional revenues to be billed in the future as a regulatory asset even though they are not an incurred cost if all of the following conditions are met: (1) the DSM program is established by an order from the utility's regulatory commission that allows for automatic adjustment of future rates to recover lost revenues—verification (an audit) of the computation of lost revenues and the adjustment to future rates by the regulator or its staff would not preclude the adjustment from being considered automatic; (2) the amount of recoverable lost revenues for the period is objectively determinable and is probable of recovery, and; (3) the additional revenues will be collected within 24 months following the end of the annual period in which they are recognized.

Mr. Brubaker stated that the requirements of FASB ASC 980-605-25 apply only to the net lost revenues and shared savings but not to incurred costs. The incurred DSM/EE costs are deferrable as a regulatory asset or if over-recovered as a regulatory liability in accordance with FASB ASC 980, formerly Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*, if it is probable that the resultant deferred incurred cost regulatory assets or regulatory liabilities will be recovered, or returned to customers, through future rates. The deferral of incurred costs does not have to meet the conditions of FASB ASC 980-605-25; however, with regard to net lost revenues and shared savings to be recovered under a DSM program, which are not an incurred cost, the net lost revenues and shared savings cannot be recorded as a regulatory asset unless the conditions of FASB ASC 980-605-25 are met.

Mr. Brubaker stated that the proposed changes to the rates under the proposed DSM/EE Program Cost Rider meet the requirements of FASB ASC 980-605-25. He explained the proposed changes to the rates under the DSM/EE Program Cost Rider include an annual reconciliation that will automatically include net lost revenues and shared savings, to either reduce, for an over-recovery, or increase, for an under-recovery, the amount to be collected in the next annual rate adjustment tracking rider. As such, it will be recovered in less than 24 months without further adjudication. Thus, I&M would meet the above stated requirements of FASB ASC 980-605-25 and, as such, would be able to record a regulatory asset and recognize revenues for net lost revenues and shared savings in the accounting period that the revenues are actually lost.

I&M Witness David M. Roush stated the Company is proposing to collect net lost revenues and Shared Savings through the Demand-Side Management / Energy Efficiency (DSM/EE) Program Cost Rider (Tariff I.U.R.C. No. 15, Original Sheet No. 51) approved in accordance with the 43306 Order. He stated the potential for such a request was contemplated and recognized in the design of the Rider and the Rider provides for a reconciliation of billing under the rider to actual costs and, upon approval, actual net lost revenues and shared savings.

Mr. Roush explained the DSM-related costs allowed to be recovered by a utility pursuant to the Commission's rules. He stated that Rule 8 (170 IAC 4-8-1, *et seq.*) sets forth guidelines for DSM cost recovery. Pursuant to 170 IAC 4-8-5, a utility is entitled to recover the reasonable cost of planning and implementing a DSM program and lists several alternative cost recovery methodologies. Pursuant to 170 IAC 4-8-6, a utility is permitted to seek recovery of lost revenue resulting from the implementation of a DSM program. Pursuant to 170 IAC 4-8-7, a utility is permitted to propose a shareholder incentive to encourage participation in and promotion of a DSM program.

Mr. Roush explained that DSM programs have many positive consequences, including reducing the use of fossil fuels, reducing emissions and delaying the need to construct generation in the future. He explained that reduced customer usage that results from DSM programs leads to reduced revenue for the Company and thus reduced recovery of fixed costs during periods between basic rate cases. He stated the recovery of net lost revenues and Shared Savings helps to mitigate the negative consequences on the Company of offering DSM programs, while still providing significant benefits to the Company's customers.

Mr. Roush explained that net lost revenues are the revenues lost less the costs saved as a result of a DSM program. As summarized in Exhibit DMR-1, the kWh impacts of each DSM program are from the Market Potential Study filed in Cause No. 43566. He stated to determine net

lost revenues he calculated the average fixed cost per kWh for customers eligible for each program based upon I&M's current rates. To determine this realization, revenues related to the customer charge, the basing point of fuel and all riders were deducted from total revenues to determine the net lost revenue component.

Mr. Roush explained that I&M considers Shared Savings as compensation for successful implementation of DSM programs. As described by the "National Action Plan for Energy Efficiency," many jurisdictions acknowledge the need to include a utility return component comparable to the Shared Savings component proposed by the Company in order to make Energy Efficiency programs comparable to supply-side alternatives from a utility financial perspective.

Mr. Roush stated that Shared Savings consists of two components: Shared Benefit and Program Incentive. The proposed Shared Benefit component shares the calculated net benefits for measurable DSM programs between customers and the Company. The net benefit as calculated on a Utility Cost basis is the difference between the costs avoided by implementing the DSM programs (avoided electric capacity and energy) and the utility-incurred costs of the DSM programs (program costs). He stated the Program Incentive component is calculated by applying a fixed percentage to the program costs for those programs that are primarily educational, have a negative net benefit as determined in the screening using the TRC test, or whose immediate benefits may be difficult to quantify using estimated kWh or kW savings.

Mr. Roush stated that the Company's use of the Utility Cost test as the basis for net benefits in the Shared Savings calculations properly motivates the utility to control DSM program administrative costs and participant incentive costs. In contrast, the TRC test traditionally excludes the cost of incentives provided to participants and could lead to higher total program costs for all customers. He noted that the Utility Cost test has also been used by Duke Energy Indiana in their Save-A Watt proposal. Mr. Roush stated that without a return based upon the Utility Cost effectiveness standard, a utility could institute highly attractive programs that meet the TRC effectiveness standard while offering excessive participant incentives. Mr. Roush stated that program effectiveness evaluation based upon the TRC standard combined with a utility return based upon the Utility Cost effectiveness standard will motivate the utility to control both administrative and participant incentive costs and thus the revenue requirement for all customers.

Mr. Roush stated that the Company proposes a sharing mechanism wherein the Company receives, after taxes, 15% of the shared benefit and a 10% program incentive. The calculation of total shared savings, comprised of the shared benefit and program incentive for the proposed programs, was shown in Exhibit DMR-2. He stated the Company's share of the Shared Savings would be treated as below-the-line for ratemaking purposes and excluded from the earnings test in the FAC proceedings. Mr. Roush stated that below-the-line treatment for ratemaking purposes is necessary for the Company to be able to realize the Shared Savings. Without such treatment of the Company's share, both the Company's share and the customer's share would be given to customers as part of a determination of earnings for ratemaking purposes.

Mr. Roush explained the calculation of the revised Rider rates. He stated that the revised Rider (Exhibit DMR-3) is identical in format and calculation as that approved in the 43769 Order. However, instead of allocating only direct and indirect program costs, the net lost revenues and Shared Savings associated with each DSM program is also allocated. He stated that since the net lost

revenues and Shared Savings are directly related to the DSM programs, a consistent allocation is appropriate.

Mr. Roush stated that specifically, the residential costs are allocated to the residential tariff classes and the commercial and industrial costs are allocated to the commercial and industrial tariff classes, excluding non-metered customers. He stated that indirect costs for the school energy education program are allocated entirely to the residential tariff classes. Mr. Roush stated that seventy-five percent (75%) of all other indirect costs are allocated to the residential class with the remaining twenty-five percent (25%) of all other indirect costs allocated to the commercial and industrial tariff classes, excluding non-metered customers. He stated that in recognition of the limited ability of SGS tariff class customers to take advantage of all components of the proposed commercial and industrial programs, the allocation of costs to that class was limited to approximately 10% of total commercial and industrial costs. He noted that any shortfall created by that limitation was allocated among the remaining commercial and industrial tariff classes.

Mr. Roush stated that subsequent rider rates will be identified in I&M's annual DSM/EE Program Cost Rider proceedings at which time the rider rates will be reconciled as provided in the DSM/EE Program Cost Rider. He stated the reconciliation process will include a true-up of actual program cost expenditures and actual net lost revenues and Shared Savings based upon achieved program participation. He stated deemed savings per participant for DSM programs would be adjusted, if warranted, for future participants.

Mr. Roush testified the requested ratemaking is consistent with the Commission's rules, consistent with the approval of the DSM/EE Program Cost Rider in the 43306 Order and permissible under the 43769 Settlement. He stated the Company's DSM/EE Program Cost Rider provides for the recovery of the cost incurred in excess of the cost that is included in basic rates. He stated I&M has no DSM costs included in basic rates. Mr. Roush stated the DSM/EE Program Cost Rider provides for the recovery of net lost revenues and Shared Savings which are both permissible under the Commission's rules. He stated the DSM/EE Program Cost Rider provides for a reconciliation of actual costs and actual collection under the rider.

Mr. Roush testified that Commission's 42693 Order identified "Core Programs" which are "... part of the basic utility service offering in a utility's service territory." He stated the Core Programs that I&M will offer include the Residential Rebate Program, the Residential Whole House Program, the Residential Low and Moderate Income Weatherization Program, the Commercial and Industrial Rebates Program and the School Energy Education Program. He stated that based upon subsequent Commission Orders, the Commission has determined that Core Programs are not eligible for incentives such as the Company's Shared Savings Proposal in this proceeding. As such, Mr. Roush testified that the Company modified its proposal to no longer request Shared Savings on the Core Programs. Mr. Roush also testified I&M also will offer two "Core Plus Programs", the Residential Appliance Recycling Program and the Commercial and Industrial Incentive Program. For these Core Plus Programs, I&M is seeking an incentive that is appropriate.

Mr. Roush noted that a primary objective of DSM/EE programs is to avoid the costs of additional generation by reducing inefficient consumption both now and in the future. He stated the Company's Shared Savings proposal simply allows the utility shareholders to receive a fraction of the benefit achieved.

He stated that under the Company's proposal, the greater incentive is appropriately provided for achieving as much as possible at the least possible cost. Mr. Roush testified I&M's calculations are based upon I&M's current basic rates which were approved in the 43306 Order and became effective in March 2009. He noted that although several of I&M's rider rates have changed since that time, those changes have no impact on the determination of net lost revenues since revenues from all riders are removed in the calculation.

Mr. Roush explained that the Program results will be evaluated by an independent third party. He noted that the 43769 Settlement included the use of an independent third-party evaluator to evaluate, measure, and verify the results of the Programs.

Mr. Roush concluded that the Company's request is consistent with Commission rules and consistent with the approval of the DSM/EE Program Cost Rider in Cause No. 43306 and 43769.

6. Settlement. The Settlement entered into by the Parties in this Cause is attached hereto and incorporated herein by reference. Specifically, the Settlement provides that:

- a. I&M shall be authorized to recover net lost revenues.
- b. I&M shall be authorized to receive a shareholder incentive based upon its proposed Shared Benefit proposal on its Core Plus Programs.
- c. The recovery of net lost revenues and the Shared Benefit mechanism shall be in place for two years following its approval by the Commission.

7. Testimony in Support of Settlement. Mr. Roush and Mr. Kilpatrick both sponsored and provided an overview of the Settlement (Joint Exhibit 1).

A. I&M's Evidence in Support of Settlement. Mr. Roush stated the Parties are of the opinion that (a) the Settlement as a whole produces a fair, reasonable, and just resolution of all matters pending before the Commission; (b) approval of the Settlement is in the public interest; and (c) the Commission, after considering the evidence in support of the Settlement, should find the Settlement to be reasonable and in the public interest and promptly enter an order approving the Settlement in its entirety.

Mr. Roush stated I&M's Petition in this case sought Commission approval to incorporate the collection of net lost revenues and Shared Savings through the DSM/EE Program Cost Rider. He stated the DSM/EE Program Cost Rider was initially approved in the Commission's Order in Cause No. 43306 with initial surcharge rates of zero (0) and that in Cause No. 43769, the Commission approved a settlement agreement which allowed I&M to commence recovering program costs through the DSM/EE Program Cost Rider.

Mr. Roush testified the Settlement Agreement is the result of investigation of issues raised by the Parties in this proceeding and substantial arms-length negotiation. He stated experts were involved with legal counsel in the development of both the conceptual framework and the details of the proposed settlement. Mr. Roush testified I&M and OUCC personnel considered various options and evaluated the issues to reach a settlement that is comprehensive, balanced, and in the public interest. He stated in the Settlement, the Parties set forth their agreement that the Commission should approve I&M's request to recover net lost revenues and a shareholder incentive.

Mr. Roush described the terms of the Settlement and sponsored Exhibit DMR-S1, which calculates the net lost revenue consistent with the Settlement; Exhibit DMR-S2, which calculates the shared savings consistent with the Settlement; and Exhibit DMR-S3, which calculates the DSM/EE rider rates consistent with the Settlement.

Mr. Roush stated the resulting DSM/EE rider rates to be incorporated in the Company's DSM/EE Program Cost Rider are as follows:

Tariff Class	¢/kWh
RS, RS-TOD, RS-TOD2 and RS-OPES	0.0696
SGS (Excluding Unmetered) and SGS-TOD	0.0579
MGS and MGS-TOD	0.0461
LGS and LGS-TOD	0.0062
IP, CS-IRP and CS-IRP2	0.0004
MS	0.0692
WSS	0.0158
IS	0.2323
EHS	0.0238
EHG	0.1118

Mr. Roush testified the effect of the initial residential DSM/EE billing factor under the Settlement of \$0.000696 per kWh will, if approved, result in an additional monthly charge of \$0.19 or an increase of 0.2% in the bill of a residential customer using 1,000 kWh. See Exhibit DMR-S6.

Mr. Roush explained how the DSM/EE Program Cost Rider rates will be implemented if the Commission approves the Settlement. He stated that upon Commission approval and consistent with established Commission practice, I&M will promptly submit its DSM/EE tariff sheet to the Commission Staff for review and approval so that the DSM/EE rates may be placed into effect beginning, if administratively possible, with the first billing month following the entry of a Commission order.

Mr. Roush stated that subsequent rider rates will be identified in I&M's annual DSM/EE Program Cost Rider proceedings at which time the rider rates will be reconciled as provided in the DSM/EE Program Cost Rider. The reconciliation process will include a true-up of actual program cost expenditures and actual net lost revenues and based upon achieved program participation. Deemed savings per participant for DSM programs would be adjusted, if warranted, for future participants.

Mr. Roush concluded the Settlement Agreement addresses the concerns raised in the OUCC's direct testimony, provides a balanced approach to sharing the benefits of DSM/EE between the Company and its customers and does not violate any regulatory principle. As such, he recommended that the Settlement Agreement and resulting DSM/EE rider rates be approved.

B. OUCC's Evidence in Support of Settlement. Mr. Kilpatrick addressed the key ratepayer protections and other considerations that exist within the Settlement. He stated that the OUCC had initial concerns that the Shared Savings design lacked appropriate ratepayer protections.

He stated that generally, the OUCC was concerned that the proposed incentive mechanism design opened the door to excessive returns for the Company based on program performance. Specifically, the OUCC's initial concerns centered around three items: (1) the shareholder incentives in regard to the Program Incentive component contained in the Company's Shared Savings proposal, (2) the lack of a cap on those proposed shareholder incentives and (3) the Company's ability to become "incentive eligible" at low levels of target achievement for high-TRC (i.e. 2.0 or greater) programs. Mr. Kilpatrick testified this concern is partially addressed via the 42693 Order. He explained the only Program-Incentive program currently proposed is Residential Low and Moderate Income Weatherization which is deemed a Core Program under the 42693 Order. He stated that with respect to potential future initiatives that would fall under the Program Incentive component, those that are educational in nature will be included as administrative costs in other programs, as appropriate. Otherwise, these programs will not qualify for incentives.

As to the OUCC's initial concern related to the lack of a cap on shareholder incentives, Mr. Kilpatrick testified the Settlement details a pre-tax cap on shareholder incentives at 15 percent of program costs. The Shared Savings incentive calculation is performed using EM&V verified results according to the initial design. The incentive payment to the Company under the proposed settlement agreement will equal the lesser of 15 percent of the net benefit or 15 percent of program costs. He stated this revised structure provides a progressive incentive mechanism that allows the Company to earn a greater incentive based on program performance, while also providing the appropriate ratepayer protection against significant rate volatility.

As to the OUCC's initial concern related to incentive eligibility, Mr. Kilpatrick testified the Settlement outlines an "incentive floor" of 50 percent of target achievement before the Company is eligible to receive any shareholder incentives. He stated that for the two programs that are currently proposed, a net benefit is not generated until much higher levels of achievement (i.e. approximately 80 percent). However, for prospective high-TRC programs, any net benefit generated before 50 percent of target achievement is at-risk until the "incentive floor" is met.

Mr. Kilpatrick addressed other considerations in the Settlement. First, the incentive payment will be based on portfolios defined by customer sector. He noted that for the proposed programs, there will be a residential portfolio and one for commercial and industrial customers. As additional programs are approved, they will be added to the appropriate sector portfolio. He stated this approach is consistent with other investor-owned utility DSM agreements and/or orders. Second, the incentive payment will be part of the earnings determination for ratemaking purposes and will not be treated as "below-the-line."

Mr. Kilpatrick recommended that the Commission approve the Settlement in its entirety, and stated that the settlement provides an innovative approach to shareholder incentive determination relative to demand cost recovery, while at the same time affording adequate consumer protections. He testified the OUCC acknowledges that this approach is different from approaches approved by the Commission for other companies. However, the OUCC's preliminary analysis indicates that in some instances this approach will produce more beneficial results for the ratepayer than found in other programs. He stated that given this would be a 2-year pilot program this is an excellent, low risk opportunity for assessing the results of this approach on DSM on a going-forward basis.

8. Discussions and Findings. Settlements presented to the Commission are not ordinary contracts between private parties. *United States Gypsum, Inc. v. Indiana Gas Co.*, 735

N.E.2d 790, 803 (Ind. 2000). When the Commission approves a settlement, that settlement “loses its status as a strictly private contract and takes on a public interest gloss.” *Id.* (quoting *Citizens Action Coalition v. PSI Energy*, 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*, 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. *United States Gypsum*, 735 N.E.2d at 795 (citing *Citizens Action Coalition v. Public Service Co.*, 583 N.E.2d 330, 331 (Ind. 1991)). The Commission’s own procedural rules require that settlements be supported by probative evidence. 170 IAC 1-1.1-17(d). Therefore, before the Commission can approve the Settlement Agreement, we must determine whether the evidence in this Cause sufficiently supports the conclusions that the Settlement Agreement is reasonable, just and consistent with the purpose of Ind. Code § 8-1-2, and that such agreement serves the public interest.

A. Lost Revenues. The Commission’s DSM Rules at 170 IAC 4-8-6 allow a utility to request recovery of lost revenues due to the implementation of a DSM program.

- (a) The commission may allow the utility to recover the utility’s lost revenue from the implementation of a demand-side management program sponsored or instituted by the utility. The calculation of lost revenue must account for the following:
 - (1) The impact of free-riders.
 - (2) The change in the number of DSM program participants between base rate changes and on the revised estimate of a program specific load impact that result from the utility’s measurement and evaluation activities under sections 4 and 5(e) of this rule.
- (b) A utility seeking recovery of lost revenue shall propose for commission review a methodology or process for incorporating a lost revenue recovery mechanism which includes the following:
 - (1) The level of free-riders in a DSM program.
 - (2) A revised estimate of a DSM program specific load impact resulting from regular utility measurement and evaluation activities.
- (c) The commission may periodically review the need for continued recovery of the lost revenue as a result of a utility’s DSM program, and the approval of a lost revenue recovery mechanism shall not constitute approval of specific dollar amount, the prudence or reasonableness of which may be debated in a future proceeding before the commission.

The settlement agreement allows I&M to recover net lost revenues based upon the number of measures installed per month and the calculated energy savings based upon I&M’s current rates

approved in Cause 43306. Unlike the recent proposal for lost revenue recovery by IPL in Cause No. 43623, the revenue margin rates I&M proposes to use are reasonably reflective of its operating system today, given that those rates have been in place since 2009. Accordingly, the Commission finds that the proposed lost revenue recovery methodology is reasonable and is hereby approved.

Further, we note that as with other DSM orders approved by this Commission and the settlement approved in Cause No. 43769, the precursor to I&M's request in this Cause, an independent third party Evaluation, Measurement, and Verification ("EM&V") evaluator is required, which should assist in providing accurate verification of the energy savings achieved. Finally, the Commission notes that lost revenues shall be included in the FAC earnings test.

B. Shareholder Incentives. The Commission's DSM Rules at 170 IAC 4-8-7(a) authorize the Commission to "provide the utility with a shareholder incentive to encourage participation in and promotion of a demand side management program" when the Commission determines it is appropriate to do so. With respect to the Core Programs, the Commission found in its Phase II Order in Cause No. 42693 (Dec. 9, 2009) 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.

The Settlement Agreement provides for the creation of a Shared Benefit approach to the implementation of I&M's Core Plus programs, as follows:

- Calculated net benefits for measurable DSM programs are shared between customers and company. Net benefit is the difference between avoided costs (capacity and energy) and utility incurred program costs.
- The Company will receive no shared benefit if actual benefits are less than 50% of the annual targets for the sector portfolio. Once the 50% threshold is met, the shared benefit component will be 15% of the net benefit on a pretax basis.
- Shared Benefit incentive will be capped at 15% of the total annual program costs for each core plus program. Program costs will be identical to those used to calculate the net benefit.
- The Company's share of Shared Benefit will be included in the determination of earnings for ratemaking purposes.

The Commission notes that a Shared Benefit approach differs from the tiered structures approved for IPL and SIGECO, and while there may be some benefit to having an alternative approach to what we have previously approved, we do not reach the point of discussing the purported merits of the Shared Benefit approach in this Cause. We note that the decision to approve a proposal for shareholder incentives under our DSM rules is permissive, and not mandatory. After further consideration of the role of shareholder incentives in the DSM process, we are not convinced that a utility should need an incentive to begin to implement DSM programs as part of its regulatory compact, whether those programs are Core or Core Plus. This is especially true in this case, where the DSM programs are unproven. The Commission believes that the appropriate time to consider

granting a shareholder incentive, if one is to be granted at all, is through the demonstration of benefits upon successful implementation of the programs.

C. Conclusion. In this proceeding, the Commission carefully analyzed the evidence and the Settlement Agreement to determine that it properly balances the interests of the utility, the customers, and the overall public interest. The Parties' testimony in support of the Settlement and their responses to our questions has enabled the Commission to understand the mechanics of the Settlement provisions and to determine that the Settlement Agreement, as modified, is supported by the evidence of record. The Commission further finds that the Settlement, as modified, is reasonable and in the public interest, and shall be approved as modified. Pursuant to the terms of the Settlement, the pilot program shall continue for two years from the date of this Order, at which point it shall terminate.

9. Effect of the Settlement Agreement. The Settlement Agreement sets forth the Parties' agreement with respect to its non-precedential effects. As noted above, the Commission has reviewed these provisions and concludes that the agreements contained therein, as modified, are reasonable and should be approved. With regard to future citation of the Settlement Agreement, we find the Settlement Agreement and our approval of it should be treated in a manner consistent with our finding in *Richmond Power & Light*, Cause No. 40434 (March 19, 1997).

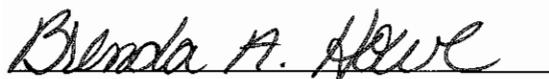
IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. The May 7, 2010 Settlement, attached hereto and incorporated herein by reference, is approved as modified herein.
2. Petitioner shall be, and hereby is, authorized to implement the accounting procedures necessary to implement the requested recovery of net lost revenues.
3. Petitioner shall file with the Electricity Division of the Commission an amendment to its tariff reflecting the approved Environmental Compliance Cost Rider rate in the form of Exhibit DMR-S5, but reflecting the modifications made in this Order.
4. This Order shall be effective on and after the date of its approval.

HARDY, ATTERHOLT, LANDIS, MAYS, AND ZIEGNER CONCUR:

APPROVED: SEP 22 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**

OFFICIAL
EXHIBITS

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF INDIANA)
MICHIGAN POWER COMPANY ("I&M"))
FOR THE TIMELY RECOVERY OF LOST)
REVENUES PURSUANT TO 170 IAC 4-8-6)
AND SHAREHOLDER INCENTIVES)
PURSUANT TO 170 IAC 4-8-7 RELATED TO)
I&M'S DEMAND-SIDE MANAGEMENT AND)
ENERGY EFFICIENCY PROGRAMS AND)
FOR APPROVAL OF MODIFICATION OF)
THE FUEL ADJUSTMENT CLAUSE)
EARNINGS TEST IN ACCORDANCE WITH)
IND. CODE §§ 8-1-2.5-1 *ET SEQ.* AND 8-1-2-)
42(a).)

CAUSE NO. 43827

IURC
JOINT

EXHIBIT No. 1
5-14-10 AT
DATE REPORTER

STIPULATION AND SETTLEMENT AGREEMENT

This Stipulation and Settlement Agreement is made and entered into as of the 7th day of May, 2010, by and between Indiana Michigan Power Company ("I&M" or "the Company") and the Indiana Office of Utility Consumer Counselor ("OUCC") (referred to herein as the "Parties").

WHEREAS, the Parties have met and discussed the proposals by I&M in this proceeding;
and

WHEREAS, the Parties have agreed to certain Terms of Agreement, which will be incorporated into a Joint Proposed Order, which will be submitted to the Commission;

NOW THEREFORE, the Parties having been duly advised by their respective staff, experts and counsel, agree as follows:

1. I&M shall be authorized to recover net lost revenues, which will be calculated monthly based upon the number of measures installed at the beginning of each month times the monthly deemed kWh savings times the average fixed cost per kWh for customers eligible for each program based upon I&M's then current rates. To determine this average fixed cost per kWh realization, revenues related to the customer charge, the basing point of fuel and all riders are deducted from total revenues to determine the net lost revenue component. Deemed savings per participant would be adjusted, if warranted, for future participants.

2. I&M shall be authorized to receive a shareholder incentive based upon its proposed Shared Benefit proposal on its Core Plus Programs, calculated as follows:

- a. The Shared Benefit component shares the calculated net benefits for measurable DSM programs between customers and the Company. The net benefit as calculated on a Utility Cost basis is the difference between the costs avoided by implementing the DSM programs (avoided electric capacity and energy) and the utility-incurred costs of the DSM programs (program costs). The program costs include participant incentive costs and, administrative costs, including an allocation of indirect costs.
- b. For each year, the Company will receive no Shared Benefit component if actual benefits are less than 50% of the annual Targets for the Sector Portfolios. The Year 1 Targets are \$945,264 and \$436,248 for Residential Appliance Recycling and Commercial and Industrial Incentives, respectively. The corresponding Year 2 Targets are \$1,259,980 and \$872,497. Performance will be determined using the same avoided cost factors used to determine these original targets for both Year 1

and Year 2 and the Actual savings per participant. The Shared Benefit component will be 15% of the net benefit on a pre-tax basis.

- c. For each year, the Shared Benefit incentive will be capped at 15% of the total annual program costs for each Sector portfolio of its Core Plus Programs. The program costs will be identical to those used to calculate the net benefit.
- d. The Company's share of Shared Benefit will be included in the determination of earnings for ratemaking purposes.

3. This Agreement shall be effective for two years following its approval by the Commission.

4. The Parties will request Commission acceptance and approval of this Settlement Agreement in its entirety, without any change or condition that is unacceptable to any Party to this Settlement Agreement.

5. OUCC will not offer prefiled testimony or exhibits into evidence in these consolidated proceedings, and OUCC agrees to waive cross-examination of all witnesses in these consolidated proceedings.

6. The Parties will work together to finalize and file an agreed upon proposed order with the Commission as soon as possible. The Parties will support the proposed order in these consolidated proceedings and will request that the Commission issue an order accepting and approving this Settlement Agreement in accordance with its terms as soon as possible.

7. The Parties will support on rehearing, reconsideration and/or appeal, a Commission Order accepting and approving this Settlement Agreement in accordance with its terms, including the submission of any applicable briefs and pleadings.

ACCEPTED AND AGREED this 7th day of May, 2010.

INDIANA MICHIGAN POWER COMPANY

By: _____


Claudia J. Earls, Attorney No. 8468-49
BARNES & THORNBURG LLP
11 South Meridian Street
Indianapolis, Indiana 46204
Phone: (317) 231-7279
Fax: (317) 231-7433
Email: claudia.earls@btlaw.com

INDIANA OFFICE OF UTILITY CONSUMER
COUNSELOR

By: _____

Jeffrey M. Reed, Esq.
Indiana Office of Utility Consumer
Counselor
115 W. Washington Street, Suite 1500 South
Indianapolis, Indiana 46204
Phone: (317) 232-2494
Fax: (317) 232-5923

7. The Parties will support on rehearing, reconsideration and/or appeal, a Commission Order accepting and approving this Settlement Agreement in accordance with its terms, including the submission of any applicable briefs and pleadings.

ACCEPTED AND AGREED this 7th day of May, 2010.

INDIANA MICHIGAN POWER COMPANY

By:

Claudia J. Earls, Attorney No. 8468-49
BARNES & THORNBURG LLP
11 South Meridian Street
Indianapolis, Indiana 46204
Phone: (317) 231-7279
Fax: (317) 231-7433
Email: claudia.earls@btlaw.com

INDIANA OFFICE OF UTILITY CONSUMER
COUNSELOR

By:



Jeffrey M. Reed, Attorney No. 11651-49
Indiana Office of Utility Consumer
Counselor
115 W. Washington Street, Suite 1500 South
Indianapolis, Indiana 46204
Phone: (317) 232-2494
Fax: (317) 232-5923
Email: jreed@oucc.in.gov