

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF SOUTHERN )  
INDIANA GAS & ELECTRIC COMPANY D/B/A )  
VECTREN ENERGY DELIVERY OF INDIANA, )  
INC. REQUESTING THE INDIANA UTILITY )  
REGULATORY COMMISSION TO APPROVE )  
CERTAIN DEMAND SIDE MANAGEMENT )  
PROGRAMS AND FOR RECOVERY OF )  
PROGRAM COSTS, LARGE CUSTOMER LOST )  
MARGINS AND PERFORMANCE INCENTIVES )  
PURSUANT TO 170 IAC § 4-8-1 ET. SEQ. VIA )  
ITS DEMAND SIDE MANAGEMENT )  
ADJUSTMENT MECHANISM, AND FOR )  
APPROVAL OF ACCOUNTING AUTHORITY )  
TO DEFER LOST MARGINS RELATED TO )  
RESIDENTIAL AND SMALL COMMERCIAL )  
CUSTOMER DEMAND SIDE MANAGEMENT )  
PROGRAMS )

CAUSE NO. 43938

APPROVED: AUG 31 2011

**BY THE COMMISSION:**

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

On August 16, 2010, Southern Indiana Gas & Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc. ("Petitioner," "Vectren South-Electric," or "Company") filed its Verified Petition with the Indiana Utility Regulatory Commission ("Commission") for approval of its Initial Three-Year DSM Plan (the "Initial Plan"), which expands Vectren South-Electric's portfolio of demand side management ("DSM") programs approved by the Commission in its December 16, 2009 Order in Cause No. 43427; authority to recover, through its demand side management adjustment ("DSMA") mechanism, costs associated with DSM program implementation, administration and evaluation, and large commercial and industrial ("C/I") customer lost margins; and authority to defer lost margins and all other recoverable costs resulting from energy efficiency measures implemented by residential and small C/I customers until such time as Petitioner has been authorized to recoup those lost margins and other costs, either via approval of decoupling in pending Cause No. 43839 or an alternative mechanism. On August 18, 2010, Petitioner filed its direct testimony and exhibits constituting its case-in-chief. Petitioner filed supplemental and revised direct testimony and exhibits on October 15, 2010, additional revisions to exhibits on November 9, 2010, and a third set of revisions and corrections to direct testimony on November 30, 2010.

On September 29, 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. The schedule and other procedural requirements for this Cause were established at the Prehearing Conference.

On November 19, 2010, Vectren South Commercial and Industrial Group ("C&I Group") filed a Petition to Intervene in this Cause, which was granted by the Presiding Officers. In accordance with the procedural schedule and scheduling modifications subsequently approved by the Presiding Officers, on November 22, 2010, the C&I Group and the OUCC filed their respective direct testimony and exhibits. On December 13, 2010, Petitioner filed its rebuttal testimony and exhibits.

On January 5, 2011, in lieu of an evidentiary hearing scheduled for that date and in light of efforts by the parties to reach a global settlement of all of the issues in this Cause, a modified procedural schedule was approved and the evidentiary hearing postponed until March 8, 2011. In accordance with the modified procedural schedule approved by the Presiding Officers, Vectren South-Electric and the OUCC filed their respective testimony and exhibits in support of the Stipulation and Settlement Agreement dated January 10, 2011 and submitted on January 20, 2011 (the "Settlement Agreement"). In accordance with further modifications to the procedural schedule as approved by the Presiding Officers, on February 18, 2011, the C&I Group filed its testimony in response to the Settlement Agreement. On February 23, 2011, Vectren South-Electric and the OUCC (the "Settling Parties") filed their respective replies to the C&I Group's response.

Pursuant to public notice duly given and published, proof of which was incorporated into the record by reference and placed in the Commission's official file, a public hearing was held in this Cause on March 8, 2011 at 1:00 p.m. EST in Judicial Courtroom 222 of the PNC Center, 101 W. Washington Street, Indianapolis, Indiana. At the hearing Vectren South-Electric, the OUCC, and the C&I Group appeared by counsel and offered their respective prefiled testimony and exhibits which were admitted into evidence without objection. No other party or members of the general public appeared.

Based upon the applicable law and the evidence of record, the Commission now finds:

**1. Notice and Jurisdiction.** Proper notice of the hearing in this Cause was given as required by law. Vectren South-Electric is a "public utility" within the meaning of Indiana Code Section 8-1-2-1 of the Public Service Commission Act, as amended, and is subject to the jurisdiction of the Commission. The Commission has jurisdiction over Petitioner and the subject matter of this Cause in the manner and to the extent provided by the laws of the State of Indiana.

**2. Petitioner's Organization and Business.** Petitioner is an operating public utility, incorporated under the laws of the State of Indiana, with its principal office and place of business in the City of Evansville, Indiana. Petitioner is subject to regulation by the Commission in the manner and to the extent provided by the laws of the State of Indiana. Vectren South-Electric provides electric utility service to approximately 140,000 customers in six (6) counties in southwestern Indiana. Vectren South-Electric renders such electric utility service by means of utility plant, property, equipment and related facilities owned, leased, operated, managed and controlled by it which are used and useful for the convenience of the public in the production, treatment, transmission, distribution and sale of electricity.

3. **Background.** On January 22, 2008, Petitioner filed a petition in Cause No. 43427 seeking approval to offer a specific set of DSM programs to its residential and small commercial customers, for the ability to recover program costs, for the opportunity to earn an incentive upon achieving certain energy and demand savings goals, and a decoupling mechanism applicable to residential and small commercial customers. During the pendency of Cause No. 43427, the Commission issued an Order on December 9, 2009 in Phase II of Cause No. 42693, captioned *In the Matter of the Commission's Investigation into the Effectiveness of Demand Side Management Programs* (the "Phase II Order") within which the Commission undertook the following key actions: (1) established policy objectives and DSM goals for all jurisdictional utilities; (2) developed a consistent statewide approach to DSM program offerings; (3) selected administrative models for DSM program delivery; (4) discussed DSM program oversight, including establishing the demand side management coordination committee ("DSMCC") and (5) addressed DSM program evaluation.

The Commission's Phase II Order delineated DSM programs as Core and Core Plus Programs. In selecting an administrative model for DSM program delivery, the Phase II Order required all jurisdictional electric utilities in Indiana to implement five statewide Core Programs using an independent third party administrator ("TPA") to be selected and supervised by the DSMCC. Pursuant to the Phase II Order, all jurisdictional utilities are required to offer DSM programs to all of the customers in their service territories, including large C/I customers. In addition, the Phase II Order encouraged utilities to implement Core Plus programs to assist with meeting the energy savings goals also defined in the Phase II Order.

The Commission's December 16, 2009 Order in Cause No. 43427 approved Vectren South-Electric's petition for (a) approval to offer certain DSM programs to its residential and small commercial customers; (b) recovery of program costs; and (c) the opportunity to earn an incentive upon achieving certain energy and demand savings goals. These DSM programs were designed to reduce residential and commercial customer energy usage by 61 million kWh at the end of three years, representing approximately a 1% reduction in energy consumption from current usage levels.

4. **Petitioner's Request.** In this proceeding, Vectren South-Electric requests approval of an Initial Three-Year DSM Plan that expands Vectren South-Electric's portfolio of Core and Core Plus DSM Programs in a way that is cost effective and designed to meet the energy savings goals established by the Commission in the Phase II Order. Vectren South-Electric also seeks recovery, via its existing DSMA, of the costs associated with DSM program implementation, administration and evaluation, and large C/I customer lost margins. In addition, Vectren South-Electric requests a modification to its previously approved performance incentive mechanism to include large C/I customer Core Plus Programs. Finally, given the request pending in Cause No. 43839 for a decoupled rate design applicable to residential and commercial customers, Vectren South-Electric seeks accounting authority to defer such lost margins until such time as recovery has been authorized, either via approval of decoupling or some alternative mechanism if necessary, to recoup lost margins.

5. **Vectren South-Electric's Proposed Initial Plan.** Vectren South-Electric's Initial Plan, as revised pursuant to the Settlement Agreement (the "Revised Initial Plan"), consists of the following Core and Core Plus Programs:

### **Core Programs**

- Residential Lighting
- Home Energy Audit and Direct Install
- Low Income Weatherization
- Energy Efficient Schools
- Commercial & Industrial Prescriptive

### **Core Plus Programs**<sup>1</sup>

- Residential Appliance Recycling
- Residential New Construction
- Residential HVAC
- Residential Behavioral Savings
- Residential Multi-Family
- Commercial & Industrial Audit & Custom
- Commercial & Industrial New Construction

**6. Petitioner's Case-In-Chief.** L. Douglas Petitt, is Vice President of Marketing and Conservation for Vectren Utility Holdings, Inc. ("VUHI"), which is the immediate parent company of Vectren South. In his prefiled testimony, Mr. Petitt discussed Vectren South-Electric's current energy efficiency initiatives; provided a summary of Vectren South-Electric's filing and the Order issued in Cause No. 43427; introduced and summarized the Company's proposal in this proceeding; discussed the proposed means of recovering lost margins created by large C/I customer participation in DSM; provided policy support for Vectren South-Electric's proposal in this proceeding; and discussed the reasons the proposal in this proceeding is in the public interest.

Mr. Petitt summarized Vectren South's current energy efficiency initiatives for its gas and electric divisions, including Vectren South-Electric's DSM Programs and related cost recovery mechanisms as approved in Cause No. 43427. He described the impact of the Commission's Phase II Order on those DSM Programs approved in Cause No. 43427. He explained that Vectren South-Electric's Cause No. 43427 DSM program portfolio consisted of initiatives that yielded both energy and peak demand savings, but the Phase II Order set goals primarily based upon energy savings rather than peak demand savings. (LDP-1 p.7) In addition, the Cause No. 43427 DSM program portfolio, including program budgets and expected savings, consisted of several of the programs the Commission's Phase II Order deemed Core Programs to be implemented on a consistent statewide basis by an independent TPA to be selected by the DSMCC. He explained that the Commission approved Vectren South-Electric's request to implement those DSM programs it labeled as Core Programs in conjunction with the TPA and indicated that all other proposed programs were approved as Core Plus Programs to be implemented by Vectren South-Electric to assist it with meeting its savings goals. (LDP-1 p.8) Mr. Petitt explained that the Phase II Order also required all jurisdictional electric utilities to

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<sup>1</sup> As part of the Settlement Agreement, Vectren South-Electric agreed to remove the Commercial and Industrial Retro Commissioning program, as described in the description of the Settlement Agreement below.

offer DSM programs to all of its customers, including large C/I customers. Vectren South-Electric did not include DSM Programs for large C/I customers in Cause No. 43427. (LDP-1 p.8)

Mr. Petitt summarized the incentive mechanism approved by the Commission in Cause No. 43427, which includes penalties of negative four percent (-4%) for failing to achieve at least fifty percent (50%) of program energy savings goals, and provides a credit (or incentive) to the Company after it reaches at least sixty-five percent (65%) of the established energy savings goals. He explained that the Phase II Order created the need to expand the approved incentive mechanism to include DSM programs for large C/I customers.

Mr. Petitt then provided a summary description of Vectren South-Electric's proposal in this Cause. The Initial Plan as proposed included ten (10) residential programs and four (4) C/I programs.<sup>2</sup> The Initial Plan has a term of 2011 through 2013 to coincide with the time frames established in the Phase II Order. Mr. Petitt explained that in Cause No. 43427, the Commission granted Vectren South-Electric authority to defer all program costs, including implementation, administration, and evaluation costs, and for recovery through its DSMA of Core and Core Plus Programs as defined in that proceeding. He stated that the Company requests the cost recovery and related relief granted in Cause No. 43427 be extended to include costs of the Core and Core Plus Programs as defined in the Initial Plan. The Commission also granted Vectren South-Electric authority to recover incentives associated with meeting its energy savings targets from the Core Plus Programs as defined in Cause No. 43427. Accordingly, Mr. Petitt stated Vectren South-Electric now seeks approval to apply the same performance incentive mechanism to the modified Core Plus Programs in the Initial Plan. He stated Vectren South-Electric also proposes to recover via the DSMA lost margins associated with the delivery of energy efficiency programs to its large C/I customers. With respect to lost margins associated with DSM programs offered to residential and small commercial customers, he explained Petitioner has proposed a decoupled rate design in its pending base rate case in Cause No. 43839 and that if decoupling is approved in that Cause, lost margins directed towards residential and small commercial customers will be recovered through the decoupling mechanism. Accordingly, while the decoupling proposal is pending, Vectren South-Electric seeks approval to defer lost margins associated with programs implemented by residential and small commercial customers. Mr. Petitt stated that if the decoupling mechanism is not approved in Cause No. 43839, Vectren South-Electric will need to make an alternative proposal to the Commission to address recovery of residential and small commercial lost margins.

Mr. Petitt stated that Vectren South-Electric also seeks approval of the implementation of an evaluation, measurement and verification ("EM&V") program for the proposed Core Plus Programs.

Mr. Petitt testified that Vectren South-Electric's proposed rate design and the performance incentive proposals for the Core Plus Programs provide necessary and reasonable financial support for the proposed DSM programs, in recognition of the inherent impact DSM has on the Company's financial performance. He stated the proposed cost recovery, lost margin recovery and performance incentive structure will help position Vectren South-Electric to attract

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<sup>2</sup> There are only three C/I programs included in the Revised Initial Plan agreed to in the Settlement Agreement.

capital on favorable terms by providing an illustration to potential investors of the level of regulatory support and risk mitigation it has in place.

Mr. Pettitt then described how the current regulatory framework in Indiana, including the Commission's DSM Rules and the Phase II Order, supports Vectren South-Electric's proposed Initial Plan. He stated that Vectren South-Electric modified its DSM program portfolio to align with the requirements of the Phase II Order by including Core and Core Plus Programs in the Initial Plan that will provide the means to cost effectively meet the three year savings targets. Mr. Pettitt also testified that the Initial Plan is consistent with other policies in the State of Indiana, including the Hoosier Homegrown Energy Strategic Plan. He stated the Initial Plan serves the public interest by reducing load and providing opportunities for customers to manage current energy usage and costs thereby reducing or deferring future generation needs. He explained that using less energy is also more environmentally friendly, reducing carbon emissions from Vectren South-Electric's system, and helps to mitigate future rate impacts for Vectren South-Electric's customers.

Mr. Pettitt stated that Vectren South-Electric's Oversight Board (the "Oversight Board") will monitor the Core Plus Programs component of the Initial Plan. He stated Vectren South-Electric has also been an active participant in the DSMCC and will continue to seek out appropriate ways for the DSMCC to participate in all aspects, including oversight, of Vectren South-Electric's DSM efforts. He testified Vectren South-Electric proposes an EM&V process for its Core Plus Programs that is consistent with EM&V industry standards, the statewide Core Program efforts and Vectren South-Gas' current EM&V efforts.

Robert C. Sears, Director of Conservation for VUHI, discussed the effects of the Phase II Order on Vectren South-Electric's planned DSM programs as approved in Cause No. 43427 and Vectren South-Electric's participation in the DSMCC. He also provided a detailed explanation of the specific DSM programs included in the Initial Plan and discussed Vectren South's intent to coordinate its gas and electric DSM efforts.

Mr. Sears explained that the Phase II Order, in addition to designating Core Programs, required all jurisdictional utilities to participate in a statewide coalition, the DSMCC, for the purpose of implementing a consistent statewide energy efficiency program. He described the active role Vectren South-Electric has played and continues to play in the DSMCC, including being represented on all three DSMCC subcommittees and playing a key role in completing requests for proposals ("RFPs") for selection of the TPA and the EM&V Administrator.

Mr. Sears explained that the Commission's Phase II Order set aggressive annual electric savings goals, with a 2010 savings goal of 0.3% of weather-normalized average electric sales for the prior three years, with that goal increasing by 0.2% each year until 2019 when the goal is 2% of sales. He explained that the Commission recognized that achieving the aggressive sales goals set out in the Phase II Order will not be possible with Core Programs alone and encouraged participating utilities to implement Core Plus Programs to assist with reaching the annual savings goals.

Vectren South-Electric has implemented several Core Plus Programs, as approved in the Commission's Order in Cause No. 43427. Mr. Sears stated that the Core Plus Programs

approved in Cause No. 43427 and launched in April 2010 are performing well. He stated that the Company's experience so far with the DSM implementation process underscores the fact that proper planning is crucial to the overall success of the programs and that flexibility is needed to ensure the best possible desired outcome for program success. He explained that the Commission's empowering of the Oversight Board with the discretion to shift program funds from less successful programs to more successful programs will support the overall success of Vectren South-Electric's DSM initiative.

Mr. Sears stated the Initial Plan consists of Core and Core Plus Programs designed to meet the specified savings targets identified in the Commission's Phase II Order. The Initial Plan will replace the program plan approved in Cause No. 43427. He explained the Initial Plan primarily focuses on energy savings but also yields demand savings related to those programs. He stated the Initial Plan is expected to yield greater energy and demand savings than the programs approved in Cause No. 43427 since Vectren South-Electric has significantly expanded the funding and planned savings for many of the programs initially approved in Cause No. 43427. Although the programs approved in Cause No. 43427 were planned for residential and small commercial customers, Mr. Sears explained that the DSM programs proposed in the Initial Plan will allow Vectren South-Electric to offer DSM programs to all customers in its service territory, including large C/I customers, further expanding the potential savings that could be achieved. Vectren South-Electric also proposes additional new Core Plus Programs in order to meet the savings goals established in the Phase II Order.

Mr. Sears stated the forecasted annual energy savings goals for the Initial Plan were developed in accordance with the methodology outlined in the Phase II Order and are outlined in the Vectren Electric DSM Three Year Plan July 2010 which was submitted to the Commission on July 1, 2010 as required by the Phase II Order. Mr. Sears predicted the savings goals will probably change over the course of the program since the forecasted goals are based on historical weather normalized sales for 2007-2009 instead of actual sales and will need to be updated to reflect the rolling three year average as prescribed in the Phase II Order.

Mr. Sears described the planning process utilized to determine the programs for the Initial Plan. He stated that Vectren South-Electric relied on the *Electric DSM Action Plan: Final Report* prepared by Forefront Economics, Inc. and H. Gil Peach & Associates, LLC in April 2007 (the "Peach Report"). In addition, Mr. Matthew F. Rose from Terra Vista Energy Group, LLC ("Terra Vista") assisted Vectren South-Electric in updating the technical potential data and cost effectiveness data used in analyzing the cost effectiveness of Petitioner's proposed DSM program portfolio. Programs that could be expanded or added to provide offerings for large C/I customers were also considered as part of the planning process. Mr. Sears stated that most of the programs approved in Cause No. 43427 provided significant opportunities for large C/I customers as well. Of the fourteen (14) DSM programs included in the Initial Plan as proposed, Mr. Sears testified that four (4) Residential Core Programs, one (1) C/I Core Program, three (3) Residential Core Plus Programs and three (3) C/I Core Plus Programs were approved in Cause No. 43427, but have been modified to achieve greater participation and savings. The C/I DSM programs have been expanded in this proceeding to include large C/I customers, which were not part of the filing in Cause No. 43427. The remaining three (3) Residential Core Plus Programs are new. Mr. Sears stated that three of the DSM programs approved as part of Cause No. 43427 were not included in the Initial Plan: the Residential Direct Load Control ("DLC")

program, the Commercial DLC program and the Residential Pool Pump Pilot program. He stated that the Residential and Commercial DLC programs have been deferred for consideration for future implementation given that they were designed to provide demand response benefits and the Phase II Order focuses on energy savings goals as opposed to demand savings. He explained that the Residential Pool Pump Pilot program was very small and did not provide significant overall energy savings benefits. All three of these programs may be considered for future program planning.

The programs included in the Initial Plan are designed to increase energy efficiency and reduce usage by all customers with the exception of Back-up, Auxiliary and Maintenance Power Services (“BAMP”), lighting and emergency siren rate customers. In addition, Mr. Sears stated that the Direct Use pilot program, which has been proposed in Cause No. 43839, will be added to the set of Core Plus Programs approved in this Cause if the pilot program is approved in Cause No. 43839. Mr. Sears also stated that Vectren South-Electric has proposed the expansion of its net metering tariff in Cause No. 43839 and is considering how savings tied to on-site renewable customer generation can be accounted for as part of its qualified DSM savings goals. (RCS-1, pp15-16)

Mr. Sears provided estimated participation costs and benefits of the Initial Plan. The Initial Plan, as originally proposed, includes annual funding amounts of \$8.9 million in Year 1, \$10.1 million in Year 2, and \$12.2 million in Year 3. The annual amounts include anticipated evaluation costs. Mr. Sears explained that the level of savings and funding contemplates a shortfall in achieving the 2010 energy savings targets set out in the Phase II Order and adds sufficient savings and funding over the remaining three year period (2011 through 2013) to make up that shortfall by the end of 2013. The Initial Plan aims to achieve cumulative energy savings of 141,525 MWh after the third year. Mr. Sears provided participation, energy/demand impacts and program costs for the overall Initial Plan as well as on a program specific basis. He stated the results of the TPA RFP will be used to adjust Core Program estimates.

Mr. Sears described the cost-effectiveness tests employed by Vectren South-Electric for DSM program planning and evaluation. He stated that Vectren South-Electric worked with Terra Vista to model the cost-effectiveness of each DSM program included in the Initial Plan. The modeling approach included capturing the economics from various perspectives reflecting the California Standard Practice Methodology, including the Participant Test (“PT”), Utility Cost Test (“UCT”), Rate Impact Measure (“RIM”) Test and the Total Resource Cost (“TRC”) Test. For this analysis, the results of all the tests were reviewed, with an emphasis on the TRC and UCT tests to gauge program cost-effectiveness. The TRC test compares the total costs and benefits of a program, including costs and benefits to the utility and the participant with the avoided costs of energy supply. The programs that were found to be cost effective from a TRC perspective were included in the Initial Plan.

Mr. Sears testified that the UCT was also considered as part of the planning process. The UCT assesses the benefits and costs from the utility’s perspective by comparing the utility benefits versus the utility costs (e.g., benefits of avoided fuel and operating capacity costs compared to rebates and administrative costs). The UCT captures all the same costs and benefits as the TRC test while also including the utility program incentive as a program cost. Incentives are treated as a transfer of payments in the TRC test and not included in the stream of costs and

benefits. Mr. Sears stated that the UCT was used in conjunction with the TRC test in assessing whether the programs are cost-effective when considering Vectren South-Electric's proposed performance incentive for successful management of the Initial Plan.

Mr. Sears stated that including the programs which passed the TRC test is consistent with 170 IAC 4-7-7(b) which requires that at least one of the tests listed above be used to evaluate the cost-effectiveness of a DSM program. He stated the TRC test is commonly used to determine the cost-effectiveness of energy efficiency programs throughout many state jurisdictions.

Mr. Sears testified that in assessing the cost-effectiveness of potential DSM programs, Vectren South-Electric utilized the avoided costs from Vectren South's 2009 Integrated Resource Plans ("IRP"). The avoided costs represent the annual average marginal costs from Petitioner's base case resource plan. The avoided capacity costs were based upon the combustion turbine costs in the IRP. Vectren South-Electric also included a Transmission & Distribution avoided cost proxy equal to 10% of the generation capacity avoided costs in the benefit cost analysis. This value was also used in the 2009 IRP for DSM program screening and cost benefit analysis.

Mr. Sears explained that Vectren South-Electric is requesting approval to recover all costs associated with the Core and Core Plus Programs, as well as, with respect to the latter, performance incentives, via the same methodology approved in Cause No. 43427, with some modifications to include large C/I customers. Tables RCS-4 and RCS-5 in Petitioner's Exhibit RCS-1 outline the Core and Core Plus Program goals, participation, energy/demand impacts and program costs. Mr. Sears stated that the program parameters, including budget, design and potential savings, of the Core Programs included in the Initial Plan are subject to change once the final selection of the TPA and the EM&V Administrator occurs. Vectren South-Electric proposed to make a compliance filing in this Cause to revise its DSMA and include the supporting documents incorporating the final contract costs of the selected TPA and EM&V Administrator. The parties to this proceeding would then have ten (10) days to review the filing and notify the Commission of any objections. 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 DSMA Tariff Sheet will be approved and become effective upon the date of approval. Because it is anticipated the Commission will have approved both the TPA and EM&V Administrator contracts, Vectren South-Electric does not believe this process will be controversial.

In his Supplemental Direct Testimony, Mr. Sears explained that program costs were classified into fixed and variable costs for purposes of developing DSM program cost estimates. He stated there is a distinction between costs incurred to administer and promote programs ("fixed costs") and costs incurred to actually implement programs ("variable costs"). He stated fixed costs are typically costs incurred independent of program participation and variable costs are typically costs which are incurred as customers participate in the programs. Mr. Sears identified the fixed and variable costs for the proposed programs. Vectren South-Electric responded to concerns raised by the OUCC and C&I Group regarding the fixed/variable cost distinction, but has agreed to continue to allocate program costs in the manner provided in its April 2010 compliance filing in Cause No. 43427.

Also in his Supplemental Direct Testimony, Mr. Sears provided additional details regarding Vectren South-Electric's request, summarized by Mr. Pettitt in his direct testimony, for authority to defer, for future recovery, all prudently incurred program costs related to implementation of the Initial Plan and to treat such costs as a regulatory asset using FERC CFR account 182.3 until inclusion of such costs in retail rates. Upon receipt of approval of ratemaking authority necessary to recover these costs through the DSMA, Mr. Sears explained, the regulatory asset will be recovered in accordance with approved allocation methodologies.

Mr. Sears also provided details regarding the performance incentive mechanism previously approved in Cause No. 43427, which Vectren South-Electric requests be applied to the Core Plus Programs included in the Initial Plan, with modifications to cover large C/I customer participation in the programs. The performance incentive mechanism approved in Cause No. 43427 rewards Vectren South-Electric for actual verified energy efficiency savings achieved through the Core Plus Programs. Mr. Sears explained it is calculated based on two components. The first measures the energy savings by comparing the projected kWh savings from installed measures (planned savings) and the actual kWh savings from installations (installed savings). The second measures the demand savings by comparing the projected kW savings from installed measures (planned savings) and the actual kW savings from installations (installed savings). There will be two separately calculated incentives: the Residential Sector Incentive and the Commercial Sector Incentive. The incentive amount for each of these sectors is dependent on the amount of combined savings from each of the sector's individual programs. The performance level achieved will determine the percentage of the incentive to be awarded to Vectren South-Electric, as outlined in Table RCS-6 in Petitioner's Exhibit RCS-1. Vectren South-Electric will not earn a performance incentive unless the verified actual energy and demand savings percentage is equal to or greater than sixty-five percent (65%) of the planned energy and demand savings. This threshold will be applied separately to the residential and C/I sectors. Vectren South-Electric's programs must also pass both the TRC and UCT cost-effectiveness tests with the incentive amount included in order to earn an incentive. For purposes of calculating the performance incentive, Mr. Sears explained the planned energy efficiency budget is defined as the actual Core Plus Program costs, including the Core Plus Program outreach and education costs, not to exceed the total Core Plus Program budget approved annually by the Oversight Board.

The performance incentives will be calculated annually for the Initial Plan programs, based on the results of the previous program year's achieved savings versus target savings. The incentive will then be trued up the following year in the annual DSMA filing, based upon EM&V results performed by the EM&V Administrator. The verified net-to-gross ratios determined by the EM&V Administrator will be used to determine the actual verified net energy and demand impacts, and the resulting actual verified net energy and demand impacts will be compared to the planned net energy and demand savings. Mr. Sears provided an illustration of the performance incentive for the Core Plus Programs included in the Initial Plan in Table RCS-7 in Petitioner's Exhibit RCS-1. The performance incentive illustrated is based upon achievement of target performance (100% or higher) which would provide for a 12% performance incentive of Core Plus Program costs, or approximately \$1.309 million over the initial 3-year program term. The amount of the penalty would be approximately \$436,000 if less than 50% of the performance targets are met.

Mr. Sears described Vectren South-Electric's plan to administer the Initial Plan in accordance with the Phase II Order. The Core Program TPA will be chosen from the RFP process managed by the DSMCC. Vectren South-Electric will serve as the Core Plus Program administrator. Mr. Sears explained that potentially some of the Core Plus Programs can be implemented by the same TPA selected for Core Program implementation. However, Vectren South-Electric will likely use third party program implementers to deliver specific programs or program components where specialty expertise exists (such as the refrigerator and window AC recycling programs) in order to avoid an unnecessary layer of management, oversight and expertise.

Mr. Sears stated that the Core Plus Programs will be governed by the Oversight Board, as approved in Cause No. 43427. The Oversight Board will include the OUCC and potentially other members from the DSMCC. Non-voting Board members, such as Purdue State Utility Forecasting Group or the Indiana Office of Energy Development, may be added to provide additional advisory insight. By unanimous vote, the Oversight Board may add voting or advisory members. The Oversight Board will be responsible for monitoring the progress and effectiveness of the Core Plus Programs included in the Initial Plan, and for making key decisions with respect to the direction of the Initial Plan and the use of Initial Plan funding. The Oversight Board will agree upon evaluation methodology and will assess program evaluations. During the term of the Initial Plan, the Oversight Board may agree to modify program design and/or shift funds among programs to maximize benefits or propose new programs. Each Oversight Board member will have one vote.

Mr. Sears testified that Vectren South-Electric envisions that the Oversight Board will make decisions using a consensus process similar to that used for the Vectren South-Gas programs. Any individual member of the Oversight Board could raise issues and seek a majority decision. In the event the Oversight Board deadlocks on a voting issue, then the members of the Oversight Board could present their positions to the Commission for a decision.

Mr. Sears explained that Vectren South-Electric will perform EM&V of the proposed DSM programs in accordance with the Phase II Order and intends to use the Core Program EM&V Administrator chosen from the RFP process managed by the DSMCC to evaluate the Core Plus Programs. The EM&V Administrator will conduct impact evaluations, process evaluations, market effects evaluations and related studies of the programs. Mr. Sears stated Vectren South-Electric will initiate EM&V efforts for Core Programs once the EM&V Administrator is selected and a contract is executed. He stated Vectren South-Electric also plans to engage the same EM&V Administrator for Core Plus Program evaluation as soon as possible following approval of the proposed Core Plus Programs. If for some reason, Vectren South-Electric cannot negotiate terms for Core Plus Programs evaluation with the chosen EM&V Administrator, Mr. Sears explained Vectren South-Electric will find another qualified independent third party to do the EM&V for the Core Plus Programs. In his Supplemental Direct Testimony, Mr. Sears clarified that EM&V activities will be performed under the direction of the Oversight Board and the selection of the EM&V Administrator will be subject to approval of the Oversight Board. Mr. Sears stated that Vectren South-Electric anticipates that the EM&V process will be similar to that used by the DSMCC for evaluation of Core Programs. He stated the EM&V Administrator will manage, at the direction of the Oversight Board, the development, oversight and implementation of program evaluation projects and related studies throughout the

program period. He stated the EM&V Administrator will design and present program-specific evaluation plans to the Oversight Board for approval and will design the program-specific data collection plans to ensure they are sound from an evaluation research perspective.

Mr. Sears stated that the Phase II Order requires annual updates regarding the Core and Core Plus Programs in order to monitor progress toward meeting the energy savings objectives of the Phase II Order. He stated Vectren South-Electric will work with the TPA and the EM&V Administrator to summarize (1) the accomplishments of the previous year; (2) any proposed changes to the Initial Plan and the rationale for the proposed changes; and (3) revised program budgets and goals for the following year. He stated Vectren South-Electric will work with the DSMCC on any Core Program changes and with the Oversight Board on any Core Plus Program changes. Mr. Sears explained that the revised goals summarized in the annual updates will also serve as the basis for the targets for the performance incentive.

Mr. Sears testified to the need for the Oversight Board to have flexibility to consider appropriate modifications to the programs based upon EM&V results, and to shift costs within a program budget or between programs as needed. He stated the Oversight Board should be allowed to shift excess funding to other Core Plus or Core Programs as the Oversight Board deems appropriate. In addition, he stated the TPA, DSMCC and the Oversight Board should have the ability to work together to reallocate unused funds from both Core and Core Plus programs. He explained that given that large C/I customers will be eligible for programs beginning in 2011, the possibility exists for a small number of customers to quickly exceed the budget target for a program. He stated the Oversight Board must be provided the flexibility to allow additional funds to be allocated to a specific program if implementation exceeds budget targets for that program. Vectren South-Electric requests that the Oversight Board have the flexibility to consider the approved spending levels as 3-year targets rather than as annual fixed amounts and to allow the funds to be shifted between programs so long as the programs still pass the TRC test and the overall DSM budget is not exceeded. Mr. Sears summarized Vectren South-Electric's proposals regarding the ability to earn an incentive on funds that may be reallocated. As part of the Settlement Agreement described in greater detail below, the Settling Parties agreed the Oversight Board will have the discretion to review and approve the shifting of funds between Core Plus programs and the Oversight Board, TPA and DSMCC must approve any shifting of funds from Core to Core Plus Programs and vice versa. Under the Settlement Agreement, if approved, the energy savings associated with transfers of program dollars from Core to Core Plus Programs will be ineligible for shareholder incentives.

Mr. Sears described the importance of the position of Electric DSM Manager, approved in Cause No. 43427, in order to support the implementation and administration of Core Plus Programs to be implemented, as well as the ongoing activities of the DSMCC toward the establishment and implementation of Core Programs. Based on the DSM programs proposed in the Initial Plan, Mr. Sears stated Vectren South-Electric is requesting four (4) positions in addition to the previously approved Electric DSM Manager. Mr. Sears explained the additional positions are required due to the increase in the scale and scope of the programs proposed in the Initial Plan. The four (4) additional positions include two (2) DSM Representatives (one for residential and one for commercial/industrial) to oversee the internal and external activities related to the programs in each sector, an EM&V Coordinator to work with the selected independent third party evaluator and facilitate measurement and verification efforts, and a DSM

Program Administrative Assistant to process customer rebate requests, input program results into tracking systems and assist customers with information on energy efficiency. Petitioner's Exhibit RCS-S3 includes budget provisions for these staffing requirements in the fixed cost budgets.

Mr. Sears discussed Vectren South's intent to coordinate its gas and electric DSM efforts where possible and cost effective. He explained that Vectren South plans to work with the gas and electric Oversight Boards to integrate the gas and electric program offerings including delivery of specific gas and electric programs by a single party, wherever possible. He stated opportunities exist for joint program delivery of both Core and Core Plus Programs. He explained that costs which are associated with savings specific to gas or electric will be allocated to that particular energy source and costs that are associated with savings of both gas and electric as well as program delivery and administration costs will be allocated on a pro-rata basis. Mr. Sears described Vectren South-Electric's development of plans to include some electric energy savings measures in the school education kits that are funded by the gas DSM program. Vectren South will work with its respective gas and electric Oversight Boards to determine the cost allocation for the program.

Matthew F. Rose, Principal at Terra Vista, explained the analysis used to determine program costs and benefits. He stated that Vectren South-Electric's programs were developed through a sequential set of planning steps aimed at taking the most current industry and market information to screen and prioritize the relevant opportunities based on their costs and benefits.

Mr. Rose stated that a formal economic analysis of each candidate technology and program was conducted. The analysis served to identify the associated costs and benefits as compared to projected electric supply costs to determine cost-effectiveness. Mr. Rose testified that the analysis included all the relevant program costs including program administration, training, incentives and evaluation as well as estimated annual program participation. These costs were compared to electric avoided costs to provide a net present value impact of all costs and benefits. The result was a benefit-cost ratio and estimate of the economic value of the proposed Initial Plan. Mr. Rose stated that by simulating the results of the programs included in the Initial Plan using a dedicated spreadsheet cost-effectiveness model, the full range of economic impacts were determined.

Mr. Rose explained that the economic analysis included a full range of market perspectives including the PT, UCT, RIM Test and TRC Test. The results of each of the tests were conducted for each program. All the economic tests were based on the cost-effectiveness methodologies from the publication *California Standard Practice Manual: Economic Analysis of Demand-Side Programs and Projects*, California Governor's Office of Planning and Research, 2002.

Mr. Rose stated that the DSM planning effort took into consideration the priorities and goals established by the Commission in the Phase II Order for all jurisdictional utilities in the state of Indiana, leveraged Vectren South-Electric's current experience based on its current utility programs in Indiana, applied information from the Peach Report and utilized input and cost data from proposals from various implementation contractors to deliver selected programs for Vectren South-Electric to help detail delivery and cost estimates based on Vectren South-

Electric's market. Mr. Rose also stated Terra Vista examined recent DSM and energy efficiency plans from other utilities looking to implement programs.

Mr. Rose stated that Vectren South-Electric's avoided costs were developed by Vectren South-Electric using its planning models and consistent with its IRP process. In his analysis, the electric avoided costs are used as a proxy for utility supply costs to assess the relative cost effectiveness of the DSM programs. The avoided costs consist of both avoided energy (cents per megawatt-hour) and capacity (dollar per kilowatt) per year. A twenty-year series of costs was used to allow comparison of DSM to supply-side costs for measures into the future. Mr. Rose testified that all the relevant economic analyses are based on modeling the net present value of costs and benefits to address the time value of money. The end result is a direct comparison of whether a candidate DSM program is more or less expensive than the supply alternative. Mr. Rose stated that programs with positive net present value results and a positive benefit-cost ratio indicate the DSM program is less expensive than the supply option.

Mr. Rose described the process used to identify and screen candidate DSM and energy efficiency measures. He stated the process consisted of three steps. First, an extensive list of candidate measures was developed by examining similar planning efforts at other utilities, incorporation of measures from existing Vectren South-Electric programs and experience of Terra Vista staff. More than 50 measures were considered. Second, a technology analysis was conducted for each of the candidate measures, based on simulating the economic impacts of each measure on the basis of one single adopter using the TRC test. The technology analysis does not include any costs for marketing, delivery or evaluation. Finally, measures which pass the technology analysis are packaged into program concepts for a more detailed economic examination. The program concept is designed to incorporate all the relevant costs, participation and delivery components to provide an accurate economic assessment. The full program costs are compared to Vectren South-Electric's avoided costs to determine relative cost effectiveness. Programs which resulted in positive benefit-cost impacts were included in Vectren South-Electric's Initial Plan.

Mr. Rose stated the cost effectiveness analysis distinguished between Core Programs and Core Plus Programs. In addition, a key planning consideration incorporated into the analysis was the purposeful inclusion of large C/I customers.

The cost effectiveness analysis results were contained in Petitioner's Exhibit MFR-4 and Petitioner's Exhibit MFR-5, showing the net present value and benefit-cost results for each of the Core and Core Plus candidate programs, respectively, for each of the relevant perspectives.

Mr. Rose stated that each program was designed to incorporate delivery mechanisms which best allow the programs to overcome market barriers and cost-effectively promote the relevant technologies in the marketplace. The mix of delivery mechanisms include education, leverage with trade allies/contractors, training, and incentives.

Mr. Rose stated that the program design includes costs reflecting market outreach activities, including media advertising and positioning of Vectren South-Electric as an informed and willing source of helping its customer efficiently consume its product. Mr. Rose testified

that the costs for market outreach were developed by Vectren South-Electric and are included in the cost-effectiveness analysis.

Mr. Rose stated that the DSM programs included in the Initial Plan are designed to attract more than 118,000 participants over the three-year program term. As modeled, the programs are expected to save nearly 140,000 megawatt-hours by the third year. The total budget for the entire portfolio is estimated at \$31.2 million. Overall, the Core and Core Plus Programs in the Initial Plan as proposed have a net present value of \$58.8 million and an aggregate benefit-cost ratio of 2.67.

Mr. Rose explained that each of the program designs includes a dedicated budget for program evaluation. The percentage of costs for each program dedicated to evaluation range depending on the size and installation requirements of each program. Those programs needing careful follow-up, such as new construction initiatives and customer installed measures such as the Residential Lighting (CFL) Program, require higher costs for evaluation due to the need to properly sample participants and obtain verification of proper installations.

Scott E. Albertson, Director, Regulatory Affairs at VUHI explained how Vectren South-Electric proposes to recover the costs of the Core and Core Plus Programs, including administrative costs and Core Plus Program performance incentives and large C/I customer lost margins resulting from the Core and Core Plus Programs through the DSMA.

Mr. Albertson described how Vectren South-Electric currently recovers costs of Core Plus Programs implemented in April 2010 as approved in Cause No. 43427 via the Energy Efficiency Funding Component (“EEFC”) of the DSMA. He explained that Core Plus Program costs are allocated to both energy and demand based on the estimated energy and demand savings to be realized from the programs to be implemented. The demand allocation is based on the demand Four Coincident Peak (“4CP”) percentages from Cause No. 43111, Vectren South-Electric’s most recent general rate case. Once the energy/demand allocation is determined, the resulting costs are allocated to the Rate Schedules based on the benefit(s) provided. Mr. Albertson explained that energy-related program costs are allocated only to the Rate Schedules to which energy savings programs are applicable, while demand-related costs are allocated to all Rate Schedules. He stated that under the cost recovery methodology approved in Cause No. 43427, costs are recovered in the DSMA via energy charges from smaller customers who do not have demand charges and via demand and energy charges from larger customers who have both charges. Under the Cause No. 43427 recovery methodology, demand-related Core Plus Program costs allocated to large C/I customers are recovered via demand charges. Mr. Albertson explained that, with the addition of Core Program cost recovery in the DSMA as proposed in this Cause, Vectren South-Electric is proposing to modify this cost recovery methodology to recover all costs of programs included in the Initial Plan through an energy charge from all customers, both large and small, in order to reduce the complexity of the DSMA filing schedules and simplify the customer billing process and reconciliation of variances. Mr. Albertson also stated that the Company proposed to distinguish between fixed and variable program costs as described in Mr. Sears’ Supplemental Direct Testimony. Petitioner’s Exhibit SEA-2 (Second Revised) illustrates how the EEFC would be impacted by this change.

Mr. Albertson provided a description of the reconciliation of Core and Core Plus Program costs. He stated actual EEFC recoveries are subtracted from actual program costs incurred to arrive at an over or under recovery variance. The resulting customer class variances are then included in the subsequent DSMA filing in order to reflect the variance attributable to each Rate Class in the prospective DSMA.

Mr. Albertson described how the performance incentives will be included in each DSMA filing which reconciles actual program results. The incentive amount will be trued up in the next subsequent DSMA filing based upon EM&V results.

Mr. Albertson summarized Vectren South-Electric's lost margin recovery proposal. With respect to large C/I customers, he stated that Vectren South-Electric recovers margins from these C/I customers via applicable monthly customer facilities charges, energy charges, and demand charges included in its approved Tariff for Electric Service. He explained that the margin recovered from each customer is directly dependent on the energy and demand units billed to each customer. Mr. Albertson testified that the success of Vectren South-Electric's DSM programs applicable to large C/I customers in generating energy and demand savings will result in a decline in the Company's margin recovery. Accordingly, Vectren South-Electric proposes to recover large C/I customer lost margins via a "lost margin component" of the DSMA. The lost margin component will be projected in each DSMA filing based on expected DSM program implementation, as illustrated in Petitioner's Exhibit SEA-3 (Second Revised). The derivation of the projected lost margin component begins with an estimate of the projected number of expected participants in each program by Rate Schedule. Projected energy savings per program, by Rate Schedule, are then multiplied by the projected number of equivalent participants to arrive at a total energy (kWh) savings estimate by program. The same methodology is used to arrive at total demand (kW) savings by program. The total savings (energy and demand, respectively) are then multiplied by the appropriate energy or demand charge in the tariff (the charge that would have been applicable to additional energy or demand billings in the absence of the DSM programs, less fuel and variable costs) to arrive at projected energy- and demand-related lost margins. The total projected lost margin (both energy and demand related) will be recovered from large C/I customers through a lost margin component energy charge, determined by dividing total projected lost margin by projected energy sales for all applicable Rate Schedules.

Mr. Albertson stated the Company will track actual program results by the number of participants by Rate Schedule, as well as the months in which each participant enrolled in each program. This information will be used to calculate an equivalent number of participants for the year, to account for the fact that each program will commence at different points in time throughout each year for each participant. The energy savings and demand savings will then be multiplied by the appropriate energy or demand charges to arrive at energy- and demand-related lost margins as described in detail in Petitioner's Exhibit SEA-1 (Revised), 12-13. Actual lost margin component recoveries will be subtracted from actual lost margins to arrive at an over or under recovery variance by Rate Schedule. This variance will be added to the estimated lost margin for the projection period to arrive at total lost margins to be recovered in the DSMA filing.

With respect to customers other than large C/I customers, Mr. Albertson explained that Vectren South-Electric has proposed a decoupling mechanism in Cause No. 43839 pursuant to which margin recovery from those customers would be decoupled from energy sales. If decoupling is approved in Cause No. 43839, he stated lost margin recovery for these smaller customers via a lost margin component of the DSMA is neither necessary nor appropriate. In the event Vectren South-Electric's decoupling proposal is not approved, the Company would propose in a future proceeding an alternative lost margin recovery mechanism applicable to residential and small C/I customers.

Mr. Albertson testified that Vectren South-Electric proposes to file the DSMA annually by April 1 so that DSM program spending and results need not be divided into separate, six month segments. Vectren South-Electric believes this change will reduce administrative burden for the Commission and the OUCG, as well as for the Company. Estimated residential bill impacts will be reflected in each DSMA filing as illustrated in Petitioner's Exhibit SEA-5 (Second Revised). The proposed DSMA tariff sheet reflecting the proposals discussed by Mr. Albertson is contained in Petitioner's Exhibit SEA-8 (Second Revised).

7. **OUCG's Testimony.** April M. Paronish, Utility Analyst in the Resource Planning and Communications Division of the OUCG, chronicled the OUCG's involvement in the development of Vectren's proposed DSM programs; provided an overview of Vectren South-Electric's existing and proposed electric DSM programs; and described the OUCG's concerns regarding the manner in which Vectren South-Electric is modifying its DSM portfolio, its request for performance incentives for its proposed large C/I programs and its proposed Direct Use Pilot program, and its request to defer lost margins.

Ms. Paronish described the DSM Collaborative consisting of staff from Citizens Action Coalition (CAC), Vectren South and the OUCG formed as a result of the Settlement in Cause No. 42861. She explained that the DSM Collaborative selected a consultant to perform a Market Assessment and DSM Action Plan (the Peach Report) for DSM programs in Vectren South's electric service territory. The DSM Collaborative reached agreement on programs, funding levels, program implementation, EM&V, reporting, and oversight which formed the basis for Vectren South-Electric's filing in Cause No. 43427. Ms. Paronish provided a summary of Vectren South-Electric's proposed modifications to the program portfolio originally proposed in Cause No. 43427 and testified that the OUCG does not object to Vectren South-Electric removing the DLC programs from its portfolio.

Ms. Paronish stated the OUCG's position that the Oversight Board should be allowed to shift funding only between Core Plus Programs offered to the same customer sector and does not support shifting funds between Core Programs and Core Plus Programs. With regard to shifting funds among Core Programs within the same sector, she recommended such shifts be approved by the DSMCC after consultation with the TPA. She stated the OUCG prefers funds designated for Core Programs and those designated for Core Plus Programs remain as originally designated. However, in the event this is allowed, the OUCG recommends the Commission find that any transfer of funds originally designated for Core programs to Core Plus Programs be ineligible for shareholder incentives. In the Settlement Agreement, the Settling Parties agreed that funds shifted from Core Programs to Core Plus Programs would not be eligible for shareholder incentives.

Ms. Paronish testified that in Cause No. 43427, outreach and education costs were allocated equally between the residential and commercial sectors. Because large C/I customers were not included in Cause No. 43427, Ms. Paronish contends they were not allocated outreach and education costs. Since large C/I customers are included in the Initial Plan proposed in this Cause, Ms. Paronish stated they should share equitably in those costs.

Ms. Paronish expressed the OUCC's concerns with Vectren South-Electric's proposal to make the Direct Use Pilot program, proposed in Cause No. 43839, a Core Plus Program eligible for incentives if the pilot program is approved in Cause No. 43839. She expressed her opinion that the Direct Use pilot program is not a DSM program designed to promote conservation, but rather a fuel switching program that does not encourage customers to change usage behavior. Ms. Paronish testified that insufficient evidence was provided to support inclusion of the Direct Use pilot program in Vectren South-Electric's DSM portfolio. Should the Commission approve the program, the OUCC recommends the shareholder incentive be denied for the program. Ms. Paronish stated the OUCC has concerns over the lack of benefit-cost test information related to the Direct Use pilot program and the lack of information as to whether Vectren South-Electric investigated and considered other manners of heating water, such as an electric heat pump water heater.

Ms. Paronish requested that information regarding the cost effectiveness of each individual program in the Initial Plan be provided to both the DSMCC and the Oversight Board prior to implementing the Initial Plan.

She also expressed the OUCC's opposition to Vectren South-Electric's request to implement the previously approved shareholder incentive structure for its large C/I programs. She stated Vectren South-Electric did not perform its own formal study of large C/I programs and has no experience with offering such programs. She also contended that the Commission's recent rulings suggest shareholder incentives for DSM programs should be reserved for those utilities that have been offering DSM programs with good results over a period of time that is sufficient to determine the utility's commitment to providing its customers with cost-effective DSM programs.<sup>3</sup> Accordingly, she recommended shareholder incentives be made available for only those DSM programs previously approved by the Commission in Cause No. 43427 and only to those specific customer classes identified by Vectren South-Electric in that Cause.

Ms. Paronish then addressed Vectren South-Electric's request for lost revenue recovery. She explained that the OUCC is generally opposed to deferral of costs associated with programs that have not been approved by the Commission and therefore approval to defer lost revenue associated with residential and small commercial customers pending the outcome of Vectren South-Electric's proposal for decoupling in Cause No. 43839 should be limited to only those approved programs identified in Cause No. 43427. She further stated that in the event the decoupling proposal is not approved, until an alternative lost margin recovery mechanism has

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<sup>3</sup> Ms. Paronish cited the Commission's Orders in *Indianapolis Power & Light Co.*, Cause No. 43623, Phase I Order (IURC 6/30/2010) and *Duke Energy Indiana, Inc.*, Cause No. 43374 (IURC 2/10/2010). She also cited to the Commission's denial of I&M's request for shareholder incentives in its September 22, 2010 Order in Cause No. 43827. However, subsequent to the filing of Ms. Paronish's Testimony, the Commission issued its subsequent Order on Reconsideration in Cause No. 43827 and granted I&M's request for shareholder incentives.

been proposed, the Commission should deny Vectren South-Electric's request for deferral, including lost revenue associated with programs approved in Cause No. 43427.

Ms. Paronish agreed that if the Commission approves the large C/I customer programs included in the Initial Plan, the Commission should grant Vectren South-Electric's request for lost revenue, but only after third-party EM&V has been completed. She stated that such recovery should be based on the resulting net savings and that recovery should not occur until Vectren South-Electric proposes a method to recover lost revenue in a manner consistent with 170 IAC 4-8-6, including the requirement to account for the impact of free riders.

Wes R. Blakley, Senior Utility Analyst for the OUCC, provided testimony recommending denial of Vectren South-Electric's proposed changes to the DSMA, specifically its request for the allocation of DSM costs between fixed and variable components. He explained that the current mechanism was approved less than one year ago, is much less complicated than Vectren South-Electric's proposal and that Vectren South-Electric failed to provide justification for the change. Mr. Blakley testified that Petitioner's proposal would result in small and medium sized non-residential customers bearing a disproportionate share of "fixed" DSM costs allocated to non-residential customers because those customers account for roughly 98% of the non-residential class although they account for only about 25% of annual kWh energy sales to the non-residential class. He recommended Vectren South-Electric continue recovering DSM program costs as approved in Cause No. 43427 and not split DSM costs between fixed and variable categories.

Mr. Blakley also recommended that special contract customers not be excluded from DSM programs due to their large energy usage. In addition, he noted a large disparity in the DSMA rate for Rate Schedule SGS versus other rate classes and stated that Vectren South-Electric had not explained this disparity.

**8. C&I Group's Testimony.** Nicholas Phillips, Jr., Managing Principal with Brubaker & Associates, Inc., submitted testimony on behalf of C&I Group to address Vectren South-Electric's proposal to recover DSM program costs, including implementation, administration and evaluation costs, the recovery of lost margins and the performance incentives through the DSMA. He also provided testimony on self-directed DSM plans for large C/I customers.

Mr. Phillips testified that in his opinion, as a matter of policy, the Commission should keep trackers to a minimum. He stated if a tracker is approved in this proceeding, for the recovery of Core and Core Plus Program costs, the tracker should not be expanded and the operation of the tracker should not be modified later to reduce complexity or adopt changes proposed by Vectren South-Electric. He advocated a reduction in the Company's allowed return on equity if the Commission approves the continuation or expansion of the DSMA, to recognize what he designated as the reduced business risks faced by the Company's shareholders due to the assured recovery of DSM program expenditures.

Mr. Phillips recommended the Commission reject Vectren South-Electric's proposal to recover lost revenues (margins) associated with its DSM programs. He stated recovery of lost margins would reduce the Company's incentive to promote economic development and to

control rate increases. If the Commission is concerned about lost margins due to implementation of DSM, he recommended the use of a cost based rate design for large C/I customers that contains only fuel and variable operation and maintenance expense in the energy charge (straight fixed/variable) instead of tracking lost margins. Mr. Phillips stated that if recovery of lost margins is granted it should only apply to small general service and residential classes and such recovery should only be allowed for verified metered sales reductions solely attributable to Vectren South-Electric's approved DSM programs for these customer classes. Mr. Phillips also recommended that lost margin recovery should not be granted unless sales levels for small general service and residential classes are lower than the sales levels used to establish the most recently approved rates for these customer classes. He further recommended that lost margins should be net of fuel and variable operating and maintenance expenses.

Mr. Phillips did not support collection of financial incentives for implementing the proposed Core Plus Programs. He suggested that if the DSMA is expanded to include lost margin recovery, such assured recovery of costs would negate any arguments that shareholder incentives are needed to remedy any disincentive to pursue DSM programs on the part of the Company's management. He testified that if the Commission permits the Company to recover financial incentives through the DSMA, Vectren South-Electric should only be permitted to earn the incentive if the Company exceeds 100% of its Commission-mandated demand and energy savings targets. He recommended that any reward be granted as a percentage of the verified, net cost savings achieved through the Company's Core Plus Programs, rather than as a percentage of the DSM budget for such programs.

Mr. Phillips recommended that a self-directed program be added to Vectren's DSM program portfolio. He testified that utility-sponsored programs are not the best means of promoting energy efficiency efforts in the Company's service area for some customers. Many large customers have their own resources or utilize independent energy services companies to improve the energy efficiency of their manufacturing processes. These measures require a high degree of customization and there is no reason to believe that the utility can procure these energy efficiency services more cost-effectively than customers who directly access the market. Mr. Phillips also raised concerns that DSM programs where the utility acts solely as a bank to fund highly customized projects for some of its customers raises questions as to discriminatory service and equity between ratepayers. Companies who have already invested in DSM using their own financial resources should not be forced to pay for energy efficiency twice. Mr. Phillips testified that these concerns can be addressed through a self-directed energy efficiency program.

Mr. Phillips described the application process for the self-directed program. He testified that large customers with an annual aggregate demand of 1 MW or greater could submit a proposal, which would consist of an audit identifying energy efficiency opportunities at their facility(ies) in Petitioner's service territory; and the customer's proposed plan to pursue cost-effective energy efficiency measures from the audit over a three-year period. The customer's proposed self-directed plan could include a proposal to participate in a demand response program administered by Petitioner. For the first approval period, the customer's plan could also incorporate projects the customer has completed since January 1, 2010. At the end of the three-year period, the customer would report on its progress and submit independent verification of the energy and/or demand savings achieved through the implemented measures.

Mr. Phillips proposed that a collaborative consisting of Petitioner, the OUCC, the Vectren South Large Customer Group and any other interested stakeholders would review any self-directed plan applications. Self-directed plans would be approved if the customer can demonstrate that it is making a reasonable financial investment in energy efficiency and/or demand response measures based on the audit of its facility(ies). As part of its plan, the customer would be allowed to present information about its past investments in energy efficiency measures. Mr. Phillips also recommended that the collaborative should consider that past investments in energy efficiency by the customer may reduce cost-effective future opportunities. In the event a customer disagrees with the collaborative's decision regarding its self-directed plan, he recommended a process to request resolution by the Commission. Finally, Mr. Phillips recommended that procedures be included for protecting confidential information which may be submitted as part of a self-directed program application.

Mr. Phillips testified that customers who participate in an approved self-directed plan would be fully responsible for the costs of its own energy efficiency efforts. In exchange, those customers would not be assessed charges under the proposed DSMA or any other charges that may be assessed to recover the costs associated with Vectren's DSM programs. The savings from self-directed programs would count toward Vectren's energy savings targets from the Phase II Order.

**9. Petitioner's Rebuttal.** In his rebuttal testimony, Mr. Petitt responded to the testimony of Ms. Paronish from the OUCC and Mr. Phillips from the C&I Group related to recovery of program costs, lost margin and direct use. Mr. Petitt discussed how the Phase II Order underscores the significance of maintaining the DSMA to recover not only DSM program costs, but also lost margins on a going forward basis. He stated that approval of the expanded DSM programs included in the proposed Initial Plan is necessary for the Company to meet its obligations pursuant to the Phase II Order and maintaining the DSMA is important to recovering the program costs and lost margins associated with the expanded programs. Mr. Petitt responded to Mr. Phillips' opposition to recovery of lost margins created by DSM programs, explaining that Vectren South-Electric's request in this proceeding to recover verified lost margins resulting from large C/I customer participation in DSM programs results from the Commission's requirement to successfully offer programs to reduce energy consumption by the Company's customers over the next ten years by 11-12% on a cumulative basis. Mr. Petitt stated that Vectren South-Electric recovers a significant amount of its fixed costs from its large C/I customers based on their continued use of energy at the level estimated when its base rates were most recently established. He explained that the lost margin recovery mechanism attempts to alleviate the financial harm due to decreased sales resulting from the DSM programs and does not address any other business risks that existed prior to these programs being offered. As for Mr. Phillips' suggestion that lost margin recovery would reduce Vectren South-Electric's incentive to promote economic development and to control operating costs, Mr. Petitt responded that the Company's incentive to attract customers to create greater margins and thereby offset increasing costs, spread fixed costs and limit future rate increases exists with or without DSM programs and with or without lost margin recovery. Mr. Petitt testified that Mr. Phillips' suggestion that approval of lost margin recovery will make the Company less responsive to the needs of its customers is without merit and not supported by the evidence. He stated promoting economic development and providing quality, reliable services within its service territory are and

shall remain top priorities for Vectren South-Electric and, the Commission's approval of the lost margin adjustment mechanism will not change that fact.

Mr. Petitt explained that at best, lost margin recovery provides recovery of the amount of margins lost due to DSM programs, but never any more than that level. Moreover, Mr. Petitt explained, margins attributable to economic development efforts often result from incremental investment in new facilities on the part of the Company. Therefore, to recoup the cost of such incremental investments, the Company needs to retain the new margins. If the Company sacrifices lost margin recovery due to imposition of a cap such as the sales levels used to establish the current base rates in effect, as suggested by Mr. Phillips, it will have new risk related to recovery of costs related to such investments with no way to offset down years of margins due to weather or other factors. Mr. Petitt opined that the lost margin recovery mechanism proposed by the Company is fair and should not be modified.

Mr. Petitt testified that Vectren South-Electric's proposal is consistent with national and state policies supporting active utility engagement in DSM. He stated policymakers have recognized that such support requires supportive regulatory policies that protect utilities from financial detriment that inherently results from customer usage reductions created by efficiency efforts. He stated that given the Commission's mandate to offer DSM programs to all customer classes, the savings targets imposed by the Phase II Order, the Commission's acknowledgement in Cause No. 43911 that DSM programs reduce sales and the Commission's desire to level the playing field between demand-side and supply-side resources as stated in Cause No. 43911, Vectren South-Electric's request to recover lost margins associated with large C/I customer DSM programs through the DSMA is reasonable and in line with the Commission's DSM rules.

Finally, Mr. Petitt responded to Ms. Paronish's recommendation that deferral of lost margins should only be allowed for previously approved small customer programs. He stated that Vectren South-Electric's request to defer lost margins for later recovery should apply to all programs approved in this proceeding and offered by the Company in response to the Phase II Order. As existing programs continue and previously approved programs are rolled-out, energy sales are reduced in increasing magnitude and Mr. Petitt testified that it is fair and appropriate to provide the opportunity to recover such lost margins. He also noted there is no legal or regulatory limitation to deferring lost margins for those programs approved simultaneously with this proceeding. Mr. Petitt clarified that Vectren South-Electric has not requested a lost margin adjustment mechanism in this proceeding for residential and small commercial customers. If the decoupling mechanism proposed in Cause No. 43839 is not approved and Vectren South-Electric has to submit an alternative proposal for the recovery of lost margins for residential and small commercial customers, then the deferral authority granted herein will simply allow the subsequently approved mechanism to capture the verified lost margins incurred and deferred beginning January 1, 2011. Mr. Petitt stated the OUCC will have ample opportunity to comment on the mechanism. To the extent decoupling is approved, Vectren South-Electric will not seek recovery of any deferred lost margins for the applicable customer classes. Mr. Petitt agreed that EM&V will be used to calculate lost margin recovery for large C/I customers.

In his rebuttal testimony, Mr. Sears responded to Ms. Paronish's testimony regarding: (1) the development of the Initial Plan to comply with the Phase II Order, (2) program funding

flexibility, (3) the Direct Use pilot program and (4) the performance incentive mechanism. He also responded generally to issues raised by Mr. Phillips.

Mr. Sears reiterated that the expansion of the Residential and Commercial DLC programs has been deferred for consideration for future implementation. He also explained that the Company plans to keep the current DLC programs in place and continues to have an open enrollment approach to the programs.

Mr. Sears testified on rebuttal that shifting Core Plus funds within the same customer segment is not consistent with the current practice of the Vectren South-Gas Oversight Board and the limitation would be an unnecessary restriction. With regard to electric programs, in Cause No. 43427, Mr. Sears recommended that the Oversight Board have flexibility to consider, based on results of independent third party evaluations, appropriate modifications to the program portfolio on a prospective basis, including reallocation of funding between programs. Mr. Sears testified on rebuttal that the Vectren South-Electric Oversight Board has actually followed this practice in 2010. He stated this level of flexibility has proven to be invaluable to the Oversight Board and its ability to ensure that the established energy savings goals are achieved. Mr. Sears agreed that shifting Core program funds between various Core programs, as needed, is a matter for the TPA and the DSMCC to coordinate. He testified that the ability to shift funds to and from Core and Core Plus programs is an important component to further ensure that DSM funding is used as effectively as possible and that the Commission's energy efficiency goals are ultimately achieved. Mr. Sears maintained that this process could be handled in a straightforward fashion, as proposed in this proceeding. He explained the TPA, DSMCC and the Oversight Board should have the ability to work together to reallocate unused funds from both Core and Core Plus programs in order to ensure that the Commission's energy savings goals are achieved. Mr. Sears agreed that any shifting of funds would have to be agreed upon by the TPA, DSMCC and the Oversight Board.

To alleviate any concerns, Mr. Sears expressed the willingness of Vectren South-Electric to agree that any transfer of funds originally designated for Core DSM programs to Core Plus programs would be ineligible for shareholder incentives, unless agreed to by the Oversight Board.

With regard to the proposed Direct Use Pilot Program, Mr. Sears explained that such programs are consistent with the Commission's definition of DSM in 170 IAC 4-7-1, which defines DSM as the planning, implementation, and monitoring of a utility activity designed to influence customer use of electricity that produces a desired change in a utility's load shape. He stated DSM includes an activity that involves deliberate intervention by a utility to alter load shape. He compared Direct Use programs to other programs where there is an incentive offered by the utility to the customer to install a more energy efficient piece of equipment. He stated Vectren South-Electric's energy efficiency efforts are not only made up of programs that encourage changes in usage behavior but also programs that provide customer incentives to install more energy efficient equipment, such as the Direct Use program. Mr. Sears explained that all Vectren South-Electric requests in this case is that, to the extent the pilot is approved by the Commission in Cause No. 43839, the resulting energy savings be counted like any other Core Plus program for purposes of determining compliance with the energy savings targets. Given it is

a proposed pilot, Mr. Sears expressed Vectren South-Electric's willingness to withdraw its request for performance incentives related to the Direct Use pilot program.

Mr. Sears testified that during the course of the technology screening analysis as described in Petitioner's Exhibit MFR-2 both a heat pump water heater and solar water heater were analyzed. He also stated that Vectren South-Electric is willing to include in the Direct Use program rules that gas must already be present at the home in order to participate in this program.

Mr. Sears offered a response to the OUCC's opposition to the opportunity to obtain performance incentives related to large C/I customer programs as well as new and expanded residential and commercial programs. He explained that whether Vectren South-Electric has experience or not is irrelevant since it gets paid for actual achievement. He then described the Commission's Order on Reconsideration, issued on December 7, 2010 in I&M's DSM case, (Cause No. 43827), which reversed the findings on performance incentives relied upon by the OUCC and C&I Group in this case. That Order states:

The Commission notes that under the Phase II DSM Order in Cause 42693, the Commission imposed an aggressive two percent reduction target for electric utilities to achieve by 2019. While our conclusion in the September 22 Order provided that I&M could seek a shareholder incentive upon the successful implementation of DSM programs, upon further consideration, we find that the Shared Benefit approach contained in the Settlement Agreement is based on an on-going demonstration of net benefits to the utility's customers as the DSM programs are implemented. The Shared Benefit mechanism, based on information known at the time the incentive is calculated, will reflect the value to the utility's customers of the supply-side resource cost avoided by the utility's DSM program minus the utility-incurred costs of the DSM programs. This ongoing analysis is consistent with our approvals of settlements with IPL and SIGECO, versus a review occurring after implementation.

*Indiana Michigan Power Company*, Cause No. 43827, at 2 (IURC Dec. 7, 2010) (Order on Reconsideration) [the Dec. 7 I&M Order].

Mr. Sears testified that consistent with the findings in Cause No. 43427 and the Dec. 7, I&M Order, Vectren South-Electric should be granted the opportunity to earn performance incentives for all of the Core Plus programs proposed in its Initial Plan. He also explained that the OUCC's contention that Vectren South-Electric has no experience with offering programs to its large C/I customers and little to no experience in offering DSM programs is inaccurate. He described how, since 1992, Vectren South-Electric has utilized DSM programs, including large customer programs approved as part of its IRP process, as a means of reducing customer load and thereby providing reliable electric service to its customers. As described below, in the Settlement Agreement, the Settling Parties agreed that performance incentives shall be available for all Core Plus Programs included in the Revised Initial Plan, except the Direct Use pilot program and with respect to the Residential New Construction program, only to the extent that program is shown to be cost-effective with the incentive included.

Mr. Sears explained that it makes sense to allocate these costs between the residential and C/I programs, since the same programs are being offered to the small and large C/I customer groups and the outreach and education will be similar. He also stated the approach proposed by Vectren South-Electric is consistent with the approach approved in Cause No. 43427, but instead of allocating the costs 50% to each class, Vectren South-Electric determined that a higher allocation of outreach costs would be needed in order to adequately address the outreach and education requirements for the residential market where mass outreach is more common. (RCS-R1, p. 15)

Mr. Sears explained that the benefit-cost modeling with the shareholder incentive of 12% at the residential and commercial portfolio level is consistent with the approach outlined in Cause No. 43427 with regard to how the performance incentive would be calculated. He stated this approach provides more focus on the actual goal of delivering overall energy savings to the customer versus shifting focus throughout the year to ensure that each individual program achieves a desired incentive level. In addition, he testified that this approach is also consistent with incentive plans for other utilities across the country and with the California Energy Efficiency Policy Manual For Post- 2005 Programs. For information purposes, Vectren South-Electric provided in Petitioner's Exhibit RCS-R6 a copy of the benefit-cost analysis with the performance incentive included at the individual program level. All but two programs pass both the UCT and the TRC benefit cost tests with the full 12% performance incentive included. The Residential New Construction program has a TRC of 0.94 with the full incentive included and the Commercial/Industrial Retro Commissioning program has a TRC of 0.95 with the incentive included. Mr. Sears noted that both of these programs come very close to passing the TRC and UCT and the actual benefit cost results will be based upon actual costs and benefits that will be evaluated by an independent evaluator. He further explained that based upon the residential and commercial portfolio approach which was approved in Cause No. 43427, it is reasonable that these programs remain eligible for the Core Plus incentives.

Mr. Sears testified that Vectren South-Electric did perform research options for large C/I customers. He acknowledged that, as Ms. Paronish stated, the Peach Report addressed customers with loads below 500 kW. He noted, however, that the large customer tariffs (Rate LP and HLF) which are now being offered the new DSM programs start at 300 kW. Therefore, the Peach Report did include analysis that would include programs for large C/I customers. Mr. Sears explained that Vectren South-Electric also relied upon a number of resources to develop the program offering. Mr. Sears described Vectren South-Electric's planning process to develop a plan that would achieve the goals of the Phase II Order as well as add large C/I customer offerings during which it was determined that many of the programs that Vectren South-Electric had identified for the smaller C/I customers would equally apply to the large C/I customers.

Mr. Sears also responded in rebuttal to Mr. Phillips' expressed preference for "voluntary" customer efficiency efforts and his recommendations to limit or deny recovery of program costs, lost margin and incentives, especially to the extent such costs are to be collected from large C/I customers. Mr. Sears stated that Mr. Phillips seems to be challenging aspects of the Phase II Order in this utility specific proceeding which has been initiated to consider and approve Vectren South-Electric's DSM Plan, and the associated costs thereof. Mr. Sears explained that the Phase II Order made it clear that all customers were to be offered Core DSM programs and charged the resulting costs. Much of Mr. Phillips' testimony supports a proposal related to self-directed large

C/I customer programs that has not been made by Vectren South-Electric. Mr. Sears stated that to the extent such a separate proposal is to be considered, it should not delay evaluation and approval of Vectren South-Electric's Initial Plan, but instead it should be considered on a uniform, statewide basis. He stated that such a proposal would require the presentation of far more detail in terms of how such an approach could work in concert with utility DSM plans that provide programs to all market segments in compliance with the Phase II Order.

Mr. Sears stated this is a case where Vectren South-Electric has made a proposal to comply with the Phase II Order, and the requirements of that Order were not contingent on the outcome of any individual utility's IRP. Mr. Sears agrees with Mr. Phillips when he states that Vectren South-Electric's November 2009 IRP includes no additional generating capacity. Mr. Sears conceded that it may be possible that the degree to which programs are successful will impact the IRP in the future, but he stated nothing in this proceeding will impact, or be impacted by, the November 2009 IRP. Mr. Sears also noted that the November 2009 IRP did include a plan for DSM programs.

Mr. Sears disagreed with Mr. Phillips' contention that program cost recovery should be limited to the extent costs are in "excess of the least cost qualified bid" for core program administration, because the TPA contract to provide Core Programs will be approved by the Commission. He explained that the C&I Group has the opportunity to challenge (and is challenging) the TPA selection, but once the Commission approves the TPA contract, the costs incurred there under should not be subject to further challenge as "excessive."

Mr. Sears responded to the C&I Group's opposition to performance incentive opportunities, explaining that the Commission approved the performance incentive mechanism for Vectren South-Electric's Core Plus Programs in Cause No. 43427 based on the need to promote energy efficiency, pursue the aggressive DSM goals for the state, and the robust evaluation of program results. He stated that these factors still exist and any program that creates cost effective energy savings should be eligible for incentives.

Mr. Sears stated that with respect to a DSM program of this size, lost margins are a much larger issue and incentives are not a substitute. He described the estimated \$100 million or more of lost margins over the next 10 years and stated they cannot be offset by a maximum incentive opportunity of \$5.9 million. Mr. Sears stated that lost margin recovery, which allows the utility (if well designed) to recoup fixed costs, remains of paramount importance.

Mr. Albertson offered rebuttal testimony to respond to specific DSM program cost allocation and recovery issues raised by the OUCC and C&I Group. He stated that while Vectren South-Electric conceptually continues to support its distinction between fixed and variable program costs and specific allocations thereof, it will agree to continue to allocate program costs in a manner consistent with the April 2010 compliance filing in Cause No. 43427. He noted that the Company believes this issue may merit further review after additional experience with the DSM programs.

Mr. Albertson explained that the Company's proposed cost allocation methodology simply mirrors the way the costs are expected to be incurred and therefore allocating fixed and variable costs differently is more appropriate than continuing the currently approved program

cost allocation methodology. He stated that if “fixed” costs are allocated in the same manner as “variable” costs, then it is at least possible that customers in one rate class will subsidize those in another. He explained that the Company’s proposal sought to recognize that all customers should bear appropriate responsibility for program costs incurred in order to make programs available to each customer class, and that the proposal passed the test in terms of whether the rates are cost-based. With respect to Ms. Paronish’s testimony concerning the allocation of outreach and education costs, Mr. Albertson explained that given the Company has agreed to continue the allocation methodology approved in Cause No. 43427, large C/I customers will continue to pay an allocated portion of outreach and education costs. Under Vectren South-Electric’s proposal, these costs fall into the “fixed” program cost category and would have been allocated to large C/I customers along with other fixed program costs.

Mr. Albertson testified that if the OUCC and the C&I Group would prefer that demand billing within the DSMA continue, the Company does not object. He noted, however, that how DSM program costs are billed to customers and how costs are allocated to customers are two different matters entirely.

Mr. Albertson agreed with Mr. Blakley that Special Contract customers should not be excluded from DSM programs due to their large energy usage and stated that there is nothing in the Company’s proposal that suggests otherwise. He reiterated that DSM programs will be made available to all customers, and all customers will bear an appropriate share of program costs under either Vectren South-Electric’s proposal or the current methodology. Mr. Albertson also agreed with Mr. Blakley that without active participation by large energy users, the overall burden of reducing energy usage would necessarily fall upon the residential class. He stated this is why Vectren South-Electric had proposed the fixed/variable cost allocation methodology - to ensure that customers are required to support program investment and provide additional incentive to participate.

With respect to Mr. Phillips’ claims that the Company has failed to provide cost based rates to assist DSM efforts, Mr. Albertson responded that the outcome of the Company’s pending rate case will dictate the extent to which the Company’s rates are cost-based. He stated that the Company did, however, propose a cost allocation methodology in this proceeding that is consistent with the objective of cost-based rates. He also explained that the costs the Company has identified as variable do not vary by the number of customers as Mr. Phillips suggests, but rather with the magnitude of energy savings. Mr. Albertson agreed with Mr. Phillips’ assertion that certain customer classes should not subsidize program costs for the class receiving the programs and described how under Vectren South-Electric’s proposal, the variable program costs would be allocated to the rate class in which the beneficiary customers reside.

Mr. Albertson defended Vectren South-Electric’s proposed changes to program cost allocation in the DSMA as representing an attempt to thoughtfully and fairly allocate the costs of the expanded portfolio of DSM programs and respond to the fact that large C/I customers will now also be participants. Nevertheless, the Company concedes that allowing the current DSMA approach to continue is reasonable, will provide further experience, and can be revisited if necessary. Thus, Vectren South-Electric has withdrawn its proposed DSM program cost allocation changes at this time.

Mr. Albertson then summarized the Company's position on program cost recovery, stating, as with program cost allocation, the Company recognizes that the OUCC and the C&I Group appear to be in favor of the status quo - that being that program costs are recovered via both demand (per kW or per kVa) and energy (per kWh) charges in the DSMA. In order to avoid litigation on this issue, Mr. Albertson expressed the Company's willingness to agree to continue to bill DSM program costs in the DSMA in this manner which is consistent with the April 2010 compliance filing in Cause No. 43427.

Mr. Albertson responded to Mr. Phillips' suggestion that the DSMA should not be expanded nor modified. He explained that the Phase II Order requires Vectren South-Electric to offer programs to all customers, thus requiring some modification of the DSMA also. He noted the currently approved DSMA has, since its inception, provided for "other DSM costs approved for recovery by the Commission" in recognition that, over time, it was expected that DSM programs would grow and evolve. He stated that Mr. Phillips' argument that the DSMA reduces Vectren South-Electric's business risk and warrants a reduction in return on equity ignores the difference between the DSMA and other cost trackers. Mr. Albertson stated that most trackers focus on changes to an operating cost for which a test year amount is included in base rates. Those trackers reflect increases and decreases to the base amount and protect the utility and customers from changes in costs that are beyond the control of the Company. In the present case, Vectren South-Electric is about to implement a portfolio of DSM programs as required by the Commission to aggressively create energy savings, and the cost of the programs, which increase over time to achieve increasing savings targets, are not already in base rates. Mr. Albertson pointed out that Vectren South-Electric sets DSM program budgets to meet savings targets, and cannot make decisions to reduce those program costs. Mr. Albertson explained that the DSMA does not reduce Vectren South-Electric's pre-Phase II Order business risk- it simply represents a means of recouping the costs required to comply with the Phase II Order. He stated that in this proceeding the Company is attempting to address cost recovery issues that were not in play when its base rates were last approved. He stated recovery of DSM program costs and lost margins in the DSMA will only maintain Vectren South-Electric's opportunity to recover its costs and there is no evidence to suggest that expansion of the DSMA would alter the relative risk of Vectren South-Electric at all. Mr. Albertson contrasted that with the impact on the Company's risk if it were expected to manage the required investment necessary to produce the energy savings required by the Phase II Order - as well as the resulting lost margins - without recovery of these incremental costs. He stated it would be reasonable to assume that investors would react negatively to such an outcome.

Mr. Albertson agreed with Mr. Phillips that it is appropriate to include fuel and variable O&M expense as cost offsets in the calculation of lost margins, consistent with the Company's proposal in its pending rate case and in this proceeding.

**10. Stipulation and Settlement Agreement.** On January 10, 2011, the OUCC and Vectren South-Electric entered into a Stipulation and Settlement Agreement ("Settlement Agreement"), filed with this Commission on January 20, 2011 that resolved all issues between those two Parties in this Cause. The C&I Group was not a signatory to the Settlement Agreement. A copy of the Settlement Agreement is attached hereto and incorporated herein by reference and provides for the resolution of the issues between the OUCC and Vectren South-Electric in this Cause on the following basis:

1. The OUCC supports approval by this Commission of Vectren South-Electric's Revised Initial Plan, which modified the original DSM plan by withdrawing the Commercial Retro Commissioning program.

2. Expansion of the DLC program will not be included in the Initial DSM Plan, but Vectren South-Electric will provide an analysis of the technology and merits of the program to the Vectren Oversight Board prior to submission of the next proposed Three Year DSM Plan (2014-2016).

3. If the Direct Use pilot Program is approved in Cause No. 43839, then electric energy savings realized as a result of customer participation in the Direct Use pilot Program shall count towards the energy savings goals established in the Phase II Order and the Revised Initial Plan will be further revised to include that program. Savings from the Direct Use Pilot Program will not be eligible for shareholder incentives during the term of the pilot.

4. An Industrial Program Study will not be conducted at this time.

5. The performance incentive mechanism approved in Cause No. 43427 shall remain in place and performance incentives shall be available for all Core Plus Programs included in the Revised Initial Plan, except the Direct Use Pilot Program and the Residential New Construction program. For the Residential New Construction Program, to the extent the program results, with inclusion of a potential incentive, exceed 1.00 (TRC and UCT benefit cost tests) for that program at the end of the program year, then Vectren South-Electric shall earn the shareholder incentive.

6. Vectren South-Electric shall be allowed to allocate outreach and education funds between the residential and C/I programs as proposed by Vectren South-Electric in this Cause.

7. The Oversight Board shall have the discretion to review and approve the shifting of Core Plus DSM program dollars between Core Plus DSM programs, including from the residential sector to the C/I sector and vice versa. Decisions regarding shifting of funds between Core Plus DSM programs will be made by the Vectren Oversight Board on a case by case basis and will consider, among other things, the impact to the affected rate classes.

8. Any shifting of funds from Core to Core Plus Programs and vice versa, must be approved by the Oversight Board, the TPA and the DSMCC. If approved, the energy savings associated with transfers of program dollars from Core to Core Plus Programs shall be ineligible for shareholder incentives.

9. The lost margin component of the DSMA to recover lost margins, as verified by EM&V, associated with large C/I customer DSM programs should be approved as proposed by the Company in this proceeding. Vectren South-Electric may defer lost margins associated with such programs without carrying costs until such time as lost margins are included in the DSMA.

10. Pending the outcome of its request for a decoupled rate design in Cause No. 43839, Vectren South-Electric shall be authorized to defer lost margins with respect to the residential and commercial DSM programs set forth in the Revised Initial Plan as follows:

a) lost margins resulting from implementation of approved DSM programs for the period of January 1, 2011 through December 31, 2011 shall be deferred up to \$1 million dollars, with ultimate recovery of deferred lost margins subject to an EM&V process as well as approval of a recovery mechanism as discussed below;

b) if verified lost margins in calendar year 2011 exceed \$1 million, then Vectren South-Electric shall have the opportunity to seek recovery of such lost margins in excess of the \$1 million cap and the OUCC reserves its right to oppose such recovery;

c) Vectren South-Electric shall not earn carrying costs on deferred lost margins;

d) if the proposed decoupled rate design is not approved in Cause No, 43839, then ultimate recovery of residential and commercial lost margins is subject to approval of a recovery mechanism (to be proposed in a subsequent proceeding) and the OUCC reserves its rights to review the proposed mechanism and to oppose the design of such a mechanism in the subsequent proceeding;

e) recovery of deferred residential and commercial lost margins will be amortized over two (2) years in the recovery mechanism described in (d) above (if approved); and

f) Vectren South-Electric agrees that if the decoupled rate design as proposed in Cause No. 43839 is approved, it will not seek to recover the deferred lost margins related to these residential and commercial programs.

11. The DSMA mechanism shall be used to recover program costs, and program costs will be allocated in a manner consistent with the allocation methodology reflected in Cause No. 43427. Vectren South-Electric shall continue to reflect both energy and demand billing components in the DSMA and the Company shall reconcile costs recoverable and costs recovered on a Rate Class basis.

12. Vectren South-Electric shall continue to work with the Vectren Oversight Board to plan and evaluate DSM programs.

In addition, the Settlement Agreement also contains other terms commonly found in settlement agreements submitted to the Commission for approval, including terms providing that the Settlement Agreement must be approved in its entirety without changes or conditions unacceptable to any Party. The C&I Group was not a signatory to the Settlement.

**11. Testimony in Support of Settlement.** Mr. Sears, Mr. Albertson and Ms. Paronish submitted supplemental testimony in support of the Settlement Agreement. Mr. Sears testified that the Settling Parties, including their respective counsel and technical experts, met to discuss and exchange information regarding the Company's DSM efforts and, specifically, the Initial Plan submitted for approval in this proceeding. After good faith efforts, including scrutiny of all of the evidence filed in this Cause and the give and take of settlement negotiations, Mr. Sears stated the Settling Parties were able to reach agreement on the Settlement Agreement which is a reasonable resolution of the issues in this proceeding and a means to avoid further

litigation. Mr. Sears stated that the Settlement Agreement represents an agreement on issues that allows approval of programs designed to provide benefits in terms of energy savings and opportunities for customers to reduce costs and allows an efficient response to the Commission's Phase II Order. He testified that prompt approval of the Settlement Agreement will allow Vectren South-Electric to offer those Core Programs and expand its Core Plus Program offerings in order to meet the requirements of the Phase II Order.

Mr. Sears provided a summary description of some of the key terms of the Settlement Agreement as follows:

(a) Initial Plan. Vectren South-Electric agreed to remove the Commercial Retro Commissioning program from the Initial Plan. Mr. Sears explained that the energy savings from this particular program are relatively small and the program is marginally cost effective without shareholder incentives and is not cost effective with the full shareholder incentive included. The Revised Initial Plan is contained in Petitioner's Exhibit RCS-S3. According to Mr. Sears, if the Revised Initial Plan performs as expected, then removal of the Commercial Retro Commissioning program should not impact Vectren South-Electric's opportunity to meet the savings goals established in the Phase II Order. The Residential New Construction program is included in the Revised Initial Plan and will be monitored by the Oversight Board on an annual basis to determine if it can be offered cost effectively with and without performance incentives. The OUCC and Vectren South-Electric agreed that programs such as the Residential New Construction program which address energy efficiency lost opportunities at the time of building construction can be beneficial. Mr. Sears testified that Vectren South-Electric plans to work with both the gas and electric oversight boards in the coming months to consider joint delivery of the Residential New Construction program, which should help to make it more cost effective.

(b) Direct Use Pilot Program: The Settling Parties agreed that if the Direct Use Pilot Program is approved in Cause No. 43839, then electric energy savings that result from the program will be counted towards the Phase II Order savings targets, but will not be eligible for shareholder incentives. Vectren South-Electric agreed to withdraw its request for shareholder incentives on this program and the OUCC agreed to support counting the verified electric energy savings that result from this program towards the Phase II Order goals. Mr. Sears explained that if the Direct Use Pilot Program is approved in Cause No. 43839 then Vectren South-Electric will further revise the Revised Initial Plan to include the expected program savings and costs.

(c) Industrial Program Study: The Settling Parties agreed that an industrial program study will not be conducted at this time and that the C/I programs included in the Revised Initial Plan are reasonable and will be closely monitored by the Vectren Oversight Board to ensure that the programs are performing as expected. Mr. Sears stated that the Vectren Oversight Board will closely monitor the performance of large C/I customer programs over the initial 3 year program period to determine whether an industrial program study would be beneficial for future program development.

(d) Performance Incentives: The Settling Parties agreed that the performance incentive component of the DSMA approved in Cause No. 43427 should remain in place. The Settling Parties further agreed that Vectren South-Electric should be allowed to earn shareholder incentives on all of the Core Plus Programs included in the Revised Initial Plan, except the

Residential New Construction program, and the Direct Use pilot program as set forth above. Mr. Sears stated that the Settlement Agreement outlines the terms under which the Company can earn shareholder incentives for the Residential New Construction program, which is dependent upon actual performance of the program during a program year. The Settling Parties agreed that it is reasonable for Vectren South-Electric to earn shareholder incentives on the Residential New Construction program as long as it is cost effective. If the program is not cost effective with the incentive included, then no incentive will be earned. Mr. Sears explained that the Settlement Agreement addresses the OUCC's concerns that marginal programs (in terms of cost effectiveness) are not burdened by incentives.

(e) Outreach and Education Cost Allocation: The Settling Parties agreed that allocation of outreach and education costs between the residential and C/I programs, as proposed in Mr. Sears' direct testimony, is reasonable and should be approved by the Commission.

(f) Shifting of Funds: The Settling Parties agreed that the shifting of funds from one Core Plus Program to another (and between residential and C/I sector Core Plus Programs) will be subject to Vectren Oversight Board approval on a case by case basis. Mr. Sears testified that this approach has proven to work well for the current gas and electric Core Plus DSM programs. The shifting of funds from Core to Core Plus Programs and vice versa will be subject to approval by the TPA, DSMCC and Vectren Oversight Board and funds shifted from Core to Core Plus Programs will be ineligible for shareholder incentives.

(g) Lost Margin: The Settling Parties support the lost margin adjustment component of the DSMA as a means of recovering lost margins associated with large C/I customer DSM programs. Mr. Albertson's settlement testimony indicated that under the Settlement Agreement, the Company may recover lost margins associated with programs offered to large C/I customers via the Lost Margin Component of the DSMA. He stated that actual lost margin recovery will ultimately be dependent upon the results of the EM&V process (i.e. actual recoveries will be reconciled with lost margins recoverable as determined by the EM&V administrator). Any variances will be allocated only to the large C/I customer class, as defined in Mr. Albertson's prefiled testimony.

(h) Deferral of Lost Margins: Mr. Sears and Mr. Albertson both testified that the Settling Parties agreed that verified lost margins associated with large C/I customer DSM programs may be deferred without carrying costs until such time as those verified large C/I customer lost margins are included in the DSMA. The Settling Parties further agreed that residential and small commercial DSM program costs, including lost margins, may be deferred, pending the outcome of the Company's decoupled rate design request in Cause No. 43839 and subject to the contingencies outlined above. If decoupling is approved in Cause No. 43839, then Vectren South-Electric will not seek recovery of the deferred lost margins for residential and small commercial programs. Mr. Sears testified that the Settlement Agreement terms related to deferral of lost margins for residential and small commercial customers are reasonable in light of the fact that Vectren South-Electric has already experienced lost margins for these customer classes since rolling out Core Plus Programs in April 2010. As Vectren South-Electric contemplates rolling out certain Core Programs and anticipates continuing to lose margins with each successful program, Mr. Sears explained that the Company and OUCC agree that it is reasonable for Vectren South-Electric to defer lost margins for residential and small commercial

customers subject to the contingencies agreed to in the Settlement Agreement. Mr. Sears stated that the OUCC reserves its right to review any adjustment mechanism that is proposed, if necessary in the absence of decoupling.

(i) DSMA: Mr. Albertson addressed the issues related to the DSMA. He explained that the EEFC will now include costs related to large C/I customer programs. He stated that Vectren South-Electric will continue to recover program costs from the Rate Schedules using the current methodology (originally approved in Cause No. 43427). Customers with demand meters will continue to pay for demand-related costs through a demand billing component (\$ per kW or kVa) and customers without demand meters will continue to pay demand-related costs through an energy billing component (\$ per kWh). All customers will continue to pay for energy-related program costs through an energy billing component (\$ per kWh). Mr. Albertson explained that program costs recovered from a given Rate Class will be reconciled only with costs incurred on behalf of that Rate Class. He further testified that program costs will continue to be allocated on the basis of estimated energy and demand savings to be realized from the programs to be implemented. He explained that once an allocation between energy and demand is determined, the energy-related program costs will be allocated to the Rate Schedules on the basis of projected energy usage, and demand-related program costs will be allocated to the Rate Schedules based on the 4CP percentages utilized in the Company's most recently approved general rate case. Mr. Albertson stated that the Company will make a compliance filing in the DSMA (Cause No. 43405) within 15 days of Commission approval of the Settlement Agreement which reflects the terms approved in this Cause. Vectren South-Electric will also file a statement of compliance in this proceeding, referring to the DSMA compliance filing, for the record.

(j) Program Evaluation: Vectren South-Electric agreed to work closely with the Vectren Oversight Board to develop an EM&V plan to be used to verify the energy savings resulting from the Core Plus Programs defined in the Revised Initial Plan. Core Programs will be evaluated by the EM&V Administrator selected by the DSMCC and approved by this Commission. Mr. Sears stated that both the Company and the OUCC recognize that the role of the EM&V administrator for the Core Plus Programs will be important, as verified energy savings form the basis for calculation of lost margins, performance incentives and progress towards meeting the energy savings targets defined in the Phase II Order. He testified that it is reasonable for Vectren South-Electric to work closely with the Vectren Oversight Board to plan EM&V activities for Core Plus Programs. The Settling Parties agreed that the Vectren Oversight Board will have responsibility for the selection and oversight of the Core Plus Program EM&V administrator.

Mr. Sears' settlement testimony stated that the Settlement Agreement is reasonable and in the public interest in light of the goals established in the Phase II Order. He stated that the Settling Parties' request for prompt approval of the Settlement Agreement is critical for Vectren South-Electric so it can begin offering programs to large C/I customers and expanding its existing Core Plus Program offerings. Vectren South-Electric desires to implement its Revised Initial Plan, as soon as possible, in order to meet the savings targets set out in the Phase II Order. In addition, Mr. Sears stated that prompt approval of this Settlement Agreement will mean that Vectren South-Electric will be ready to roll out Core Programs as soon as the TPA is selected and Core Programs are launched. He stated that approval of a reasonable settlement agreement

like the one proposed by the Settling Parties is essential to the vitality of the settlement process as an alternative to protracted and expensive litigation.

Ms. Paronish also provided a description of certain terms of the Settlement Agreement in her settlement testimony. She recommended the Commission approve the Settlement Agreement between the OUCC and Vectren South-Electric and testified that the Settlement Agreement represents a reasonable compromise between Petitioner and the OUCC on the disputed issues. She stated the Settlement Agreement was reached through a collaborative process between the OUCC and Petitioner and adequately addresses the OUCC's concerns and is in the public interest.

**12. C&I Group Testimony in Response to Settlement.** Mr. Phillips filed testimony on behalf of the C&I Group in response to the Settlement Agreement, recommending that to the extent the Settlement Agreement is presented as a complete resolution of the issues in this proceeding, it should not be approved. He contended that the Settlement Agreement does not adequately alleviate C&I Group's concerns with Vectren South-Electric's proposal as discussed in his direct testimony and thus is not reasonable, just or in the public interest.

He reiterated C&I Group's position that recovery of lost margins from large C/I customers reduces the Company's incentive to promote economic development and to control rate increases and opposes recovery of shareholder incentives and lost margins by the Company for meeting its obligation to pursue the least-cost means of meeting resource requirements in its service territory. He stated the Settlement Agreement is deficient insofar as it limits the exposure for residential and small commercial customers with regard to lost margins, but makes no effort to contain lost margins for large C/I customers. Mr. Phillips asserted that lost margins should be capped at the dollar amounts projected by Vectren South-Electric in its Response to the C&I Group's Data Response 2-2.

Mr. Phillips testified that a self-directed plan would lower the overall costs of achieving the energy savings goals established by the Commission. He stated that self-directed programs have no administrative costs, no shareholder or participant incentive costs, and no evaluation, measurement and verification costs which have to be collected from other ratepayers. He testified further cost savings come from the elimination of lost margins.

Mr. Phillips described that a self-directed program is consistent with the primary goal of Indiana's Strategic Energy Plan – job creation. He testified that in order to create jobs, Indiana should encourage the voluntary efforts of its large energy consumers which are not only good for job retention and creation but also make energy efficiency gains at lower costs. He expressed concern that the mechanism for funding energy efficiency embodied by the Settlement Agreement sends the signal that Indiana does not care if large customers actually engage in energy efficiency so long as they pay to fund energy efficiency efforts of others.

Mr. Phillips described that a self-directed program is a good fit for Petitioner's service territory. First, he noted that the utility's rates are currently the highest in the state and further increases are pending. Mr. Phillips also raised the issue that Vectren South-Electric's 2009 IRP did not show the need for any additional generation or purchase power agreements on its system during its 20 year planning horizon. He testified that if Vectren South-Electric is not projecting

the need for additional generation, the proposed energy efficiency programs in this proceeding do not eliminate or defer the need for additional generation, and therefore the cost-benefit of such programs to the system cannot be premised on this basis. He argues that the opportunity for customers to “lower their total bill” through demand-side management programs as stated in Vectren South-Electric’s most recent IRP, only exists for customers who can save fuel costs by implementing energy efficiency measures. According to Mr. Phillips, ratepayers who have been early adopters of energy efficiency measures have fewer opportunities to implement new measures. He contends that a self-direct program would help to address these timing issues.

**13. Settling Parties’ Reply Testimony.** Supplemental Rebuttal Testimony was filed by Mr. Sears and Mr. Albertson on behalf of Vectren South-Electric in response to C&I Group’s response to the Settlement Agreement. Mr. Sears again reiterated that approval to recover lost margins from large C/I customers has no impact on the Company’s incentive to promote economic development and to control operating costs since attracting customers creates greater margins, offsets increasing costs and helps to spread fixed costs and limit future rate increases. He explained that if costs increase, the Company’s earnings will decline regardless of the recovery of lost margins due to DSM, since such recovery merely allows the Company to recoup verified efficiency losses and does not provide added revenue to offset higher costs.

In his supplemental rebuttal testimony, Mr. Albertson stated that the costs recovered via the proposed lost margin mechanism are already in the Company’s approved rates. He explained that, all other things being equal, an approved lost margin recovery mechanism would serve to postpone future rate increases which might otherwise be proposed based, in part, on the fact that Vectren South-Electric’s margin recovery would be insufficient to cover the very operating costs the Commission approved in the Company’s last rate case. Mr. Albertson stated that the Company’s lost margin proposal would recover the fixed costs of providing service (that are recovered via a charge per kWh used) that are not recovered to the extent customers use less energy as determined by the EM&V process conducted after DSM programs have been implemented. He explained there is no recovery of variable costs, such as fuel costs, that are avoided by the customer as a result of DSM initiatives and so, contrary to Mr. Phillips’ assertion, Vectren South-Electric’s lost margin proposal would not result in the Company being paid for services not provided. He testified that the Company’s proposed lost margin recovery mechanism is not intended to provide incremental margins, but will simply restore that portion of fixed cost recovery that has not been recovered due to the implementation of DSM as required by the Commission.

Mr. Albertson refuted Mr. Phillips’ statement that if self-directed programs are a part of Vectren South-Electric’s DSM portfolio, “further cost savings would come from the elimination of lost margins.” (C&I Exhibit NP-2 at 3) Mr. Albertson explained that DSM efforts by any customer that result in a reduced level of energy usage lead to lost margins, which is a “cost” to the Company. While Mr. Albertson acknowledged that self-directed program customers who are not required to pay for lost margins would experience a cost saving, he stated that the shortfall in margin recovery for Vectren South-Electric is real. Mr. Albertson noted that as stated in the Commission’s DSM rules, lost margin recovery eliminates the inherent financial bias against DSM. He stated that Mr. Phillips’ testimony appears to be supportive of lost margin recovery when the Company’s sales fall below rate case levels, which seems to support the policy case for a decoupling mechanism such as the one proposed by the Company in Cause No. 43839 for

residential and small general service customers which adjusts margin recovery, on a per customer basis, to the levels authorized in a rate case.

With respect to shareholder incentives, Mr. Sears' supplemental rebuttal testimony highlighted the language of the Phase II Order (at p. 29) which recognized the value of incentives: "Beyond helping to ensure accountability to state policy objectives, goal-setting is also a necessary component of incentive mechanisms that reward utilities for attaining specified levels of energy savings." He pointed out that the Commission approved the performance incentive mechanism for Core Plus Programs in Cause No. 43427 and found it to be reasonable based on the reliance on an EM&V process and Oversight Board review of the process. Mr. Sears explained that the Settlement Agreement supports the continued use of the previously approved incentive mechanism for Core Plus Programs as defined in the Initial Plan. He noted that the performance incentive mechanism approved in Cause No. 43427 and contained in the Settlement Agreement is similar to the performance incentives approved by the Commission for I&M in Cause No. 43827, rewarding the Company for successful implementation of DSM programs in terms of energy savings as measured by an independent evaluation and including a penalty for failing to perform at expected levels. He stated the opportunity to earn performance incentives is both necessary and appropriate.

Mr. Sears stated that on a conceptual level, Vectren South-Electric agrees with Mr. Phillips that a framework whereby large C/I customers engage in self-directed energy efficiency programs could be workable and add another means of obtaining efficiency, as long as the goal of the self-directed programs is to achieve future incremental energy savings beyond the normal business practices of these customers. However, Mr. Sears cautioned that allowing customers to engage in self-directed programs at this time would potentially delay contracting for all of the programs and put at risk the ability for Vectren South-Electric to meet the savings targets of the Phase II Order. He noted that in the Phase II Order (p. 30), the Commission considered the possibility of opt-out provisions and concluded:

Therefore, with respect to potential market coverage to be achieved, namely, whether DSM programs should be available to all sectors or whether there should be opt-out provisions available to certain market segments, such as large industrial facilities, we find that all market segments should participate in an effort to remedy the specific shortcomings identified by the Commission in its Phase I Order. While we are not foreclosing possible consideration of opt-out provisions as recommended in the Phase II Report at some future date, we recognize that a broad approach that includes all market participants is appropriate and should ensure that all DSM opportunities are fully pursued and that significant reservoirs of untapped cost effective energy efficiency potential are not omitted from consideration.

Mr. Sears stated that if the Commission is inclined to establish a self-directed option for large C/I customers, it should be done in a separate proceeding, so as not to delay approval of Vectren South-Electric's Revised Initial Plan in this Cause, as time is of the essence for implementation of Core and Core Plus Programs. He further stated that this type of an issue should likely be considered on a uniform, statewide basis since consistency is a key objective of the Phase II Order. Consideration of any such proposal by the C&I Group should include far

more detail than what has been provided by Mr. Phillips. Mr. Sears explained that it is critical that such efforts compliment utility programs and be equitable in terms of how all large C/I customers are treated.

Mr. Sears testified that investment in both Core and Core Plus Programs will create jobs in Indiana and that this goal was considered when evaluating Core Program TPA proposals. He stated that the additional Core Plus programs offered by utilities will also help to retain and create energy efficiency oriented jobs in Indiana.

Mr. Sears explained that while Mr. Phillips is correct when he states that Vectren South-Electric's November 2009 IRP base case included no additional generating capacity, Mr. Phillips fails to acknowledge that the 2009 IRP contained significant DSM built into the forecast and approval of the Revised Initial Plan is essential to achieve the forecasted DSM savings. Mr. Sears stated that the issue in this proceeding is the Company's proposed DSM Plan designed to achieve the Commission's energy savings goals, the recovery of associated program costs incurred, and the recovery from large C/I customers of lost margins resulting from implementation of those programs. He acknowledged that it may be possible that the degree to which programs are successful will impact the IRP in the future, but nothing in this proceeding will impact, or be impacted by, the November 2009 IRP.

Finally, Mr. Sears explained that the Settlement Agreement simply limits the amount of lost margins with respect to residential and small commercial customers to be deferred in 2011 pending approval of a recovery mechanism. He stated if the decoupling mechanism proposed in Cause No. 43839 is approved, Vectren South-Electric will forego the deferred amount. However, Vectren South-Electric requested approval to begin deferring lost margins and program costs, as necessary, beginning January 1, 2011 for later recovery if the decoupling mechanism is not approved in order to commence rollout of new programs as quickly as possible. The OUCC agreed to allow Vectren South-Electric to defer lost margins during 2011 up to \$1 million, pending approval of a recovery mechanism. The \$1 million deferral cap was intended to limit the amount of lost margins that could be deferred prior to approval of a recovery mechanism, not the amount of lost margins to be recovered once the mechanism is approved beyond 2011. Mr. Sears stated that the cap was set at a level higher than the projected level of such lost margins in 2011. He then explained that the recovery mechanism for large C/I customers proposed in this Cause would become effective simultaneously with large C/I programs; therefore, a cap like the one included in the Settlement Agreement is not necessary for those customers.

Ms. Paronish submitted testimony on behalf of the OUCC in reply to C&I Group's response to the Settlement Agreement. She testified that granting recovery of lost margins is within the Commission's discretion pursuant to 170 IAC 4-8-6(a). She stated that utilities must justify such an award and that Vectren South-Electric has done so in this proceeding through its detailed plan explaining implementation of its DSM programs and its agreement to utilize the Oversight Board to address any issues that may arise during program implementation. She stated the OUCC agrees lost margins are appropriate to make Vectren South-Electric whole and believes granting lost margins in this case is reasonable. She offered an explanation of the \$1 million cap on deferral of lost margins related to residential and small C/I customer programs for 2011 pending a decision with respect to Vectren South-Electric's proposed decoupling mechanism in Cause No. 43839. Because large C/I customers were not included in the proposed

decoupling mechanism, Ms. Paronish explained that a similar cap is not needed for lost margins recovery with respect to those customers. Ms. Paronish supported the performance incentive mechanism with respect to the Revised Initial Plan as consistent with the Phase II Order, stating that it is appropriate to reward successful implementation of the programs. Ms. Paronish concluded that C&I Group's concerns regarding lost margin and shareholder incentives have previously been addressed by the Commission and C&I Group has not presented evidence to support a change in course.

With respect to C&I Group's request for inclusion of self-directed programs in Vectren South-Electric's DSM portfolio, Ms. Paronish testified that the request is premature and should be sought in a separate proceeding in which C&I Group's evidentiary support can be fully developed.

**14. Commission Discussion and Findings.** Our Phase II Order requires jurisdictional electric utilities to submit three-year DSM plans designed to achieve annual electric savings goals as required by this Commission and as part of the efforts to achieve such specified goals over a ten year period. Phase II Order, 31. Vectren South-Electric initiated this proceeding to obtain approval of its Initial Plan necessary to comply with our Phase II Order. Vectren South-Electric's plan included the Core Programs mandated by our Phase II Order which we found "shall be deemed a part of the basic utility service offering in a utility's service territory." Phase II Order, 35. Vectren South-Electric also proposed Core Plus Programs necessary "to meet the annual energy savings goals established in [the Phase II Order]." Phase II Order, 36. Many of the Core and Core Plus programs have already been implemented by Vectren South-Electric pursuant to our Order in Cause No. 43427, approving Vectren South-Electric's DSM programs and in this case are being "sized" and expanded to include large C/I customers in compliance with the Phase II Order. Together, the Core and Core Plus Programs were designed by Vectren South-Electric to satisfy the aggressive energy savings targets established by the Phase II Order over the initial 3 years. We find that Vectren South-Electric has complied with the Phase II Order's requirements to submit an initial 3-year plan and that the Revised Initial Plan is consistent with the framework of that Order.

While we find that Vectren South-Electric has complied with the requirements of the Phase II Order by submitting its Initial Plan, the OUCC and C&I Group raised concerns about the design of the initial Plan. The OUCC and Vectren South-Electric engaged in discussions throughout this proceeding, which resulted in the Settlement Agreement between those two parties. The C&I Group did not join in the Settlement Agreement. We address the Settlement Agreement and issues raised by the C&I Group below.

**A. Settlement Agreement.** Vectren South-Electric and the OUCC reached consensus, as reflected in the Settlement Agreement, on the details of Vectren South-Electric's Revised Initial Plan. In evaluating the Settlement Agreement, the Commission begins with the general statement that settlements presented to the Commission are not ordinary contracts between private parties. *U.S. Gypsum v. Ind. Gas Corp.*, 735 N.E.2d 790, 803 (Ind. 2009). When the Commission approves a settlement, the 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.

The Commission is not required to accept a settlement simply because the parties have agreed to it, and agreements filed by some or all of the parties must still be supported by probative evidence. *Id.* The Commission may also consider a settlement that is not supported by all of the parties. We have noted in evaluating non-unanimous settlements that:

in agency proceedings settlements are frequently suggested by some, but not necessarily all of the parties; if on examination they are found equitable by the regulatory agency, then the terms of the settlement form the substance of an order binding all the parties, even though not all are in accord as to the result.

*Northern Indiana Public Serv. Co.*, Cause No. 41746, p. 24 (IURC 9/23/2002) *citing Pennsylvania Gas & Water Co. v. Federal Power Comm’n*, 463 F.2d 1242, 1246 (D.C. Cir. 1972). In all cases involving a settlement, the Commission decision, ruling, or order—including approval of a settlement—must be supported by specific findings of fact and sufficient evidence. *U.S. Gypsum*, 735 N.E.2d at 795 (citing *Citizens Action Coalition v. Public Serv. Co.*, 582 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 Agreement is reasonable, just, and consistent with the purpose of Ind. Code Ch. 8-1-2, and that such agreement serves the public interest.

**B. Program Implementation.** While the OUCC initially raised concerns with various aspects of Vectren South-Electric’s Initial Plan, the Settlement Agreement provides a reasonable resolution of these issues. Vectren South-Electric committed to work with the Vectren South-Electric Oversight Board to plan and evaluate DSM. It withdrew the Commercial Retro Commissioning program. As approved in by Commission Order in Cause No. 43839, the energy savings derived from the Direct Use pilot program will count towards Vectren South-Electric’s energy savings goals but Vectren South-Electric will not be eligible for shareholder incentives during the term of the pilot. The Settlement Agreement provides for the shifting of funds among programs subject to necessary approvals from the Vectren South-Electric Oversight Board and the Demand Side Management Coordination Committee. Having considered the testimony filed by the OUCC and Vectren South-Electric in support of the settlement, we agree that the program implementation terms of the Settlement Agreement represent a reasonable resolution of the issues raised by the parties. No party opposed these provisions.

The C&I Group contended that large customers should be permitted to opt-out of Vectren South-Electric’s Revised Initial Plan by investing in their own self-directed programs and be excused from payment of the DSMA. Our Phase II Order found that “[w]hile we are not foreclosing possible consideration of opt-out provisions as recommended in the Phase II Report at some future date, we recognize that a broad approach that includes all market participants is appropriate and should ensure that all DSM opportunities are fully pursued and that significant reservoirs of untapped cost-effective energy efficiency potential are not omitted from

consideration.” Phase II Order, p. 30.<sup>4</sup> We continue to believe that, at this time, a broad approach that includes all market participants is appropriate.

As set forth in the Phase II Order, DSM offers a cost effective means of meeting customer energy requirements and should be pursued in a consistent manner, with all customers having access to utility programs. Vectren South-Electric’s Revised Initial Plan is consistent with these objectives. Notably, we have yet to approve an opt-out or self-directed alternative for any electric utility in the State, and in keeping with the concept of uniform design and offerings, we are not inclined to approve such a deviation from the Phase II Order in this proceeding. While there may be benefits to individual customers avoiding incurrence of certain costs, we believe that during the initial stages of the creation of a statewide DSM program, any opt-out or self-directed options could interfere with the TPA’s ability to implement the Core Programs, which includes commercial and industrial programs, throughout the State.

**C. Accounting and Ratemaking.** The Settlement Agreement provides for timely recovery of costs associated with Vectren South-Electric’s Core and Core Plus Programs through the DSMA mechanism, that program costs will be allocated in a manner consistent with the allocation methodology reflected in Cause No. 43427, that Vectren South-Electric shall continue to reflect both energy and demand billing components in the DSMA, and that Vectren South-Electric shall reconcile costs recoverable and costs recovered on a Rate Class basis. Evidence presented in this proceeding demonstrated that the methodology by which costs are to be allocated to Vectren South-Electric’s customer classes is reasonable, fair and consistent with the program cost allocation approved in Cause No. 43427. No party objected to the Settlement Agreement’s cost recovery and allocation methodology. We find that the Settlement Agreement’s proposed cost recovery and allocation methodology is consistent with our DSM rules and is just, reasonable and in the public interest.

The C&I Group opposed Vectren South-Electric’s recovery of lost margins and performance incentives as contemplated in the Settlement Agreement. The Settlement Agreement provides that the lost margins (as verified by EM&V) associated with large C/I customer DSM programs will be recovered and that Vectren South-Electric may defer such lost margins without carrying costs for future recovery until such costs are included in the DSMA. The OUCC and Vectren South-Electric reached a different agreement on the recovery of lost margins for other customers, due to Vectren South-Electric’s request for a decoupled rate design in Cause No. 43839.

With respect to recovery of lost margins from commercial and industrial customers, the C&I Group contended such recovery reduces Vectren South-Electric’s incentive to promote economic development and to control rate increases. We do not believe that allowing a utility to recover margins lost to customer participation in utility-sponsored DSM program impacts its incentive to promote economic development or control rate increases. As Mr. Albertson explained, Vectren South-Electric’s recovery of lost margins ensures Vectren South-Electric recovers the fixed costs of providing services that are not recovered to the extent customers use less energy due to DSM programs. Petitioner’s Exhibit SEA-SR1, p. 3. Vectren South-Electric

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<sup>4</sup> Although the C&I Group appears to distinguish an opt-out from a self-directed program, we use those terms interchangeably. *See also* May 22, 2009 Docket Entry in Cause 42693 (Phase II) (Phase II Report, pages 23-25).

will not recover variable costs that are avoided as a result of DSM initiatives. *Id.* In other words, recovery of lost margins is intended as a tool to remove the disincentive utilities would otherwise face as a result of promoting DSM in its service territory. For this reason, our DSM rules (170 IAC 4-8-6(a)) provide that “[t]he 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 C&I Group also opposed recovery of lost margins when sales are higher than the levels used to establish the current base rates in effect. The purpose of recovery of lost margins on verified energy savings from DSM programs is to return the utility to the position it would have been in absent implementation of a DSM measure. Eliminating recovery of lost margins when sales are higher than the levels used to develop the current base rates is contrary to this objective. As the C&I Group itself notes, utilities are incented to promote economic development in their service territories by the regulatory paradigm to increase revenues between rate cases.

Finally, the C&I Group objected to recovery of lost margins because a utility should not be granted a financial reward for simply meeting its obligation in its service territory. C&I Group Exhibit NP-2, p. 3. As previously noted, we disagree that the award of lost margins is intended as a financial reward. We have already found that the purpose of allowing recovery of lost margins is to remove a financial disincentive for utilities to pursue DSM, not to reward a utility for success in pursuing DSM programs.

The Settlement Agreement provides for Vectren South-Electric to defer up to \$1 million in lost margins for the period of January 1, 2011 through December 31, 2011 and recover over two years the deferred lost margins in the event the decoupled rate design proposed in Cause No. 43839 was not approved. Vectren South-Electric will not earn carrying charges on the deferred amounts and will have the opportunity to seek recovery of lost margins in excess of the \$1 million cap, subject to the OUCC’s right to oppose such recovery. The C&I Group did not contest the proposed treatment of lost margins for non-industrial customers. We find this accounting treatment to be appropriate.

Pursuant to the Settlement Agreement, the performance incentive mechanism we previously approved for Vectren South-Electric in Cause No. 43427 will remain in place for all Core Plus Programs except the Direct Use pilot program approved in Cause No. 43839 and the Residential New Construction program.<sup>5</sup> The performance incentive mechanism includes both rewards to Vectren South-Electric for hitting targets and penalties for failure to achieve a minimum level of performance and thereby incorporates both risk and reward. *See also Indiana Michigan Power Company*, Cause No. 43827 (IURC Dec. 7, 2010) (Order on Reconsideration).

**D. Approval of Settlement Agreement.** Based on the evidence presented in this Cause, the Commission finds that the Settlement Agreement represents a comprehensive resolution of the issues presented in this matter, is in the public interest, is just and reasonable and should be approved in its entirety. The terms of this Settlement Agreement should not be

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<sup>5</sup> The Residential New Construction Program shall be eligible for performance incentives if the Total Resource Cost (“TRC”) test and Utility Cost Test (“UCT”) exceed 1.00 with the incentive included at the end of the program year.

used as precedent in any other proceeding or for any other purpose, except to the extent necessary to implement or enforce its terms. Consequently, with regard to future citation of the Settlement Agreement, we find that our approval herein should be construed in a manner consistent with our findings in *Richmond Power & Light*, Cause No. 40434, 1997 Ind. PUC LEXIS 459 (IURC, Mar. 19, 1997).

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

1. The Settlement Agreement between Vectren South-Electric and the OUCC, a copy of which is attached, shall be and hereby is approved without modification.

2. Vectren South-Electric's Revised Initial Plan, including the Core and Core Plus programs and proposed budgets, as proposed by Vectren South-Electric and amended by the Settlement Agreement, shall be and hereby is approved as discussed above. Pursuant to Para. 2 of the Settlement Agreement, Vectren South-Electric shall, within 30 days of the effective date of this Order, file, under this Cause, a second Revised Initial Plan to include the Direct Use Pilot Program approved in Cause No. 43839.

3. Vectren South-Electric's request for timely recovery of costs associated with the Core and Core Plus programs, including costs incurred under the contracts for the Third Party Administrator and Evaluation, Management and Verification Administrator through Vectren South-Electric's DSMA shall be and hereby is approved.

4. Vectren South-Electric's request for recovery of lost margins associated with large C/I customer Core and Core Plus programs through the DSMA, consistent with the Settlement Agreement, shall be and hereby is approved.

5. Vectren South-Electric's requests to defer up to \$1 million in lost margins associated with residential and small customer Core and Core Plus programs for the period of January 1, 2011 through December 31, 2011 and to recover, over a two year period, those deferred lost margins in a separately docketed proceeding, shall be and hereby are approved.

6. Vectren South-Electric's request for recovery of a performance incentive associated with its Core Plus programs through the DSMA, consistent with the Settlement Agreement, shall be and hereby is approved.

7. Vectren South-Electric's request for accounting and ratemaking treatment, including the authority to defer the over and under recoveries of projected Core and Core Plus costs through the DSMA pending reconciliation in subsequent rider periods shall be and hereby is approved.

8. Vectren South-Electric's request to make annual DSMA filings, rather than semi-annual filings, shall be and hereby is approved.

9. The Demand Side Management Adjustment, Tariff I.U.R.C. No. E-12, Sheet No. 66, Seventh Revised Page 1 and Sixth Revised Page 2 shall be and hereby is approved. Vectren

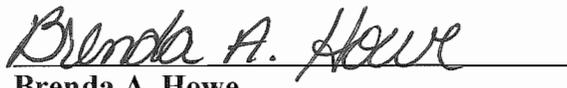
South-Electric shall file such tariff sheet revisions with the Electricity Division of the Commission.

11. This Order shall be effective on and after the date of its approval.

**ATTERHOLT, LANDIS AND ZIEGNER CONCUR; BENNETT AND MAYS NOT PARTICIPATING:**

**APPROVED: AUG 31 2011**

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



**Brenda A. Howe  
Secretary to the Commission**

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF SOUTHERN INDIANA )  
GAS AND ELECTRIC COMPANY D/B/A )  
VECTREN ENERGY DELIVERY OF INDIANA, )  
INC. REQUESTING THE INDIANA UTILITY )  
REGULATORY COMMISSION TO APPROVE )  
CERTAIN DEMAND SIDE MANAGEMENT )  
PROGRAMS AND FOR RECOVERY OF ) CAUSE NO. 43938  
PROGRAM COSTS, LARGE CUSTOMER LOST )  
MARGINS AND PERFORMANCE INCENTIVES )  
PURSUANT TO IAC § 4-8-1 ET. SEQ. VIA ITS )  
DEMAND SIDE MANAGEMENT ADJUSTMENT )  
MECHANISM, AND FOR APPROVAL OF )  
ACCOUNTING AUTHORITY TO DEFER LOST )  
MARGINS RELATED TO RESIDENTIAL AND )  
SMALL COMMERCIAL CUSTOMER DEMAND )  
SIDE MANAGEMENT PROGRAMS )

STIPULATION AND SETTLEMENT AGREEMENT

This Stipulation and Settlement Agreement ("Settlement") is made and entered into as of the 10<sup>th</sup> day of January 2011, by and between Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc. ("Vectren South-Electric" or "Company") and the Indiana Office of Utility Consumer Counselor ("OUCC") (collectively referred to herein as the "Parties").

WHEREAS, the Parties have met and reviewed the testimony in this proceeding, discussed the issues, and negotiated the terms set forth herein; and

WHEREAS, the Parties agree that the role of the Vectren Oversight Board as established in Cause No. 43427 shall remain unchanged and that the terms and conditions of this Settlement are not intended to supersede or alter the roles and responsibilities of the Vectren Oversight Board.

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

1. The Parties agree that Vectren South-Electric's Three Year DSM Plan (2011-2013) (the "Initial DSM Plan") submitted in this proceeding as Petitioner's Exhibit No. RCS-4, should be modified to withdraw the Commercial Retro Commissioning program, and should be approved with that revision. The Revised Initial DSM Plan will be submitted by Petitioner's Witness Sears as Petitioner's Exhibit RCS-S2 as an attachment to his supplemental testimony in support of this Settlement. The Parties agree that expansion of the Direct Load Control ("DLC") program will not be included in the Initial DSM Plan, but Vectren South-Electric will provide an analysis of the technology and merits of the program to the Vectren Oversight Board prior to submission of the next proposed Three Year DSM Plan (2014—2016).

2. The Parties agree that if the Direct Use Pilot Program is approved in Cause No. 43839, then electric energy savings realized as a result of customer participation in the Direct Use Pilot Program shall count towards the energy savings goals established in Cause No. 42693 (the "Phase II Order"). If the Direct Use Pilot Program is approved by the Commission, then the Revised Initial DSM Plan will be further revised to include that program. The Parties agree that electric energy savings from the Direct Use Pilot Program as verified by the evaluation, measurement and verification ("EM&V") administrator selected by the Vectren Oversight Board shall count towards the savings targets established in the Phase II Order, however, savings from the Direct Use Pilot Program will not

be eligible for shareholder incentives during the term of the pilot. At the conclusion of this initial pilot program, the Vectren Oversight Board will convene to determine whether the Direct Use Pilot Program shall continue.

3. The Parties agree that an Industrial Program Study will not be conducted at this time. The Vectren Oversight Board will monitor the results of the Vectren South-Electric Commercial and Industrial ("C/I") DSM programs and, after the first program year, will evaluate the need for a formal Industrial Program Study.

4. The Parties agree that the performance incentive mechanism approved in Cause No. 43427 shall remain in place and that performance incentives shall be available for all Core Plus Programs included in the Revised Initial DSM Plan, except the Direct Use Pilot Program and the Residential New Construction program. For the Residential New Construction Program, the results of the first year will be measured and the Total Resource Cost ("TRC") test and Utility Cost Test ("UCT") calculated. To the extent the program results, with inclusion of a potential incentive, exceed 1.00 (TRC and UCT benefit cost tests) for that program at the end of the program year, then Vectren South-Electric shall earn the shareholder incentive. If the program is not cost effective (i.e. TRC and UCT results are less than 1.00 with the incentive included), then no incentive will be earned. During the initial three (3) year period, the Vectren Oversight Board shall continually monitor the progress and impact of the Residential New Construction Program and retain the right to discontinue the program at any time after the first year, if it has not become cost effective.

5. The Parties agree that Vectren South-Electric shall be allowed to allocate outreach and education funds between the residential and C/I programs as proposed by Vectren South-Electric in this Cause.

6. The Parties agree that the Vectren Oversight Board shall have the discretion to review and approve the shifting of Core Plus DSM program dollars between Core Plus DSM programs, including from the residential sector to the C/I sector and vice versa. Decisions regarding shifting of funds between Core Plus DSM programs will be made by the Vectren Oversight Board on a case by case basis and will consider, among other things, the impact to the affected rate classes.

7. The Parties agree that the shifting of funds from Core to Core Plus Programs and vice versa, must be approved by the Vectren Oversight Board, Third Party Administrator ("TPA") and the Demand Side Management Coordination Committee ("DSMCC"). Requests for such transfers shall be initiated by the Vectren Oversight Board and shall be subject to the provisions of the TPA contract, if applicable, and DSMCC approval. If approved, the energy savings associated with transfers of program dollars from Core to Core Plus Programs shall be ineligible for shareholder incentives.

8. The Parties agree that the lost margin component of the Demand Side Management Adjustment mechanism ("DSMA") to recover lost margins, as verified by EM&V, associated with large customer DSM programs should be approved as proposed by the Company in this proceeding. Vectren South-

Electric may defer lost margins associated with such programs without carrying costs until such time as lost margins are included in the DSMA.

9. The Parties agree that, pending the outcome of its request for a decoupled rate design in Cause No. 43839, Vectren South-Electric shall be authorized to defer lost margins with respect to the residential and commercial DSM programs set forth in the Revised Initial DSM Plan as follows:

- a. lost margins resulting from implementation of approved DSM programs for the period of January 1, 2011 through December 31, 2011 shall be deferred up to \$1 million dollars, with ultimate recovery of deferred lost margins subject to an EM&V process as well as approval of a recovery mechanism as discussed below;
- b. if verified lost margins in 2011 exceed \$1 million, then Vectren South-Electric shall have the opportunity to seek recovery of such lost margins in excess of the \$1 million cap and the OUCG reserves its right to oppose such recovery;
- c. Vectren South-Electric shall not earn carrying costs on deferred lost margins;
- d. ultimate recovery of these residential and commercial lost margins is subject to approval of a recovery mechanism (to be proposed in a subsequent proceeding if decoupled rate design is not approved in Cause No. 43839) and the OUCG reserves its rights to review a proposed mechanism and to oppose the design of such a mechanism in the subsequent proceeding;

- e. recovery of deferred residential and commercial lost margins will be amortized over two (2) years in the recovery mechanism described in (d) above (if approved); and
- f. Vectren South-Electric agrees that if the decoupled rate design as proposed in Cause No. 43839 is approved, it will not seek to recover the deferred lost margins related to these residential and commercial programs.

10. The Parties agree that the DSMA mechanism shall be used to recover program costs, that program costs will be allocated in a manner consistent with the allocation methodology reflected in Cause No. 43427, that Vectren South-Electric shall continue to reflect both energy and demand billing components in the DSMA, and that the Company shall reconcile costs recoverable and costs recovered on a Rate Class basis.

11. The Parties agree that Vectren South-Electric shall continue to work with the Vectren Oversight Board to plan and evaluate DSM programs.

12. The Parties agree that time is of the essence in this proceeding and will request prompt Commission acceptance and approval of this Settlement in its entirety, without any change or condition that is unacceptable to either party to this Settlement.

13. The Parties agree to waive cross examination of each other's witnesses in this proceeding.

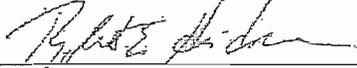
14. The Parties will work together to finalize and file testimony in support of the Settlement as well as an agreed upon proposed order with the

Commission. The Parties will support the Settlement and proposed order in this proceeding and will request that the Commission issue an order accepting and approving this Settlement in accordance with its terms as soon as possible.

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

ACCEPTED AND AGREED this 10<sup>th</sup> day of January 2011.

SOUTHERN INDIANA GAS AND ELECTRIC  
COMPANY D/B/A VECTREN ENERGY  
DELIVERY OF INDIANA, INC.

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