ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF DUKE ENERGY INDIANA, INC. FOR APPROVAL TO OFFER ADDITIONAL ENERGY EFFICIENCY PROGRAMS; FOR APPROVAL OF PROGRAM COST RECOVERY, LOST REVENUES AND INCENTIVES PURSUANT TO 170 IAC 4-8-5, 170 IAC 4-8-6, AND 170 IAC 4-8-7; AUTHORITY TO DEFER COSTS PENDING APPROVAL AND FOR AUTHORITY TO IMPLEMENT ANNUAL TRACKING MECHANISM	)	CAUSE NO. 43955 APPROVED: MAR 21 2012

BY THE COMMISSION:
David E. Ziegner, Commissioner
David E. Veleta, Administrative Law Judge

On September 28, 2010, Duke Energy Indiana, Inc. ("DEI") filed with the Indiana Utility Regulatory Commission ("Commission") its Petition requesting approval to offer additional energy efficiency programs ("EE"); approval of program cost recovery, lost revenues, and shareholder incentives pursuant to 170 IAC 4-8-5, 170 IAC 4-8-6, and 170 IAC 4-8-7; authority to defer costs pending approval; and authority to implement an annual tracking mechanism.

Nucor Steel-Indiana ("Nucor"), the Kroger Co. ("Kroger"), Steel Dynamics, Inc. – Engineered Bar Products Division ("SDI"), and DEI Industrial Group ("Industrial Group") filed Petitions to Intervene, which were subsequently granted by Docket Entries.

Pursuant to various motions to modify the procedural schedule, Kroger, OUCC, Nucor, SDI, and the Industrial Group filed their respective direct testimonies and exhibits.

On February 28, 2011, DEI filed its Motion to Suspend Procedural Schedule and Request for Attorneys' Conference, which was granted by Docket Entry on March 8, 2011. DEI sought suspension of the procedural schedule and an attorneys' conference in order to establish a new procedural schedule because DEI claimed it discovered errors in its rate calculations included in its case-in-chief filing.

On March 11, 2011, DEI filed its rebuttal testimony, exhibits, non-confidential workpapers, and corrections to direct testimony.

On March 17, 2011, an Attorneys' Conference was held to discuss modifying the procedural schedule in this proceeding. An informal discussion was held regarding the procedural schedule; however, the Parties were unable to reach an agreement. Therefore, on March 24, 2011, the Presiding Officers issued a Docket Entry revising the procedural schedule.

On June 3, 2011, SDI filed supplemental testimony and Nucor filed its testimony and non-confidential exhibits and its notice of withdrawal of sponsorship of its earlier-filed direct and crossanswering testimony and exhibits. On July 1, 2011, DEI filed its supplemental rebuttal testimony and exhibits.

Pursuant to notice as provided by law, proof of which was incorporated into the record, an evidentiary hearing in this Cause was held on July 14-15, 2011 at 9:30 a.m. in Room 222, PNC Center, Indianapolis, Indiana. The Parties appeared and participated at the hearing. No members of the general public appeared.

The Commission, based upon the applicable law and the evidence of record, now finds as follows:

1. **Notice and Jurisdiction.** Due, legal, and timely notice of the public hearing in this Cause was given and published by the Commission as provided by law. DEI is a public utility within the meaning of the Public Service Commission Act, as amended. The Commission has jurisdiction over DEI and the subject matter of this proceeding in the manner and to the extent provided by the law of the State of Indiana.

2. **DEI's Characteristics.** DEI is a public utility corporation organized and existing under the laws of the State of Indiana with its principal office in Plainfield, Indiana, and is a second tier wholly-owned subsidiary of Duke Energy Corporation. DEI is engaged in rendering electric utility service in the State of Indiana. DEI directly supplies electric energy throughout its 22,000 square mile service area to approximately 780,000 customers located in 69 counties in the central, north central, and southern parts of the State of Indiana.

3. **Relief Requested.** DEI requests approval of its proposed Core Plus Demand Side Management ("DSM") Programs, as well as authorization to recover the costs associated with implementing the Core and Core Plus Programs, including ongoing program costs, and evaluation, measurement and verification ("EM&V") costs, through an annual rate adjustment mechanism, the proposed Rider EE. Additionally, DEI requests recovery of lost revenues and costs associated with the third-party administrator, who will implement the Core Programs pursuant to the Commission's Phase II Order in *Commission Investigation*, Cause No. 42693, 2009 Ind. PUC LEXIS 482 (IURC December 9, 2009)(the "Phase II Order"), via Rider EE. DEI also requests approval of a performance-based shareholder incentive mechanism and lost revenues for its Core Plus Programs, to be recovered as a part of Rider EE. Finally, DEI requests authority to defer and subsequently recover costs associated with Core and Core Plus Programs, including pilot program costs and Core Program start-up and implementation costs, until such time as the costs are included in rates, and authority to use deferred accounting on an ongoing basis to ensure proper matching of expenses with the rate recovery of such expenses through the proposed Rider EE.

4. **Evidence Presented.**

A. DEI's Case-in-Chief. Douglas F. Esamann, President of DEI (who adopted the prefiled testimony of Gianna M. Manes), testified that DEI is seeking authority to recover the program costs of Core Programs to be administered by the third-party administrator (including associated EM&V) estimated at approximately $69 million for the three-year period.

Mr. Esamann testified regarding DEI's request for recovery of incentives assuming achievement of Core Plus targets for conservation and demand response programs. He stated that during the three-year period (2011-2013), DEI seeks a total estimated incentive of approximately $6.3 million.

Michael Goldenberg, Director, Products and Services, testified as to DEI's long history of EE programs and savings, dating back to 1991. Mr. Goldenberg testified that since 1992, approximately 188 megawatts ("MW") and 760,900 megawatt-hours ("MWH") have been saved as a result of DEI's EE efforts. He testified that DEI currently has authority to offer the following programs: (1) Home Energy House Call, which includes Audits and the Indiana National Energy Education Department Program (school education program); (2) Low-Income Programs, which include Weatherization and Refrigerator Replacement; (3) Smart $aver, including air-conditioning and heat pumps; (4) ENERGY STAR New Construction; (5) Small Commercial and Industrial Programs, including lighting, HVAC, and motor/pumps; and (6) Power Manager, a residential air conditioner cycling program.

Mr. Goldenberg explained that the Commission's Phase II Order required all Indiana jurisdictional electric utilities to offer a portfolio of five conservation programs ("Core Programs") in their retail service territories and to hire an independent third-party administrator ("TPA") to oversee the administration and implementation of the Core Programs and an independent party to perform EM&V. Mr. Goldenberg testified that DEI is requesting authority to offer the following Residential Core Plus programs over the next three years (to coincide with the term of the independent TPA): (1) Online Home Energy Calculator; (2) Personalized Energy Report ("PER"); (3) Smart $aver for Residential Customers; (4) Agency CFLs – Low Income Services (Agency Assistance Portal and CFLs); (5) Refrigerator Recycling; (6) Freezer Recycling; (7) Property Manager CFL; (8) Tune and Seal; (9) Home Energy Comparison Report; (10) Home Energy House Call Retrofit (marketed as Energy Solutions @ Home); and (11) Power Manager. Mr. Goldenberg testified that DEI is also requesting authority to offer the following commercial and industrial ("C&I") Core Plus programs over the next three years: (1) Smart$aver for Non-Residential Customers; (2) Non-Residential Energy Assessments; and (3) PowerShare CallOption. Mr. Goldenberg testified that these programs were selected from successful programs in DEI's previous portfolio that were not included in the Core Program selection; from programs that have been successfully piloted and/or implemented in other DEI Energy jurisdictions; or from programs that are new to DEI but have been successfully implemented by other utilities. He stated that DEI was also guided, to an extent, by a previously commissioned market potential study. Mr. Goldenberg testified that DEI is not proposing any specific pilot programs at this time.

Mr. Goldenberg testified that the MWH impact for the proposed Core Plus Programs is targeted to be 223,659 MWH for the three-year period covered by this filing (2011 – 37,992 MWH; 2012 – 85,389 MWH; 2013 – 94,693 MWH), which meets the Commission's three-year gross energy savings targets, when coupled with the projected impacts from the Core Programs. However, Mr. Goldenberg explained that DEI will not meet the savings targets in 2010, but will make up this shortfall in 2011-2013 provided that the TPA is able to deliver the impacts as included in DEI's July 1, 2010 compliance filing in Cause No. 42693 S1 ("DEI's July 1, 2010 Compliance Filing").

Mr. Goldenberg testified that the total projected Core Plus Program costs for the three-year period are approximately $57.9 million, which includes both conservation and demand response programs. The amounts by year are approximately: $14.2 million for 2011, $21.3 million for 2012, and $22.4 million for 2013. Mr. Goldenberg explained that this includes all necessary costs to bring programs to market, including costs for EM&V, but does not include lost revenues or shareholder incentives. Mr. Goldenberg also explained that if the Commission approves the TPA contract as submitted, DEI's portion of the contract fees for the Core Programs, by year, is approximately: $18.5 million for 2011; $21.8 million for 2012, and $26.6 million for 2013. He noted that these numbers exclude EM&V costs that are expected to be an additional $0.7 million per year over the three-year period.

Mr. Goldenberg testified that DEI has projected that during the initial three-year period it could obtain 10% more MWH impacts in an effort to exceed the 2011-2013 targets set in the Phase II Order. He stated that the program cost difference between DEI's July 1, 2010 Compliance Filing and this filing is approximately $12.5 million for conservation programs only. He also stated that DEI's July 1, 2010 Compliance Filing did not include demand response programs, which are included in the program cost totals for the proposed rider.

Ashlie Ossege, Manager Market Analytics, testified regarding DEI's proposed EM&V protocols. She stated that EM&V determines both program and project impacts, as well as the effectiveness of that programming from the utility and customer perspective. She explained that the Commission rules and the Phase II Order require EM&V to demonstrate that DEI is meeting the aggressive annual target reductions established by the Phase II Order. Ms. Ossege discussed the five types of evaluation that DEI relies upon: cost effectiveness evaluation, impact evaluation, measurement, verification, and process evaluations. Ms. Ossege testified that DEI will utilize paper and electronic verification, field verification and monitoring, customer satisfaction surveys, and system performance tests for monitoring and verification of DEI's Core Plus Programs.

Ms. Ossege testified that DEI's estimated cost for EM&V for the proposed Core Plus Programs was 5% of total program costs, which is in line with industry experience. She explained that the timeframes and completion of evaluations for the Core Plus Programs will be based on actual program approval, initiation and realized participation rates.

Ms. Ossege testified regarding DEI's use of EM&V to calculate lost revenue and incentive amounts to be in included in Rider EE. Ms. Ossege noted that DEI will coordinate with the Core Program TPA as selected through the Demand Side Management Coordination Committee ("DSMCC") in the same manner as for Core Plus Programs.

Ms. Ossege testified that DEI's EM&V proposed plans satisfy the Commission's rules on energy efficiency for DSM program evaluation as set forth at 170 IAC 4-8-4. Ms. Ossege testified that DEI utilizes the DSMore Model to evaluate the costs, benefits, and risks of energy efficiency programs and measures.

Ms. Ossege testified that DEI analyzed the cost-effectiveness of the proposed Core Plus Programs using the Participant Test, Utility Cost Test ("UCT"), Total Resource Cost ("TRC") Test, and the Ratepayer Impact Measure ("RIM") Test for a comprehensive screening of energy efficiency measures. Ms. Ossege testified that the use of multiple tests can ensure the development of a reasonable set of energy efficiency programs, indicate the likelihood that customers will participate, and protect against cross-subsidization. Ms. Ossege sponsored DEI's Public and Confidential Exhibit D-3, which provided a matrix of the components included in each test and the cost-effectiveness test results for each program. Ms. Ossege testified that DEI's proposed Core Plus Program portfolio passes all of these tests and are therefore cost-effective. Ms. Ossege filed supplemental testimony regarding the cost-effectiveness test scores of the Core Programs. Her testimony stated that the Core Programs are cost effective as a portfolio. Furthermore, all programs passed the UCT and TRC test; Low-Income Weatherization and Home Energy Audit, did not pass the RIM test, but the other programs were cost effective under the RIM test.

Ms. Ossege testified regarding the calculation of Lost Revenues and the interaction with the EM&V process. Ms. Ossege testified that DEI will measure actual participation as an input in the EM&V process and use this information as the basis for true-ups of estimated lost revenues and incentives for the proposed rider. She stated that estimated energy efficiency impacts and free ridership levels are an output of the EM&V process and will be used prospectively to adjust assumptions used to estimate lost revenues, future target achievement levels for development of incentives, and in future cost-effectiveness evaluations.

Ms. Ossege explained that actual participation for calendar year 2011 will be incorporated into the cost-effectiveness testing, estimates of lost revenues and incentives for 2013, and will be used to true up the estimates that were made for 2011 lost revenues and incentives. She explained that the computation for the amount included in the estimation for the Rider took the relevant electric rate for each group of customers and multiplied that by the estimated level of energy efficiency impacts, reduced for free riders. Ms. Ossege stated that the base electric rate, net of variable O&M and fuel costs, is used with the energy efficiency impacts in computing lost revenues. She testified that the same residential and non-residential net rate per kilowatt hour ("kWh") was used for the calculation of both Core and Core Plus estimated lost revenues, beginning January 1, 2011.

Ms. Ossege testified that although she agrees that the decision as to whether deemed savings should be modified, as well as the modification process itself, should involve input from the DSMCC, as well as the EM&V vendor(s) and possibly third-party evaluators, DEI disagrees that the DSMCC or an oversight board is necessary in determining deemed calculations because DEI has evaluation and engineering professionals who are experts in this complex and technical area.

Bruce L. Sailers, Manager, Retail Energy Desk, testified that DEI is proposing to include two demand response programs in its Core Plus Program offerings: (1) Power Manager and (2) PowerShare CallOption. Mr. Sailers explained that DEI is including these programs in the Core Plus portfolio as they are fundamentally based on the concept of deferring or eliminating the need for building new peaking capacity as the Commission determined in Cause No. 41448 S1. He testified that these programs provide significant benefits to DEI, its customers as a whole, and participants, and meet Midwest Independent Transmission System Operator's ("MISO") Resource Adequacy criteria and can be counted toward meeting DEI's capacity requirements. Mr. Sailers testified that DEI should be allowed to earn a fair and reasonable return on promoting, coordinating, and utilizing demand response to reliably serve electric demand in its service area. Mr. Sailers also noted that DEI's PowerShare Quote Option and the new demand response programs associated with Cause No. 43566, PowerShare EDR and PowerShare DRR Type I Energy Only, are not proposed to be included as Core Plus Programs.

Nick Hall, President of TecMarket Works, testified that he had written the summary evaluation plans and that someone from his organization's evaluation team would be performing the EM&V

studies, thereby assuring that the EM&V is performed by an independent third-party. Mr. Hall stated that it was his professional opinion that DEI has adequately provided for independence in its evaluations. He also praised DEI for specifying the proposed evaluation activities in advance of program implementation so that DEI is better able to collect necessary data.

Mr. Hall further testified that the proposed evaluation summaries are consistent with evaluation protocols, including the California Evaluation protocols, and incorporate the kinds of activities and comply with the National Plan for Energy Efficiency Protocols, the International Performance Measurement and Verification Protocol and the California Evaluation Protocols.

Finally, Mr. Hall testified that DEI's proposal to verify, generally, 5% of the installed measures is adequate. He emphasized that it will be important to allocate evaluation dollars to the most important programs.

Timothy Duff, General Manager, Retail Customer and Regulatory Strategy, testified that DEI is seeking authority to implement pilot programs without specific advance regulatory approval of the pilot. He stated that DEI proposes to defer for subsequent recovery, the costs associated with developing and implementing pilot programs. He stated that, upon successful completion of a pilot program, DEI will file for approval of the program, program cost recovery, lost revenues, and incentives associated with both the pilot and the program going forward. He stated that the aggressive impacts mandated in the Phase II Order will require DEI to innovate and develop new programs, and that, in order to get the necessary new pilots to market quickly, it will be critical to expedite or eliminate the regulatory approval required for pilots.

Mr. Duff testified regarding DEI's proposal to recover lost revenues associated with the Core and Core Plus conservation programs, as permitted under 170 IAC 4-8-6. He testified that DEI is proposing to recover lost revenues through its proposed Rider EE. He stated that the lost revenue calculation is the product of the amount of reduced kWh sales resulting from the energy efficiency programs and the fixed cost portion of the volumetric price, allowing DEI to recoup the fixed costs that it would have recovered through volumetric rates had it not incurred reduced sales due to energy efficiency programs.

Mr. Duff testified regarding DEI's proposal for a performance-based shareholder incentive mechanism tied to achievement of energy efficiency targets associated with the Core Plus Programs, as permitted by 170 IAC 4-8-7. He testified that DEI is proposing two tiers of incentives through its proposed incentive mechanism. He stated that the percentage of achievement of energy efficiency targets based on actual energy savings will determine the calculation of shareholder incentives, which will be calculated as a percentage of incurred program costs, including associated EM&V costs. Mr. Duff testified that, for the purposes of an incentive, DEI seeks to treat peak-load management programs like conservation programs.

Mr. Duff testified that DEI is only proposing to receive shareholder incentives for independently measured and verified energy efficiency impacts associated with meeting its annual compliance targets. He stated DEI believes that performance-based incentives directly tie the level of incentive DEI receives with the energy efficiency savings its customers realize.

Mr. Duff stated that DEI believed the second tier of incentives was appropriate because it offered higher levels of performance incentive to offset the time, effort, and risk of developing new and innovative energy efficiency programs that will be necessary to meet the Commission's aggressive energy savings targets in later years.

Diana L. Douglas, Director, Rates, testified regarding the treatment of performance incentives in the fuel adjustment clause ("FAC") earnings test. She stated that, in order to ensure that DEI can retain a performance incentive, DEI proposes that it adjust its net operating income ("NOI") to exclude the actual amount of performance incentive billed, net of related income taxes and revenue related taxes and expenses, similar to adjustments the Commission approved for DEI in Cause No. 42736-RTO 14.

Ms. Douglas testified that DEI proposes to use Rider EE to recover the following items: program costs for Core and Core Plus Programs (including costs associated with EM&V); lost revenues for Core and Core Plus conservation programs, and a performance-based shareholder incentive for Core Plus Programs. She stated that DEI is requesting rates be set using estimates of the program costs, lost revenues, and shareholder incentives based on expected achievement levels, and that the estimates will be reconciled or "trued-up" to actual costs, lost revenues and incentives earned. She further explained that DEI is proposing that lost revenues and incentives be recovered based on estimated participation levels and impacts, assuming a 100% of target achievement level, and that they will subsequently be trued-up to reflect the difference between actual and projected customer participation levels.

Ms. Douglas sponsored rates to be billed under Rider EE for 2011 and 2012. She explained that in future filings, rates are expected to be presented for only one year, with estimated costs for the upcoming calendar year, along with a reconciliation of the prior year costs, collections, and customer participation. She explained that the existing Rider 66 rates would be reset to zero effective upon an order in this proceeding. She further explained that DEI planned to do a final reconciliation of the existing DSM rider, covering 2010 and 2011 costs for programs offered under this rider, at the same time it planned to file its next Rider EE filing in June 2012. In that filing, which will establish Rider EE rates to be effective January 2013, reconciliation will also be made for any 2011 costs for Core and Core Plus Programs offered under the EE Rider. The reconciliation will also include a true-up of 2011 lost revenues and incentives based on 2011 actual participation in the EE programs, and the lost revenue calculation will reflect actual realizations rather than the estimates used in setting the initial rates.

In addition to the recovery of lost revenues and incentives, DEI is proposing different ratemaking treatment in this case than DEI currently has in place. She stated that the primary change is to allocate some share of energy efficiency costs to all customers, because the Phase II Order requires that EE programs be available to all customer classes. Since 1996, only residential customers, plus commercial and industrial customers with annual billed peak demands less than 500 kilowatts ("kW"), were eligible to participate in DEI's energy efficiency programs. Large commercial and industrial customers – those having annual billed peak demands greater than 500 kW – were not eligible to participate in DEI's energy efficiency programs, and were not assessed any energy efficiency program-related costs. Ms. Douglas explained that customers whose loads exceed 500 kW will no longer be exempted from participation in EE programs.

Ms. Douglas testified that DEI is proposing slightly different cost assignment and allocation methodologies in this proceeding. DEI is proposing to use a combination of direct assignment and allocation. She explained that the allocation methodology in this proceeding proposes to directly assign the costs associated with its energy efficiency programs to two broad groups of customers – residential customers on the one hand, and non-residential customers on the other hand – based on the programs to be offered to each customer group. Ms. Douglas stated that, after directly assigning the non-residential program-related charges to that broad group of non-residential customers, DEI proposes to allocate the charges to appropriate customer classes within that non-residential group based on demand and energy allocators. For its predominantly energy related conservation programs, DEI proposes to allocate associated program charges on the basis of energy or kWhs; for its demand response programs, DEI proposes to allocate associated program charges on a coincident peak demand or kW basis, using each rate schedule's share of coincident peak demand from DEI's last retail rate case in Cause No. 42359.

Ms. Douglas explained that DEI currently recovers its energy efficiency program costs via Rider 66, except for PowerShare and a customer specific demand response program, which are recovered via Rider 70. Under Rider 66, DEI's energy efficiency charges are directly assigned to the rate classes eligible to participate in the programs: residential program costs are allocated to Rates RS, and the costs of commercial and industrial programs are allocated to Rate Schedules CS, FOC, LLF, and HLF (to the extent those customers are eligible to participate in the programs).

Ms. Douglas testified regarding Rider EE and the inclusion of lost revenues. She stated that lost revenues will be recovered for three years beginning as of the year of participation and that lost revenue recovery will end to the extent the associated kWh reductions are taken into consideration in future retail electric rate cases. Ms. Douglas testified that DEI is proposing that lost revenues be recovered based on the assumption that DEI will achieve 100% of its targeted impacts, and that lost revenues will be subsequently trued up to reflect the difference between the actual and projected customer participation levels. Ms. Douglas testified that the recovery of lost revenues should be included in the FAC earnings test calculations.

As other witnesses have explained, DEI proposes to include PowerShare CallOption in its Core Plus set of programs and to recover charges associated with that program (program costs and a shareholder incentive) via its proposed Rider EE. Ms. Douglas explained that, because the costs of the PowerShare CallOption program are currently included in DEI's Rider 70, historically the program has been allocated on a demand basis to all customers. Ms. Douglas testified that, with the proposed movement of the program to Rider EE, PowerShare CallOption charges would be allocated to the non-residential group of customers only, consistent with the way the charges associated with DEI's Power Manager Program, a direct load control program for residential customers which has historically been recovered in Rider 66 and directly assigned to residential customers would be allocated to residential customers only. She testified that DEI's proposed allocation method for demand response programs is reasonable, but if the Commission decides the costs of demand response programs should more properly be allocated to all customers, the revised allocation methodology should apply to all demand response programs included in the proposed rider, both PowerShare CallOption and Residential Power Manager.

Ms. Douglas also explained that, for conservation programs, rates will be established for all customer groups by using the costs allocated to the group divided by kWh sales. This will result in one rate for residential customers covering the costs of residential programs and one rate for all non-residential rate schedules covering the costs of non-residential programs. For demand response programs, the residential rate will be set similarly. However, for non-residential rate schedules, demand response rates will be set using the costs allocated to each non-residential rate schedule divided by kWh sales, except that monthly non-coincident peak demands KW will be used to develop and bill the rates for rate HLF, consistent with how rates are set for other production demand related costs in several of DEI's riders. The program cost (including the cost of EM&V) and incentive amounts used in the development of the rates will be adjusted to a revenue requirements level to cover revenue related taxes and expenses, but no such revenue requirements adjustment is required for lost revenues.

Ms. Douglas also testified that DEI is requesting authority to defer for accounting purposes using a regulatory asset account (FERC CFR account 182.3), with subsequent rate recovery in Rider EE, costs associated with Core and Core Plus Programs, including Core Program start-up and implementation costs and pilot program costs, until such time as the costs are included in rates and also for authority for the continued use of deferred accounting for EE costs on an ongoing basis to ensure proper matching of the timing of recognizing expenses with the rate recovery of such expenses through the proposed rider. Ms. Douglas testified that such ongoing use of deferred accounting helps prevent earnings erosion for DEI when estimates used in setting rates and actual costs deviate materially and that the proposed accounting treatment is in accordance with U.S. GAAP. Ms. Douglas also explained that accounting rules will require DEI to monitor financial results expected to be ultimately realized and the financial results recorded on DEI's books. A regulatory liability will be recorded and revenues will be reduced if the level of revenues billed customers is in excess of the level of revenues that is estimated to be ultimately recoverable. Ms. Douglas opined that deferral of the EE costs until they can be included in rates will minimize the timing difference between cost recognition on DEI's books and cost recovery. However, in order for DEI to defer the expenses and reflect the costs as a regulatory asset, it must be probable that such costs will be recovered through rates in future periods.

B. <u>OUCC's Case-in-Chief</u>. April Paronish, Utility Analyst for the OUCC, testified that DEI's proposed Home Energy House Call Retrofit program should be removed from the proposed Core Plus Program portfolio. With its three-year TRC score of 0.66, the program is not cost-effective and does not promote a major public policy objective nor is it market-transforming, like an LED light bulb program might be.

Ms. Paronish said that, consistent with OUCC's recommendation regarding a similar program in Cause No. 43959, DEI's proposed Home Energy Comparison Report program should initially be piloted, without shareholder incentives, for at least one year. Ms. Paronish recommended that certain programs, such as Online Home Energy Calculator and the Personalized Energy Report programs, be combined to minimize administrative, marketing and EM&V costs. In addition, given that the Refrigerator Recycling and Freezer Recycling programs both involve collecting refrigeration applications, Ms. Paronish recommended combining these programs.

Ms. Paronish testified that DEI did not properly account for EM&V and shareholder incentive costs at the program level for purposes of calculating cost-effectiveness. In support of her position, Ms. Paronish stated that DEI was including EM&V costs when calculating the amounts on which it could earn an incentive, but excluding both EM&V costs and shareholder incentives from the cost/benefit calculations. Ms. Paronish concluded that DEI should ultimately provide new cost effectiveness results for the TRC test based on customer-specific net-to-gross data to be reviewed by the DEI DSM Oversight Board and DEI's EM&V vendor. Those results would incorporate the incentives to the utility, EM&V costs, as well as high level program costs.

Ms. Paronish testified that DEI's case-in-chief did not include a high-level breakdown of program costs and as a result, it is impossible to determine whether costs are reasonable and whether the benefit/cost calculations are accurate. She further testified that it is unclear whether the $12.5 million cost of overachieving the 2011-2013 Phase II Order mandated savings' goals includes increased shareholder incentives to achieve the additional savings and/or an increased level of lost margins because the savings are being captured early in the program and for a longer period of time. She stated that planning to overachieve EE targets increases the possibility that DEI will earn at the highest shareholder incentive tier, and the OUCC is concerned that the practice of overachieving could occur each triennial filing with unnecessary increases to ratepayers' bills.

Ms. Paronish also testified that DEI did not provide program-specific EM&V budgets, which the OUCC believes to be important for transparency purposes so that the Commission can better understand the true costs and benefits associated with each program.

In response to DEI's proposed authority to implement pilots and defer pilot costs without preapproval of the pilot, Ms. Paronish testified that the public interest would not be well-served by granting this request without guidelines and protections built into the process. She recommended that the Commission deny DEI's request for deferral of costs to develop and pilot new programs without prior approval, and instead recommended that DEI work with the proposed Oversight Board.

Ms. Paronish testified regarding DEI's proposed shareholder incentives and planned overachievement of energy efficiency targets. Ms. Paronish testified that failing to incorporate the planned overachievement into the proposed incentive makes it easier for DEI to exceed its goals. She stated that DEI should only receive incentives for net energy savings goals. She stated that if the Commission approves DEI's budget increase in order to overachieve its energy efficiency targets, the incentive mechanism should reflect those higher performance targets.

Ms. Paronish also testified regarding DEI's second tier of incentives and recommended against it. She stated that the second tier should also depend on net energy savings goals and that the incentives should reflect planned overachievement. She criticized the proposal for not including any negative incentive for failure to perform. Ms. Paronish testified that the second tier would allow incentives for any program that DEI undertakes as long as the program has not yet been developed or deployed in Indiana. Ms. Paronish concluded by stating that the OUCC believes that DEI already has a regulatory incentive to be innovative and develop new programs in order to meet the Commission's energy efficiency goals and that DEI should not require a "super incentive."

Ms. Paronish testified that it would be inappropriate to defer lost revenues prior to a Commission order in this proceeding. She contended that DEI must receive Commission authority to begin earning lost margins on programs. Thus, it would be inappropriate to defer lost margins on January 1, 2011 prior to a Commission order.

Ms. Paronish recommended that the Commission establish the DEI DSM Oversight Board, similar to those successfully established for three natural gas utilities and four electric investor-owned utilities. She set forth the basic framework in her Exhibit AMP-1, describing the board's functions as monitoring monthly program progress, determining program effectiveness as well as program creation, modification, funding and discontinuation. She also stated that the oversight board should select the third-party EM&V vendor. Ms. Paronish highlighted the benefits when all stakeholders have input into program availability, operation and evaluation.

Ronald L. Keen, Senior Analyst with the OUCC, testified concerning demand response programs, particularly with regard to the then-pending Commission proceeding concerning customer participation in the MISO's demand response framework. Mr. Keen's testimony emphasized that curtailment service providers must be an integral part of the process under consideration in that proceeding, and summarized the OUCC's recommendations made to the Commission in that proceeding.

OUCC witness Duane P. Jasheway, Utility Analyst for the OUCC, testified regarding DEI's proposal to exclude shareholder incentive amounts from the FAC earnings test. Mr. Jasheway opposed DEI's proposed exclusion. Mr. Jasheway testified concerning the implementation of Rider EE. He discussed OUCC's concerns with DEI's proposed June 2012 filing intended, in part, to "reconcil[e]...all costs under both riders for 2010 and 2011...include a true-up of 2011 lost revenues and incentives...and...reflect actual [lost revenue] realizations...rather than the estimates used in setting these initial rates." He also highlighted that the filing would also include 2013 estimated costs plus any actual deferred TPA or EM&V start-up and administrative costs related to Core Programs. Mr. Jasheway testified to both the potential impact on consumer rates and the potential lack of transparency in a filing of such complexity. He recommended the Commission require DEI to provide the Commission and OUCC with two updated estimates (July 1, 2011 and January 1, 2012) that include a clear breakdown of all costs to be contained in the June 2012 filing.

C. Kroger's Case-in-Chief. Kevin Higgins, Principal of Energy Strategies, LLC, testified that DEI's proposal to reclassify the PowerShare CallOption program as a Core Plus program shifts the cost recovery from all customers to non-residential customers only and increases the costs to customers by making it subject to performance incentives. Mr. Higgins testified that the benefits produced by the demand response programs are benefits to the system and, consequently, the costs are system costs that should remain in DEI's Rider 70.

Mr. Higgins recommended against lost revenue recovery, arguing that DEI is projecting load growth through 2014. He testified that DEI is not likely to experience an absolute reduction in fixed cost recovery at any point in time, even with energy efficiency programs. Mr. Higgins testified revenues that grow beyond the level of determinants used in setting rates are known as "found" revenues and that the found revenues are expected to be greater than lost revenues through 2014. For equity reasons, he advocates against lost revenues.

Mr. Higgins' testified that if DEI experiences material net reductions in load from meeting the Commission's mandates, then the argument for lost revenues is more reasonable than in the current proceeding where DEI is proposing to voluntarily exceed the Commission's targets. Mr. Higgins concluded by recommending that the Commission use its discretion to deny lost revenue recovery.

Mr. Higgins testified regarding DEI's proposed performance-based incentive mechanism. He stated that a performance-based approach is appropriate but that the proposed structure is too favorable to DEI. He stated that receipt of incentives at sixty percent (60%) achievement is too low, and he recommended shifting the entire structure forty (40) points. Mr. Higgins testified that incentives should begin when DEI meets or exceeds the energy efficiency targets.

Mr. Higgins also recommended that the Commission reject DEI's second tier incentive as unduly complex and speculative. He stated that the current segregation of programs into Core and Core Plus categories is sufficient, without the need for a "Core Plus Plus" category.

Mr. Higgins proposed that the Commission adopt a self-direct option in which qualifying customers who commit to independently meet or exceed the energy efficiency targets for utilities established by the Commission in its Phase II Order would be exempt from funding either the Core or Core Plus programs, including recovery of lost revenues. He testified that a similar type of program has been put in place in Michigan. He explained that the Michigan program allows qualifying customers to opt to self-direct if the customer commits to meet the same energy efficiency target that the utility is obligated to meet on a growth adjusted basis. Mr. Higgins testified that in Michigan, self-direct customers are exempted from all energy efficiency charges except for the component that funds low-income conservation programs. He recommended that DEI customers with loads of 5 MW or greater be allowed to self direct and that those customers be allowed to aggregate loads from multiple sites.

Mr. Higgins testified that utility EE programs are an expensive diversion of resources for those customers who pursue energy efficiency on their own initiative. He explained that another challenge is that energy efficiency investments typically must fit within utility-sponsored program parameters. Mr. Higgins testified that Kroger has a corporate energy department that provides project support for energy efficiency and that Kroger prefers to remain outside the purview of utility programs for all of its facilities.

Mr. Higgins stated that a utility program wastes investment resources because of administrative costs, lost revenues, and incentives. He testified that this applies to both Core and Core Plus programs. He stated his belief that the self-direct proposal comports with the Phase II order because he is not recommending an opt-out. He also testified that the Phase II order contains language that an opt-out may be viable in the future and that a self-direct option is more efficient and equitable that utility-sponsored programs.

Finally, Mr. Higgins provided more detail regarding the self-direct option that he is recommending. He reiterated that any self-direct customer is committed to meet the same energy efficiency target that the utility is obligated to meet. He pointed to the Michigan program, which provides for biannual documentation of customer progress and customer-assured confidentiality. He explained that a self-direct customer which fails to meet the required energy efficiency targets is subject to having to repay the avoided DSM surcharge associated with the shortfall and may be subject to a penalty, after a hearing and an opportunity to be heard. He testified that there are 75 customers participating in the Michigan self-direct program. He stated that the Arkansas Public Service Commission has directed its Staff to draft a proposal similar to Michigan's program. Mr. Higgins recommended that the Commission recognize the efforts of early adopters by allowing self-direct customers to take account of efficiency measures undertaken in recent years, such as within the past thirty-six months.

D. Industrial Group's Case-in-Chief. Nicholas Phillips, Jr., a consultant in the field of public utility regulation and a Managing Principal with the firm of Brubaker and Associates, Inc., provided an overview of DEI's requested relief, a comparison of the relief sought in this proceeding to that sought by other public utilities, and the impact of the relief on the members of the Industrial Group. Mr. Phillips explained that based on DEI's Case-In-Chief, DEI sought a total recovery of $198 million, of which $32 million was for costs associated with Core Plus Programs, $64.5 million for lost revenue, $6.2 million for shareholder incentives, and less than $5 million for EM&V.

Mr. Phillips testified that DEI's proposal was significantly more expansive than that of other investor owned utilities in Indiana. By way of comparison, Mr. Phillips noted that the next largest proposal was that of NIPSCO, with a total expenditure of $106 million including $6 million in lost revenue, and $9 million in shareholder incentives. Mr. Phillips noted that DEI's proposal to recover $64.5 million in lost revenue was "strikingly higher than other Indiana utilities" and that each of the other utilities had made available detailed program costs. Mr. Philips also noted that DEI is the only utility to propose substantial demand response programs as a Core-Plus Program.

Mr. Phillips further testified that if DEI's requested relief were granted, total charges for the four member Industrial Group would exceed $4.25 million, and each would face significant rate increases to fund DEI's programs.

With respect to DEI's request for recovery of lost revenue, Mr. Phillips first noted that utilities should not be exempt from their duty to offer energy efficiency programs as cost effectively as possible in order to meet their obligation to maintain just and reasonable rates. Mr. Phillips expressed his view that utility sponsored DSM programs, coupled with incentives and lost margin recovery as requested by DEI were not necessarily the best means of promoting energy efficiency efforts for all customers. Mr. Phillips noted that many large customers utilize their own resources to improve the energy efficiency of their processes in ways that can require a high degree of customization. Mr. Phillips testified that there was no basis to believe that DEI could procure the energy efficiency services for such customers more cost-effectively than the customers themselves, particularly if DEI demands, and receives, a financial bonus and lost margins in exchange for providing the services.

Mr. Phillips further testified that DEI's last rate case was in 2004 utilizing a 2002 test year. Mr. Phillips opined that DEI had avoided a base rate case because of the numerous riders that have taken effect since that time. As Mr. Phillips testified, rates for large customers have increased an average of 56% between 2004 and 2009 with the average per kWh cost for a customer under DEI's HLF rising from $0.042/kWh to $0.064/kWh during that time. In Mr. Phillips' view, the continued imposition of trackers will simply exacerbate that trend, burdening DEI's customers with higher rates without an opportunity to adjust DEI's revenue requirement or make appropriate changes to DEI's cost of equity. Mr. Phillips testified that the continued approval of tracker mechanisms reduces the traditional risk associated with operating a utility by limiting exposure to fluctuations in operating costs or sales levels. Accordingly, Mr. Phillips suggested that if the Commission were to approve the riders proposed by DEI, there should be a corresponding downward adjustment to DEI's allowed return on equity in DEI's next base rate case.

Mr. Phillips identified several problems and concerns with regard to DEI's specific request for $64.5 million in lost margin recovery. These included the distortion of the "risk/reward" structure under the traditional regulatory system by removing the economic incentive for DEI to control costs that would otherwise result in declining sales; and in promoting economic development that would increase revenues. Mr. Phillips testified that he found it particularly troubling that DEI's lost revenues account for nearly 1/3 of the total cost of Duke's DSM proposal, unreasonably inflating the cost of the program.

Mr. Phillips also noted that under the Commission's regulations, the award of lost revenues is discretionary. He testified that several factors weighed in favor of the Commission exercising its discretion in denying DEI recovery of lost revenue. These included that length of time since DEI's last rate case; the extent to which decreased energy use by customers would increase DEI's opportunity to gain revenue from off-system sales; and the fact that based on testimony in Cause No. 43114 and in this proceeding, DEI is already achieving energy savings of roughly 654,000 MWh, or 2.4%, annually without recovery of lost margins.

Mr. Phillips testified that proponents of incentive payments for utility-sponsored DSM programs generally claim that such incentives are needed to offset the alleged disincentive of lost revenues associated with the adoption of energy efficiency programs. Mr. Phillips explained that under this theory, incentives are meant to level the playing field between supply-side and demand-side resource options.

Mr. Phillips stated that this rationale does not support approving DEI's proposed shareholder incentive mechanism. He noted that DEI retains its legal obligation to provide customers service at the lowest reasonable cost, and that DEI had asserted that its proposed programs are cost-effective for customers. Accordingly, DEI should not be granted a financial incentive for meeting its statutory obligations to provide service at the lowest reasonable cost. Mr. Phillips also explained that as DEI has been required to meet specific efficiency targets through the Phase II Order, it would be inappropriate to reward shareholders for DEI's compliance with a Commission mandate. Mr. Phillips further testified that if one were to accept the premise that incentives are needed to offset lost revenue, that mechanism is unnecessary to the extent the Commission approves recovery of lost margins.

Mr. Phillips also expressed his concern that the shareholder incentive program proposed by DEI would impose rate increases on customers of uncertain magnitudes. That rate uncertainty would adversely impact customers by exposing them to higher levels of financial risk, making it more difficult to manage their energy budgets and plan for their future power needs.

Mr. Phillips testified in support of allocating costs on the basis of demand allocated in DEI's last rate case rather than by allocating demand response program charges separately to residential and non-residential programs. Mr. Phillips noted that DEI, and its predecessor PSI, has offered tariff-based demand response programs for decades. This includes the PowerShare program that was implemented in 2000 and is presently offered under Rider No. 23. Mr. Phillips emphasized that at the time PowerShare was approved in Cause No. 42359, it was proposed that DEI be allowed to recover the actual cost associated with the program by including a base level in DEI's revenue requirement with a tracking mechanism to account for differences from that base level so that DEI recovered "only the costs of this program, no more and no less. . . " These costs were recovered only from those ratepayers that elected to receive service under the program.

Mr. Phillips testified that such tariff-based demand response programs are cost based, and are established so that the utility receives its cost based revenue requirement established in a base rate proceeding. Mr. Phillips took the position that moving from the previously approved recovery methodology should not occur in this proceeding, as it would effectively amount to single issue ratemaking.

Mr. Phillips testified that utility-sponsored DSM programs are not the best means of promoting energy efficiency efforts in DEI's service territory. He stated that many large customers have their own resources or utilize independent energy services companies to improve the energy efficiency of their manufacturing processes and that a high degree of customization is required.

Mr. Phillips testified that in lieu of the program proposed by Duke, the Commission should create an environment that maximizes voluntary energy efficiency efforts by its end use customers, and to that end, recommended that large customers be allowed to implement self-directed programs that could be counted towards DEI's efficiency goals. He stated that the Commission should trust its large business customers to act responsibly and that DEI's proposal is not necessarily the best means of producing energy efficiency savings for all customers. Mr. Phillips stated that individual customers are in the best position to evaluate the various measures that could be undertaken to reduce their energy and demand levels, as each customer is best aware of its own energy consumption habits and electricity costs. Mr. Phillips also testified that many of DEI's large ratepayers compete in a global marketplace, and therefore have an incentive to invest in energy efficiency programs to reduce costs and remain competitive within the marketplace. Another benefit of a self-directed program is that it avoids the wasteful use of customer resources that could have otherwise been deployed toward voluntary energy efficiency investments by end-use customers. Mr. Phillips testified that Eli Lilly and Haynes International are examples of large customers in DEI's service territory who have successfully pursued voluntary energy efficiency initiatives.

Mr. Phillips also noted that in a self-directed program, administrative costs do not have to be collected from other ratepayers making it less expensive than a utility sponsored program. He also testified that allowing recovery of lost margins and incentives artificially inflates the cost of providing efficiency programs that are available to large customers on the open-market. Further, Mr. Phillips testified that programs such as those proposed by DEI unfairly discriminate against customers who have already invested in energy efficiency measures by forcing them to pay not only for their own investments, but those of other ratepayers as well.

Mr. Phillips suggested that large customers with an annual aggregate demand of 5 MW or greater should be permitted to submit a proposal for a self-directed plan consisting of an audit identifying energy efficiency opportunities at their facilities and proposed plan to pursue cost-effective energy efficiency measures from the audit over a three-year period. He stated that a customer would report its progress and submit independent EM&V at the end of the three-year period. Mr. Phillips stated that DEI would be permitted to count independently verified energy savings accruing from self-directed programs towards DEI's Commission mandated goals.

Mr. Phillips recommended that a self-directed program would be reviewed by a collaborative consisting of DEI, the OUCC, the Industrial Group and other interested stakeholders and would be approved if the customer demonstrates that it is making a reasonable financial investment in energy efficiency and/or demand response measures based on an audit of its facilities. He stated that a self-directed customer would be permitted to present information regarding past investments and that the collaborative should consider that past investments may affect cost-effective future opportunities. Mr.

Phillips recommended that a customer who disagrees with the collaborative's recommendation has the opportunity to appeal to the Commission.

Mr. Phillips testified that customers who are approved to self-direct not be assessed charges associated with DEI's programs. He further stated that self-directed customers' energy efficiency plans be subject to confidentiality protections.

E. SDI's Case-in-Chief. Dr. Dennis W. Goins recommended that the Commission reject DEI's proposed shareholder incentive mechanism. Dr. Goins explained that shareholder incentives are not necessary at all, if the Commission approves some form of decoupling or lost revenue adjustment in this case. He reasoned that DEI's shareholders will not be harmed by implementing its proposed DSM programs under this scenario. Dr. Goins also noted that shareholder incentives are permitted by the Commission's DSM Rules, but not required. Dr. Goins stated that DEI, however, is required to meet the annual savings targets mandated by the Phase II Order, regardless of whether incentives are in place.

Dr. Goins recommended that the two-tiered incentive approach advocated by DEI should be rejected, regardless of what the Commission decides on the general issue of incentives. He maintained that DEI's argument that it should receive a higher reward for the time and effort needed to develop new and innovative programs is irrelevant. Dr. Goins stated that the Commission should expect DEI to be innovative in developing EE programs as they are needed and there is no reason to believe that they will not be forthcoming absent a second-tier incentive that is even higher than initial first-tier incentive payments.

Dr. Goins recommended three specific changes that should be made to DEI's graduated incentive structure, should the Commission decide an EE incentive mechanism is in the public interest. First, he recommended that the threshold for any positive shareholder incentive payment should be set at 100% of the portion of DEI's annual savings target that will be met by its Core Plus Programs. Second, he advocated limiting the maximum incentive to 10% of DEI's aggregate annual Core Plus Program costs, applicable only if annual energy savings exceed the annual energy savings target. Third, Dr. Goins recommended that the maximum annual incentive that DEI can earn during 2011-13 should be set at 10% of the total annual cost of the Core Plus Programs included in DEI's proposal. Dr. Goins also recommended setting a performance penalty of -2% at 40-59% of the annual savings goal and -4% at 40% or less of the annual goal. Dr. Goins advocated symmetry in the incentive structure. Dr. Goins stated that these changes would put DEI on notice that customers expect to receive a reasonable return from capital they, and not shareholders, provide for DEI's EE programs, especially since DEI is asking them to make shareholders whole for any associated lost revenues.

Dr. Goins recommended rejecting DEI's proposal to exclude net income attributable to any shareholder incentive for the FAC earnings test. Dr. Goins explained that shareholder earnings should be treated no differently than other types of rate revenue in the FAC earnings test. He stated that not doing so would expose ratepayers to potentially excessive earnings by DEI. Dr. Goins noted that the Commission has found on at least three occasions that shareholder incentives earned on EE programs should be included in the FAC earnings test.

Dr. Goins noted that in its rebuttal testimony, DEI fundamentally changed how it previously proposed to treat interruptible load with respect to cost responsibility for its energy efficiency programs. The net effect is to shift responsibility for EE programs to nonfirm loads without reasonable justification and empirical support. Based on this change of position, Dr. Goins recommended that interruptible load of large special contract customers be exempted from conservation and demand-response charges under DEI's proposed Rider EE. In addition, he recommended that DEI not be allowed to recover lost revenues allegedly associated with special contract interruptible loads, except as may be currently allowed by the Commission, nor to earn shareholder incentives related to capacity and/or energy savings attributable to special contract interruptible loads.

Dr. Goins distinguished special contract interruptible loads from nonfirm loads under DEI's other demand response programs, noting that a large steel producer, such as SDI, has electricity-intensive production processes (primarily arc furnaces) that do not require firm electric service. Dr. Goins explained that these processes can be operated using a lower priced, less reliable electricity product sold by DEI – nonfirm interruptible service. Dr. Goins further explained that such operations are typically located in utility service areas where reasonably priced interruptible service options are available. Dr. Goins contrasted this with a residential or small commercial customer that allows DEI to interrupt an air conditioner. For these customers, he noted, such service is an afterthought that requires little or no planning, investment or skill to implement. Dr. Goins stated that to a large special contract customer, reasonably priced interruptible service is central to business success. He concluded that it makes little economic sense to apply EE charges to special contract interruptible loads that did not create the need for DEI's production resources.

Dr. Goins stated that Rider EE conservation and demand response charges should not be applicable to special contract interruptible loads. He reasoned that a large customer like SDI can choose to buy both firm and nonfirm interruptible services from DEI, reflecting different products with different cost structures. He noted that under DEI's revised Rider EE proposal, a special contract interruptible customer would not only pay for Rider EE's conservation and demand response components on its firm power purchases, but also on purchases of nonfirm, interruptible power. Dr. Goins explained that the interruptible load of special contract customers does not impose supply-side fixed costs because DEI serves the interruptible load with nonfirm energy that can be interrupted. He warned that applying Rider EE charges to special contract nonfirm kWh sales raises the effective interruptible price above DEI's cost of the service and would discourage special contract customers from buying interruptible service. Dr. Goins stated that this runs contrary to the best interests of DEI's firm customers. He stated that interruptible load is a means of reducing generating capacity requirements and, under certain conditions, a substitute for such ancillary services as spinning and operating reserves. Dr. Goins stated that interruptible load expands the range of resources available to meet contingencies, lowers customer costs and can even be used to mitigate price volatility and curb potential market power problems. He explained that interruptible load can also create transmission and distribution related benefits, including capacity upgrade deferrals, reliability enhancements, and equipment life extensions. Interruptible load can also create environmental benefits when used to displace fossil generation during peak periods, thereby reducing greenhouse gas emissions.

Dr. Goins dismissed DEI's argument that special contract customers benefit from DEI's conservation and demand response programs, and therefore should help pay for them through Rider EE charges applied to both firm and interruptible billing units, unless expressly prohibited by the contract. Dr. Goins noted that DEI builds or acquires capacity to serve firm loads, not interruptible loads. Dr. Goins pointed out that special contract interruptible customers and firm service customers purchase different electricity products. He emphasized that special contract interruptible service is less expensive and less reliable than firm service. As a result, Dr. Goins stated, firm customers, in turn, benefit from interruptible service not only because of capacity cost savings attributable to interruptible load, but also because interruptible load is generally priced above cost. Dr. Goins concluded that interruptible load's effective cost is greater than avoided capacity cost attributable to the interruptible load. He stated that the excess revenue is generally treated as a credit against the utility's cost of providing firm service.

Dr. Goins also rejected DEI's argument that interruptible service for special contract customers should be priced to reflect what DEI perceives as ample compensation and incentives. Dr. Goins stated that interruptible service instead should be priced to reflect DEI's lower cost of providing interruptible service. He explained that the lower cost results from DEI's avoiding the cost of supply-side resources that are not needed to service special contract interruptible loads. Dr. Goins recalled that when pressed to provide estimates of marginal fuel cost reduction attributable to its Core and Core Plus conservation programs, which DEI witness Mr. Bailey claimed benefitted special contract interruptible loads, DEI was unable to provide any estimates of alleged marginal fuel cost savings that might support Mr. Bailey's statement. In fact, Dr. Goins noted, DEI's current fuel adjustment charge does not recognize that DEI incurs lower relative fuel costs serving a transmission voltage customer like SDI than customers served at secondary and primary voltages. Dr. Goins explained that all customers pay an average fuel rate, even though DEI incurs lower fuel costs per kWh to deliver a kWh to a transmission level customer. The fuel costs paid by a customer like SDI, he explained, exceed fuel-related costs that DEI incurs in serving SDI's firm and interruptible loads. Dr. Goins stated that DEI recognized this problem in discovery, but persisted in arguing that unless Rider EE's conservation component applies to SDI's interruptible kWh, SDI will receive a free benefit of alleged EE-related marginal fuel cost reductions that DEI cannot even estimate.

Although DEI claimed that interruptible service is a product it neither sells nor buys from customers, Dr. Goins stated that SDI buys interruptible service from DEI for a large portion of its total load and expects the service to be priced reasonably to reflect DEI's cost of service. He further stated that SDI's interruptible service will not benefit from DEI's conservation and other demand response programs because they are targeted at reducing firm loads – not interruptible loads. He further noted that SDI's interruptible service cannot benefit from the avoided cost of capacity that DEI never built or acquired. Dr. Goins concluded that there is no logical or fair justification for making SDI's interruptible loads subject to Rider EE's conservation and demand response charges.

In the event that the Commission decides that Rider EE charges should apply only to a special contract customer's firm load, but separate nonfirm/firm metering is unavailable, Dr. Goins suggested that the firm kW should be defined as the firm demand specified in the customer's contract. He recommended defining firm kWh as the customer's firm demand at the customer's average load factor for the preceding 12 months, with remaining kWh defined as interruptible kWh. Dr. Goins also recommended that special contract interruptible kW and kWh should be excluded in deriving Rider EE conservation and demand response charges for nonresidential customers.

Dr. Goins noted that only one of DEI's Core Plus programs is a demand response program – PowerShare CallOption. Dr. Goins concluded that it is possible that C&I customers could develop, finance, and implement their own EE investments that are both cost-effective and better suited to their business operations than utility-sponsored programs. He stated that large customers whose electricity budgets are a significant component of their operating costs have a strong financial incentive to cut operating costs by making cost-effective EE investments. Dr. Goins testified that these investments have to be tailored to fit the customer's particular operations model, which may involve trade-secret or competitively-sensitive production processes and technologies that the customer does not want to share with the utility or competing businesses. Dr. Goins recommended that a self-directed option be limited to customers with a maximum annual peak demand of least 2 MW (either as a single customer or a single business entity with multiple business locations).

Dr. Goins noted that SDI reserves the right to raise the opt out issue in a future proceeding. Dr. Goins recommended in this proceeding that the Commission establish a policy that credits large C&I customers for EE investments that undertake self-directed EE measures. He defined a self-directed EE measure as a customer-financed action or investment that a customer identifies, designs, and implements to reduce peak demand and/or energy consumption. Dr. Goins recommended that the customer be allowed to avoid paying some or all of the charges that it would normally pay for utility- or publicly-sponsored programs under DEI's Rider EE. Dr. Goins distinguished self-directed from opt out measures in that self-direct requires more structured measurement and verification on the back end of the administrative process. He stated that a self-directed customer is generally required to pay into the public benefit fund ("PBF") used to finance the utility's EE programs, such as Rider EE. Dr. Goins explained that the self-directed customer would later receive a credit ranging from a percentage of the self-direct project's cost to a specified percentage of the customer's PBF payments. Dr. Goins explained that his proposal recognizes and tries to balance the Commission's public policy interest, DEI's interests as an energy supplier and a regulated business, and the interests of large customers that seek cost-effective EE investments, but do not want to subsidize their competitors. Dr. Goins stated that self-direct programs are allowed in at least 17 states, some as unstructured opt-out programs. He concluded that a structured self-direct program would be a reasonable alternative to opt-out at this time.

Dr. Goins also stated that prohibiting self-directed programs fails to recognize the benefits of and provide appropriate credits for energy efficiency activities that a large commercial or industrial customer undertakes independent of the utility, as well as a disincentive for large customers to make their own cost-effective EE investments. Dr. Goins recommended that credit be given against charges under Rider EE for conservation programs included in DEI's Core and Core Plus Programs. Dr. Goins also recommended that since self-directed demand measures also provide capacity savings for DEI and its customers, such measures should receive a credit against their charges under Rider EE for demand response programs in DEI's Core Plus Programs. Dr. Goins noted that DEI is required by the Commission to offer a Core Program for C&I customers. He stated that if DEI develops EE programs and associated cost recovery mechanisms that are more cost effective than EE measures a customer can develop and implement independently, the customer will have a strong financial incentive to participate in DEI's programs. Dr. Goins testified that the customer should be able to determine which option is more cost-effective.

Dr. Goins recommended that customers who choose self-directed programs be required to provide DEI sufficient data to perform EM&V to verify the energy and peak demand reductions attributable to a customer's efforts. However, if there are no cost-effective energy efficiency projects available, Dr. Goins testified that a self-directed customer should receive an annual credit equal to all or a significant part of the customer's annual payments under Rider EE. In turn, Dr. Goins recommended that DEI's annual savings targets be credited for measured and verified self-directed energy efficiency savings. Dr. Goins cautioned that without a self-directed option, large C&I

customers will be at a competitive disadvantage with, for example, Duke Energy Ohio and Duke Energy North Carolina customers, since a DEI large C&I customer may be required to pay for EE programs that provide little or no direct benefit to the DEI customer.

F. DEI's Rebuttal Evidence. Mr. Goldenberg testified that although the Home Energy House Call Retrofit program does provide another opportunity for customers to participate in energy efficiency programs, DEI is willing to remove it from its portfolio. DEI will continue to fine tune the program and may recommend it or a variation on it in a future proceeding, if it is cost-effective. Mr. Goldenberg testified that DEI has no objection to combining the Online Home Energy Calculator and the Personalized Energy Report into one program, and the Refrigerator Recycling and Freezer Recycling into another program, as suggested by the OUCC.

Mr. Goldenberg disagreed with the OUCC's recommendation to pilot the Home Energy Comparison Report ("HECR") program for one year without any shareholder incentives. Mr. Goldenberg testified that this program has been a pilot for Duke Energy Ohio and has achieved significant impacts, a high response rate, and excellent customer ratings. Mr. Goldenberg testified that DEI believes this program will be received well by Indiana customers and will create significant value and therefore, should be included in the portfolio with appropriate incentives for DEI. Mr. Goldenberg recommended that the HECR program remain in the portfolio as a program eligible for shareholder incentives because of the positive customer response and impacts Duke Energy has seen in Ohio.

Although DEI did not propose an oversight board, Mr. Goldenberg stated that DEI is willing to work with an oversight board, but suggested that the composition be determined once the self-direct issue for larger customers is resolved. He recommended a number of changes to the OUCC proposal. He strongly recommended that the EM&V vendor should not be selected by the oversight board, in part because of economies of scale for a company such as Duke Energy that operates in five separate jurisdictions. He also suggested quarterly update meetings, as opposed to monthly meetings. Finally, he recommended that if the oversight board cannot reach a consensus, that any member can make a filing at the Commission for resolution.

Ms. Douglas provided rebuttal testimony stating that the removal of the Home Energy House Call Retrofit program from the portfolio resulted in a reduction of $1.2 million in the costs to be recovered, including lost revenues and shareholder incentives for the three-year program, which reduced the proposed residential rate impact as shown in DEI's Confidential Exhibits N-1 through N-3, and DEI's Public Exhibits N-4 and N-5.

Mr. Duff responded to the OUCC's concerns about DEI's request for authority to implement pilot programs and defer associated costs without advance approval. He stated that DEI is seeking approval to defer costs of the pilot and, if the pilot proves successful and leads to a full scale commercial program, DEI would then seek to recover the costs of the pilot. Mr. Duff explained that at the time DEI files for approval for the commercialization of a full-scale version of the program that was piloted, the Commission will have the opportunity to review the pilot results and the deferred costs to ensure cost effectiveness and determine whether the pilot costs were prudently incurred.

Mr. Duff stated that DEI believes that discussing pilots at the oversight board prior to introduction would be a prudent course of action to alleviate the OUCC's concerns, yet still allowing it to get pilots to market quickly.

Mr. Duff testified that a self-directed program needs to have EM&V processes that are consistent with the requirements and processes of the EM&V associated with the Core and Core Plus Programs. He stated that it is important to note that adoption of a self-directed program at anytime during the three-year compliance period will require adjustments to both DEI's overall annual energy efficiency targets and the achievement thresholds that DEI has proposed for its performance incentives.

Mr. Duff responded to the Industrial Group and SDI's contention that the Commission should reject a performance-based shareholder incentive because DEI already has a statutory obligation to pursue the least-cost effective means of meeting resource requirements. He stated that a number of state regulatory commissions and experts regard incentives as reasonable and necessary in order to make DSM financially competitive with supply-side investment and encourage aggressive performance.

Mr. Duff addressed the Intervenors' argument that the Commission base incentives on actual energy savings that DEI achieves, measured by EM&V, rather than gross energy savings. He testified that it is DEI's position that consistency in how achievement thresholds/targets and actual results are calculated is more important than the base measurement (net or gross savings). Mr. Duff stated that DEI chose to reflect achievement thresholds on gross energy savings because the Commission established its energy efficiency targets in its Phase II Order based on gross energy savings.

Mr. Duff responded to the Intervenors' concern with recovery of budgeted or estimated energy savings rather than actual, verified savings by pointing out that DEI seeks to use estimated impacts only until actual EM&V results are available. He stated that DEI examined EM&V results in other jurisdictions and recent engineering studies. Mr. Duff testified that DEI believes that this approach is reasonable because the true-up process is based on actual participation and the best EM&V data available for DEI's programs.

Mr. Duff testified regarding the Intervenors' objections to the second tier incentive. Mr. Duff testified that DEI is willing to consider alternatives, such as raising the authorized percentage incentive for greater than 110% achievement from 15% to 17%. He stated that this is a reasonable alternative because DEI will only be able to achieve 110% or more through new cost-effective programs.

Ms. Ossege testified that although she agrees the decision as to whether deemed savings should be modified, as well as the modification process itself, should involve input from the DSMCC, as well as the EM&V vendor(s) and possibly third-party evaluators, DEI disagrees that the DSMCC or an oversight board is necessary in determining deemed calculations because DEI has evaluation and engineering professionals who are the experts in this complex and technical area.

In response to Mr. Phillips' and Mr. Higgins' concern regarding the inclusion of demand response in DEI's proposed program portfolio, Mr. Sailers testified that DEI's proposed demand response programs meet FERC's definition of demand response in that DEI implements programs that compensate customers for being willing and able to depart from normal consumption patterns, when such a change in time of consumption is valuable for the utility system as a whole, due to high wholesale market prices or system reliability needs. Mr. Sailers emphasized that demand response programs create value for the utility system as a whole, as well as for participating customers.

Stephen M. Farmer, a rate and regulatory consultant for DEI, responded to the intervenors' concerns regarding DEI's proposed recovery of lost revenues that will occur due to the implementation of the Commission mandated energy efficiency programs. He stated that the recovery of lost revenues is intended to offset the reduction in fixed cost recovery that will occur as customers begin reducing their consumption of power, and is conservatively limited to a thirty-six month period or the life of the measure, whichever is shorter.

Mr. Farmer responded to the Industrial Group's contention that lost revenue recovery will remove the incentive to pursue economic development by pointing out that Mr. Phillips concedes that reduced sales due to energy efficiency will cause a reduction in the recovery of fixed costs that will have a detrimental effect, thus creating a hardship on DEI. He testified that the ability to grow earnings by increasing sales is a difficult task for utilities and that the more likely outcome is that utilities will be forced to accelerate the timing of rate cases to reset earnings to a fair and reasonable level and to offset the negative effect that the non-recovery of lost revenues would have caused. Mr. Farmer testified that it makes sense to have a regulatory policy that encourages energy efficiency and cost containment initiatives when they are justified, while at the same time promoting energy policies that support economic growth in the state.

He explained that utilities have significant capital expenditures that do not have special between-rate case ratemaking treatment as well as operating and maintenance expense increases between rate cases due to the costs of serving new loads. Although load growth revenues offset some of these increased costs, load growth revenues are rarely sufficient to completely offset such costs or cover lost revenues applicable to energy efficiency programs.

As to the opportunity to increase off-system sales, Mr. Farmer noted that Mr. Phillips does not mention that energy efficiency measures will also reduce the purchases of power to meet native load requirements rather than increase off-system sales. Furthermore, Mr. Farmer testified that customers receive the benefit of reduced purchases of power to meet native load requirements either through the fuel adjustment charge or through Rider 70. Because off-system sales are often priced at a point just above the marginal cost of energy required to make the sale, Mr. Farmer noted that any increase in profits from off-system sales will likely not provide a meaningful offset to lost revenues or fixed cost recovery. Notwithstanding all of this, Mr. Farmer testified that DEI's off-system sales profits are credited to customers through Rider 70, so customers will share the benefit of any increases in off-system sales.

Mr. Farmer testified that the recovery of lost revenues resulting from energy efficiency programs is consistent with the establishment of just and reasonable rates because it will encourage utilities to aggressively design, develop, and implement cost-effective energy efficiency programs, by removing a disincentive or penalty (non-recovery of fixed costs) for such actions.

Mr. Farmer agreed with the OUCC that lost revenue recovery for Core programs should commence with a final order in Cause No. 42693 S1 and that Core Plus lost revenue recovery should commence with a final order in this proceeding.

G. Nucor's Supplemental Evidence. Nucor's witness, Kerry Heid, an independent rate consultant, first summarized DEI's proposed energy efficiency programs and the implications of the Phase II Order directing that there be energy efficiency programs for all customers. Mr. Heid testified that while DEI's proposed Core and Core Plus energy efficiency programs may theoretically be available to all customer classes, he pointed out that opportunities for beneficial utility sponsored energy efficiency programs may be significantly limited for the largest energy-intensive C&I customers, such as Nucor. Mr. Heid noted that the Commission has historically limited Rider No. 66 energy efficiency programs to residential and small C&I customers under 500kW with the expectation that many large C&I customers have access to non-utility sponsored energy efficiency program providers and have already installed energy efficiency improvements at their own expense. Additionally, he observed that utility sponsored programs are not typically designed to meet the specific needs of a large industrial facility where the energy efficiency improvements are often intertwined with complex industrial processes and the facility's often unique operational characteristics. He testified that the ability to develop effective energy efficiency measures will be dependent on an intimate understanding of the facility's equipment, products, and operations. He also testified that under DEI's proposed programs, only one Core Program exists for non-residential customers. Mr. Heid further testified that there are only three Core Plus Programs that are proposed for the non-residential customers. He testified in detail regarding whether the three Core Plus Programs would be applicable to an entity such as Nucor and how Nucor would not benefit from the proposed Core Plus Programs, as proposed.

Mr. Heid testified regarding DEI's proposed lost revenue recovery. Mr. Heid objected to the proposed recovery of lost revenue based upon two considerations. Mr. Heid opined that DEI had not adequately explained how the lost revenue calculation would work or how the calculation could be confirmed. Mr. Heid noted that while the Commission's DSM Rules provide that a utility may request recovery of the utility's lost revenue from the implementation of its demand side management program, the ability to reasonably calculate lost revenues does not automatically lead to a conclusion that the Commission should authorize recovery of those lost revenues. Mr. Heid expressed concern that DEI's utilization of its DSMore model is not sufficiently transparent for the Commission and the parties to verify the data and calculations. Second, Mr. Heid expressed concern that all non-residential customers from the smallest commercial customer to the largest industrial special contract customer are considered as part of the same rate group for purposes of pricing all non-residential estimated lost revenue. He expressed concern with DEI's use of a secondary service rate from Rate LLF to price estimated lost revenue for all non-residential customers and stated it would be inappropriate for any other customer class other than Rate LLF.

Mr. Heid testified regarding Nucor's objections to DEI's proposed allocation of Rider EE Costs within the non-residential group and recommended that DEI continue to directly assign costs by rate group. Mr. Heid testified that historically DEI and its predecessor companies have directly allocated energy efficiency costs between residential and non-residential customers. As long as the energy efficiency program through Rider 66 was limited in scope to non-residential customers with annual peak loads less than 500 kW, the non-residential customers were considered as a uniform group, which may have been a reasonable assumption due to the homogeneity of its customer make-up. However, the one instance the energy efficiency program expanded beyond this limited non-residential group was in the creation of Rider 65. Energy efficiency programs under Rider 65 were made available to all customer classes, and every customer class participating under Rider 65 was directly assigned costs according to its participation in the energy efficiency programs. Therefore, Mr. Heid's primary recommendation was that all energy efficiency costs be assigned on a direct assignment basis.

In the alternative, Mr. Heid proposed that all Rider EE energy efficiency costs, both conservation and demand response, be allocated on the basis of the 12 cp demand methodology. Mr. Heid also made a number of recommendations and corrections to DEI's proposed allocation of Rider EE costs including excluding interruptible load in the energy efficiency allocations and adjusting DEI's energy allocation methodology to reflect line loses, and disagreed with DEI's proposal to transfer the Powershare Call Option program from Rider 70 to Rider EE.

Mr. Heid provided an overview of DEI's proposed allocation of energy efficiency costs to customer classes under Rider EE. Mr. Heid discussed how Rider EE costs will be classified into two components: (1) conservation program costs, and (2) demand response program costs. For both conservation and demand response programs, all costs associated with residential programs will be directly assigned to the residential customer group. Mr. Heid testified that under DEI's proposal, conservation programs related to non-residential customers will be directly assigned to the non-residential customers, as a group. Additionally, Mr. Heid stated that demand response programs related to non-residential customers will be directly but separately assigned to non-residential customers as a group. He described how DEI then proposes to distribute the directly assigned non-residential conservation program costs to the non-residential rate classes based upon the respective kilowatt hour sales, non-line loss adjusted, of each non-residential rate class. The demand response program costs related to non-residential customers are proposed to be distributed to the non-residential rate classes based on each customer rate class's share of the 12 cp demand from DEI's last retail rate case in Cause No. 42359. Mr. Heid provided confidential data to the Commission that shows DEI's proposed change in customer eligibility and customer cost responsibility resulting from the proposed transition from existing Rider No. 66 to Rider EE.

Mr. Heid noted that he agrees with DEI's general conceptual principle, as reflected in previous DSM cases, that energy efficiency costs should be directly assigned to and recovered from customer rate classes participating in those programs. While Mr. Heid agreed with the direct assignment of residential energy efficiency costs, he disagreed that all non-residential customers should be grouped together as a class and pay the same non-line loss differentiated rate for conservation costs, noting no nexus or cost causation link between the kilowatt hour sales of any non-residential customer class and the conservation programs determined to be applicable to those non-residential customer classes. He further noted it would be impossible to determine the cost causation between the customer classes and the energy efficiency programs as DEI has no idea what energy efficiency programs may be applicable to the various customer classes or the relative dollar amount of these programs during the same periods. He recommended that the Commission directly assign costs as the most fair and equitable cost allocation method for both conservation and demand response costs. Mr. Heid recommended that all energy efficiency costs, regardless of their classification of conservation or demand response to be directly assigned to the customer rate classes. Mr. Heid stated that it was consistent with DEI's historical and Commission approved conceptual basis that energy efficiency costs be directly assigned to and recovered from the customer rate classes participating in those programs. Mr. Heid also provided several other reasons why he felt direct assignment approach was appropriate. Mr. Heid further described how the direct assignment method would apply to Nucor given that Nucor is in its own customer class and has unique operating and usage characteristics, the scale of Nucor's load as well as its unique contractual supply arrangements.

Mr. Heid proposed an alternative methodology in the event that the Commission does not accept his recommended direct allocation methodology. He then recommended that all Rider EE energy efficiency costs, both conservation and demand response, be allocated on the basis of 12cp demand allocation methodology. He noted that this alternative cost methodology could be applied to all customer classes or only non-residential customer classes. Mr. Heid felt that the 12cp demand allocation methodology is an appropriate alternative because demand side resources have attributes that are similar to supply side resources in meeting future demands for energy and therefore the same concepts of costs causation and cost allocation should apply. Mr. Heid testified that resource costs, either the costs of a demand-side resource program or the costs of the supply-side resource program, would have to be incurred to meet the utility's marginal resource requirements. Therefore, Mr. Heid felt that the costs of production and the costs of energy efficiency should be allocated in the same manner. Mr. Heid testified he felt that conservation programs have a resulting effect on capacity resource planning. He testified regarding DEI's 2009 Integrated Resource Plan filing, showing conservation as a demand side resource used in satisfying the required reserve margin. Mr. Heid also noted DEI's 2011 Summer Preparedness Presentation addressed the demand related benefits of energy efficiency programs. Thus, he felt the allocation of conservation costs on a demand basis is appropriate.

Additionally, Mr. Heid recommended corrections to DEI's proposed allocation of Rider EE costs regarding DEI's inclusion of interruptible load in the energy allocation of the conservation costs as well as recommending that DEI's proposed energy allocation should be line loss adjusted.

Mr. Heid pointed out that the written arrangement between DEI and Nucor provides no unilateral right for DEI to impose rider costs on Nucor without a valid basis. He also noted that there is no contractual language that specifically mandates inclusion of Nucor's interruptible load for purposes of Rider cost allocation and testified that that the contractual language is silent with respect to the cost allocation of riders. Mr. Heid disagreed with Mr. Bailey's justification for the inclusion of interruptible load in DEI's proposed energy allocator of conservation-related energy efficiency costs and stated it is neither valid nor appropriate for Nucor. Mr. Heid took issue with Mr. Bailey's testimony noting that Mr. Bailey failed to point out that Nucor will not benefit to the same extent as the other customers whose peak demands and energy usage are reduced through energy efficiency efforts or as much as those classes which receive lower class cost allocations as a result of energy efficiency programs. Mr. Heid asserted that under DEI's proposal, Nucor will pay for programs on the same basis and to a much greater extent than the customers and classes that do participate in the program and receive the direct benefit of that participation. Mr. Heid also took issue with DEI's position that interruptible load should be allocated the same full share of conservation related energy efficiency costs as firm load as that is inconsistent with the nature of conservation costs. Mr. Heid took issue with DEI treating interruptible and firm load equally for cost allocation purposes given that interruptible load has a significant resource value that the firm load does not have.

Mr. Heid noted that in DEI's Save-A-Watt proceeding, Cause No. 43374, DEI ultimately proposed the allocation of conservation costs to only Nucor's firm load and not to its interruptible load. Mr. Heid described the 43374 proceedings, wherein on February 10, 2010, the Commission modified a proposed settlement where Nucor would have been eligible to elect to opt-out of DEI's conservation programs and not be subject to charges related to the energy conservation portion of the Save-A-Watt Rider. Mr. Heid noted that the matter was returned for litigation on the merits subsequent to that Order. Additionally, Mr. Heid provided an overview of Nucor's Complaint against DEI, in Cause No. 43754, which was settled in January 2010. Mr. Heid noted that supplemental testimony filed in 43374, which was filed after approval of the settlement between DEI and Nucor in Cause No. 43754, contained proposed cost allocation methodology where the conservation component of DEI's Save-A-Watt Rider was to be applicable solely to Nucor's firm kilowatt hour sales, not its interruptible kilowatt hour sales. Mr. Heid also noted that the Commission's February 24, 2010 Order in Cause No. 43754 noted that the settlement agreement between DEI and Nucor provided a new demand charge applicable to Nucor's interruptible load that will contribute to DEI's fixed production costs thereby benefitting DEI and its customers when DEI's base rates are reset as a result of a Commission Order in DEI's next base rate case. Mr. Heid testified that Nucor will make a significant additional contribution to DEI's fixed cost recovery via the new demand change during the entire proposed three-year period of DEI's energy efficiency plan. This contribution will be in addition to the fixed cost recovery already included in Nucor's rates. Mr. Heid asserted that Nucor presently makes, and will continue to make, a reasonable contribution to DEI's fixed costs.

Mr. Heid also recommended that DEI's energy allocation methodology be adjusted to reflect line losses, in the event that the Commission permits the use of an energy-based allocation of costs. Mr. Heid described what line losses are and the need and use of a line loss study for an electric cost of service study. Mr. Heid noted Ms. Douglas did not provide any explanation in her direct supplemental or rebuttal testimonies to explain why the non-residential rates were not line loss differentiated. Mr. Heid stated that Ms. Douglas applied line loss adjustments to the demand cost allocator but not the conservation cost allocator. Mr. Heid testified that the omission of line loss differentiation has a significant impact on the assignment of cost responsibility, especially given the expansion of Rider EE to all customers. Mr. Heid recommended that DEI should use the same energy line loss factors or multipliers for the purposes of the conservation component of Rider EE as it used in its previous rate case in Cause No. 42359, noting DEI's cost of service study reflect line lost adjustments in its development of energy and demand allocators. Mr. Heid testified that these adjustments will be an improvement, but are not a substitute for his preferred or alternative recommendations as to cost allocation. He noted that the need for the adjustments is mooted if the Commission adopts the direct assignment of costs for each customer class or the first alternative methodology, allocating all energy costs on the basis of the 12cp demand allocation methodology.

Mr. Heid also took issue with DEI's proposal to transfer the Powershare Call Option Program from Rider 70 to Rider EE. Mr. Heid noted that the Powershare Call Option Program has operated since 2004, approved in DEI's previous general rate case, without need for, nor benefit of, an incentive program, and DEI did not request an incentive when it was initially established. Under Rider 70, costs are allocated to all retail customer classes using the 12 cp demand allocation methodology approved in Cause No. 42359 for purposes of allocating production demand costs. Mr. Heid noted that transferring the Rider 70 Powershare Call Option Program to Rider EE changes the allocation of costs using a 12 cp demand allocation methodology from all customer classes to only non-residential customers. Mr. Heid concluded that DEI has not demonstrated a need for a shareholder incentive, nor has DEI provided a rationale to alter the Commission's approved customer-cost responsibility related to Rider 70, and therefore, the Rider 70 program costs should continue to be allocated as they are today per DEI's last general rate case.

Mr. Heid testified to a self-direct program. He noted that while DEI had not proposed an opt-out or self-direct program as part of its energy efficiency filing, other DEI witnesses stated their willingness to support an opt-out or self-direct program if the Commission would consider it. Mr. Heid commended DEI for its willingness to work with its largest customers with respect to the self-direct program. Mr. Heid believed that DEI's supportive statements is confirmation of Nucor's position that utility sponsored programs are not typically designed to meet the specific needs of a large industrial facility given the complex industrial processes and the facility's often unique operational characteristics. Mr. Heid noted the Commission's Phase II Order directive that all market segments should participate in DSM programs as well as the Commission's concerns regarding the opt-program proposed in Cause No. 43374. Mr. Heid stated that the concerns are not insurmountable. Mr. Heid testified that the largest, most energy-intensive customers would make an effort to achieve energy efficiency in their processes. He testified that when the cost of power is high, customers will aggressively implement cost-effective energy efficiency projects. He also stated that Nucor takes lower-quality and lower cost interruptible service and provides benefits through this demand-side resource. Mr. Heid testified that Nucor is proposing a self-direct option that can address the Commission's stated concerns without unfairly penalizing customers who have invested and continue to invest in energy efficiency projects of their own.

Mr. Heid stated large commercial and industrial customers could develop and implement energy efficiency investments that are both cost-effective and better suited to their business operations than DEI's proposed energy efficiency programs. He pointed out that large commercial and industrial customers have internal expertise in energy efficiency and have more expertise with respect to the technologies utilized by the customer. He recommended that the Commission establish a policy that permits large commercial and industrial customers to develop their own energy efficiency initiatives and self-direct their own energy efficiency investments, outlining four key elements of such a program. He noted that at least seventeen (17) other states allow self-direct or opt-out programs. He felt that a self-direct program for DEI's largest commercial and industrial customers would be a reasonable option given these customers' technical skills and level of sophistication with respect to technical resources available to identify energy savings opportunities. He felt that self-direct programs could encourage cost-effective energy efficiency investments. Additionally, Mr. Heid testified that customers be required to provide data sufficient to identify energy savings and load reductions. Mr. Heid believed his proposal did not hinder DEI's ability to meet the Commission's annual savings targets in that DEI's annual savings target should be credited for the measured and verified energy efficiency savings achieved by self-direct customers. Mr. Heid recommended that the self-direct provision be limited to commercial and industrial customers with relatively large loads with annual peak demands of at least 5 MW. He also testified that the lack of self-direct programs would disadvantage DEI's largest commercial and industrial customers compared to other jurisdictions. Last, Mr. Heid recommended that the Commission establish a subdocket in this proceeding with several technical conferences convened for the purposes of all parties to attempt to reach a mutually agreeable consensus.

H. SDI's Supplemental Evidence. Dr. Goins recommended that the Commission reject DEI's proposed shareholder incentive mechanism. Dr. Goins responded to Mr. Duff's challenge that a 10% cap on a shareholder incentive is unreasonably low by pointing out that Mr. Duff relied on two experts in the field who agreed that incentives should be capped, as opposed to DEI's proposal, which has no cap. Dr. Goins stated that these two experts note that most caps for utility EE programs range from 5 to 20% of program spending, with an average cap of 12 to 13%. Dr. Goins noted that the 10% cap he recommended fell within the range of all programs cited. Dr. Goins stated that while his recommended cap is slightly below average, the 10% is not "unreasonably low", as stated by Mr. Duff, when taken in consideration with the 5-20% range for such caps stated by Mr. Duff's experts.

Dr. Goins testified that a Commission-approved self-directed option should include not only DEI financed investments (either full or partial financing), but also customer-initiated and customer-financed investments in energy efficiency. Dr. Goins stated that DEI's proposed lost revenue and shareholder incentive mechanisms should not be applicable to demand and energy savings resulting from customer-financed self-directed investments. Dr. Goins explained that DEI should not be insulated from the normal business risk of lower sales caused by customer initiatives that reduce energy consumption. He also stated it would be unwarranted and unjustified to apply shareholder incentives to savings resulting from any customer-financed self-directed EE investments in which DEI is a sideline participant. Dr. Goins did not object to permitting DEI to be allowed to count impacts from self-directed activity towards its Phase II Order mandates.

I. <u>DEI's Supplemental Rebuttal</u>. Mr. Goldenberg explained that customers with peak loads of 500 kW or larger have been excluded from DEI's program offerings since the mid-1990s, and that this is an untapped market with tremendous potential for energy savings. He testified that the Core and Core Plus Program offerings are designed to make available measures that will be useful to virtually all customers, including customers with peak loads over 500 kW. He stated that for those customers not participating, there are still the system benefits that accrue to all DEI customers. In response to Nucor witness Heid's request that Core Program measures and costs be broken out by individual rate group for purposes of the Rider allocations, Mr. Goldenberg testified that this would be very difficult to do as neither the Phase II Order nor the RFP for the TPA approved by the Commission broke out Core Program impacts and participation by rate group, nor did any party that participated in that proceeding so suggest at any time during the RFP and selection process.

Mr. Goldenberg also took issue with Mr. Heid's contention that any programs offered by DEI are duplicative of efforts that Nucor has already undertaken. He explained that one of the programs offered by DEI is a custom-incentive program that includes incentives for equipment and systems, such as those used in large scale applications that are unique and require a case-by-case analysis.

Ms. Ossege responded to Mr. Heid's concerns regarding the DSMore model. She challenged Mr. Heid's concerns that DEI did not explain the DSMore model. As to the "black box operation of DSMore," Ms. Ossege explained that the program has been used for DSM program cost-effectiveness evaluation by DEI for many years in Indiana. Furthermore, she testified that DSMore is currently used within 30 states by utilities and regulators alike. Ms. Ossege stated that DSMore is widely used due to the fact that it produces more accurate valuations than alternative approaches.

Ms. Douglas challenged Mr. Heid's contention that DEI did not adequately explain how the lost revenue calculation would work by pointing to numerous areas in DEI's case-in-chief where DEI witnesses provided an explanation for the framework of its lost revenue recovery proposal, the basis of the calculation of the estimated lost revenues included in the development of its proposed rate adjustment factors, and how it planned to calculate the actual lost revenues to be used in the planned reconciliation or true-up process. As to the contention that DEI used the wrong rate schedule to calculate lost revenues, Ms. Douglas explained that DEI made simplifying assumptions in the calculation of the estimated lost revenues. She also stated that DEI would reevaluate whether the non-residential pricing assumptions would continue to be used for future estimates at the time of the true up.

Ms. Douglas reviewed the calculation of lost revenues by explaining that it is little more than the multiplication of a lost revenue rate by the amount of energy efficiency impacts. On a more detailed level, she testified that (1) the kWh reduction will be calculated by multiplying actual participation by measure to the initial kWh impact used for cost effectiveness testing for that vintage, and (2) the applicable LR Rate will be developed for the period being reconciled by taking actual billed base revenues (which include applicable gross-ups for utility receipts tax and revenue related costs) less the base cost of fuel and variable operation and maintenance ("O&M") expense included in base rates (also grossed-up for utility receipts tax) and customer charges (which include applicable gross-ups.) The result of this computation is divided by billed sales to obtain an average fixed charge realization. The updated kWh reduction figure and LR Rate will then be multiplied to arrive at an actual lost revenue amount, and rates will be adjusted as necessary to reconcile that actual lost revenue amount with the original lost revenue estimate. She explained this true-up will occur at the Core and Core-Plus and Residential and Non-Residential levels of granularity. She stated that the proposed calculation is understandable, verifiable, and reasonable.

Mr. Duff responded to Mr. Goins' recommendation of a ten percent cap on shareholder incentives by noting that, after taxes, the shareholder incentive DEI would receive is less than DEI's current allowed after tax rate of return, which would apply to supply-side investments, and would fail to level the field between DSM investments and supply-side investments. Mr. Duff also challenged Mr. Goins' recommendation and pointed out that Mr. Goins offered no basis for the 10% cap other than the fact that it falls within the range of allowed returns.

Mr. Duff testified that the design proposed by Mr. Heid has merit and could form the basis for a reasonable and workable self-directed plan. He testified that there were a number of detailed issues that need to be addressed for any workable self-directed plan, including customer accountability (which could be addressed by either removing the self-directed customer's load from the target impacts for purposes of determining Commission mandated impacts or requiring self-direct customer's whose impacts do not materialize to pay Rider EE) and timing issues as to when customers could choose to self direct. Mr. Duff also suggested that the Commission may want to consider whether a self-directed option is specific to DEI or should be applied on a statewide basis and whether it includes Core and Core Plus Programs.

Mr. Duff testified that DEI remains willing to work with its larger customers on a self-direct program if the Commission is receptive. However, to achieve the impacts required in the Phase II Order, Mr. Duff requested that any self-direct issues not hold up approval of the programs and ratemaking requests in this proceeding.

Kent K. Freeman, DEI's Rate Strategy and Projects Director-Rates Indiana, explained that several changes drove DEI's revised allocation methodology proposed in this case – specifically, the expansion of programs to all customers, including commercial and industrial customers with peak demands greater than 500 kW; the Commission's determination in Cause No. 43374 that an opt out for large customers as proposed in the settlement of DEI's Save-A-Watt proposal was not in the public interest; and the fact that several of the proposed programs cut across several rate classes, making direct assignment to the class level difficult.

Mr. Freeman took issue with Nucor's argument that all energy efficiency charges should be directly assigned to participating customer classes. Initially, Mr. Freeman claimed that such a methodology appears to be counter to the Commission's Order in Cause No. 43374, dated February 10, 2010. In that Order the Commission determined the opt-out provisions as proposed in settlement were not in the public interest. A direct assignment methodology would allow for no allocation of costs to special contract customers; thus, in Mr. Freeman's opinion, this direct assignment methodology could be viewed as effectively creating an implicit opt out.

Another concern related to Nucor's direct assignment proposal, noted by Mr. Freeman, is that Nucor, like most special contract customers, does have a portion of its load served under a firm rate. Yet under Nucor's proposal, special contract customers would not pay for any energy efficiency costs for their firm load if they choose not to participate in programs, despite the fact that these customers will benefit from energy efficiency programs just like any other firm commercial or industrial customer. Mr. Freeman explained that because energy efficiency programs that reduce DEI's peak demand result in a deferral of resource needs or an avoidance of the need to purchase capacity to meet peak demands, Nucor and other special contract customers will benefit from DEI's energy efficiency programs. Additionally, Mr. Freeman pointed to Mr. Bailey's testimony noting that such customers would also benefit from a decline in marginal fuel costs for both their firm and their interruptible loads.

Finally, Mr. Freeman noted that if the Commission were to adopt Nucor's proposal to directly assign energy efficiency charges to the customer class level, additional rate classes (OL, SL, AL, MHLS, MOLS and UOLS) would also need to be excluded from Rider EE charges. This would result in shifting EE charges proposed to be allocated to them and to special contract customers to the remaining customers. Mr. Freeman reiterated DEI's belief that all customers benefit from energy efficiency programs, and therefore the proposal to allocate Rider EE charges to all customers is reasonable.

With regard to Nucor's alternative allocation methodology – a proposal to allocate all energy efficiency costs including demand response and conservation based on each class' share of the average of the 12 coincident peak demands from DEI's last retail rate case -- Mr. Freeman noted this is the methodology proposed by DEI for its demand response program charges. However, Mr. Freeman stated his belief that energy conservation costs should be allocated on an energy or kWh basis and not on demands as proposed by Nucor. Mr. Freeman explained that contrary to Nucor's assertion that a primary benefit of conservation is a reduction of DEI's capacity needs, the primary benefit of a conservation program is the reduction of energy rather than capacity requirements.

Although Mr. Freeman acknowledged that conservation programs do have some impact on peak loads in addition to reducing energy requirements, he stated that conservation programs have very different primary goals as compared to demand response programs. Although conservation does have a resulting impact on demand, that is not the primary goal – just as a demand response program may reduce energy usage but that is not the primary goal. In Mr. Freeman's view, the primary impact, not the secondary impact, of a program should dictate which allocation methodology should be used to allocate program-related costs.

Mr. Freeman also noted that Nucor's proposal ignores the fact that the Commission's Phase II Order includes annual savings goals that are based on weather-normalized electric sales – including both firm and interruptible load kilowatt hours. Accordingly, DEI is required to implement energy efficiency programs that will reduce kWh sales levels primarily through conservation programs. This is another indication that conservation programs that reduce total kWh sales are required; and because they are primarily energy-related, they should be allocated on kilowatt hours, not demand.

With regard to Nucor's line loss adjustment proposal, Mr. Freeman agreed that a customer metered at a higher voltage level requires fewer kilowatt hours input to the system at the generator than a customer metered at a lower voltage. However, although he agreed with Nucor that this would lead to a more theoretically correct methodology, Mr. Freeman did not agree that this adjustment must be made in this filing, for several reasons. First, he noted that DEI's FAC filings do not include an adjustment for line losses; therefore, it would be inconsistent with the FAC proceeding, which recovers a much larger amount of revenues on an annual basis than the projected Rider 66, to implement a line loss adjustment in this filing for energy-efficiency related costs.

Mr. Freeman explained that he would not propose to make this line loss differentiation change outside of a retail base rate case, as this could have a negative impact on certain rate groups between base rate cases. Although DEI does not generally see significant changes in loss factors from one rate case to the next, DEI has not completed a new study that would include the impact of the economic recession. For this reason as well, Mr. Freeman explained that he believes the right time to address this issue would be in a retail base rate case when the line loss study would also be updated.

A final reason for not changing now, according to Mr. Freeman, is that with the proposed residential/non-residential direct allocation of energy efficiency charges, part of the impact of the line loss adjustment has been negated given that it would only relate to the recovery of costs inside the non-residential group. Because residential customers are metered at a secondary voltage, a significant amount of the higher loss customers have been removed from the calculation for non-residential customers, which reduces the average losses for the non-residential group of customers when compared to the total retail customers, resulting in Nucor's proposed change having a smaller impact. Nevertheless, Mr. Freeman explained that DEI could implement the proposed line loss adjustment calculation if ordered by the Commission, so long as the Commission were to allow DEI to use its most recent line loss study from its last rate case.

Jeffrey R. Bailey, Director, Products and Services for DEI, also addressed Nucor's and SDI's arguments that special contract customers' interruptible loads should not be allocated energy efficiency charges. Mr. Bailey based his conclusions on the terms of the special contracts themselves, as well as his strong belief that customers should pay rates that reflect the benefits they receive.

Mr. Bailey explained that in reviewing DEI's special contracts, it determined that SDI's kilowatt hours associated with its interruptible load should be included in Rider EE calculations. Mr. Bailey noted that SDI's contract provides that "All applicable Standard Contract Riders under DEI's Retail Electric Tariff shall apply for both its firm and interruptible load." Further Mr. Bailey pointed out that the Commission Order approving this special contract stated that the special contract price is subject to adjustment based on, among other things, future modifications of existing riders or any new riders approved by the Commission. Mr. Bailey thus concluded that both the terms of the SDI special contract and the Commission's Order approving that contract make clear that the intent is for firm and interruptible loads to be charged rider allocations, including Rider EE.

With regard to Nucor's special contract, according to Mr. Bailey, although Nucor's special contract is less explicit than SDI's as to whether interruptible loads should be assessed energy efficiency charges, it is certainly not clear that it should be excluded, as Nucor itself concedes. Further, from a consistency perspective, Mr. Bailey noted there is no compelling reason to include SDI's interruptible load and exclude Nucor's interruptible load from the energy conservation costs associated with energy efficiency programs.

Mr. Bailey also explained why, from a policy perspective, he did not believe that interruptible loads should be excluded. He noted that interruptible customers receive benefits from the utility's fixed capacity investments. In his view, the primary test for the applicability of costs to any customer, or customer group, or special contract should be whether tangible benefits are obtained. If such benefits can be demonstrated then costs should be allocated to customers.

Mr. Bailey agreed that interruptible customers deserve discounts relative to customers on standard firm tariff rates, because interruptible customers agree to a different level of service. The value of interruptibility can be quantified, and that value cannot logically exceed the value of avoided costs. Mr. Bailey stated that complete or piecemeal exemption of cost allocations, while ignoring benefits to customers, is an unreasonable allocation methodology and is unfair to other customers. In Mr. Bailey's view, DEI's special contracts convey appropriate value, and further discounts or exemption from costs is not warranted.

Mr. Bailey explained that despite the fact that DEI does not plan or build for interruptible loads, that argument at least partially misses the point. As he explained, special contracts customers' interruptible loads are only interruptible within specific parameters permitted under the contracts – *e.g.,* 200 hours per year. Although DEI excludes the interruptible demand from its peak demand for planning purposes, the same is not true for the interruptible loads' forecasted energy requirements. Mr. Bailey testified that from an energy requirements perspective, DEI includes the special contract customers' interruptible loads for the remaining 8560 hours per year in its planning, in order to properly plan to meet the capacity and energy needs of its customers. He stated that, as a result, DEI's special contract customers benefit from available capacity and economically generated energy. Accordingly, such customers should participate in the costs.

Moreover, Mr. Bailey reiterated that although demand response programs are targeted toward reduction of capacity or production needs, DEI's conservation programs – the bulk of the programs – are focused primarily on reducing energy usage. He further noted that interruptible loads are included in the Commission's calculation of energy usage for determination of the energy savings targets. Consequently, it would not make sense to exclude those loads from energy efficiency charges.

Mr. Bailey further emphasized that interruptible customers benefit from energy efficiency programs, primarily in terms of lower marginal fuel costs, and secondarily in terms of deferred and lower capacity costs. Although firm customers benefit from interruptible loads, interruptible customers benefit from firm loads as well – through having environmentally compliant power plants available to serve them at discounted rates on an as-available basis. Mr. Bailey noted that, as a practical matter, interruptible customers are able to fulfill their energy requirements by using DEI's facilities and capacity purchases approximately 98 percent of the time.

5. Commission Discussion and Findings.

A. Legal Consideration of DSM Proposals. The Commission has developed a regulatory framework that allows a utility to meet long-term resource needs with both supply-side and demand-side resource options in a least-cost manner. As part of its integrated resource plan, an electric utility must consider alternative methods of meeting future demand for electric service, including a comprehensive array of demand-side measures that provide an opportunity for all ratepayers to participate in DSM, including low-income residential ratepayers. 170 IAC 4-7-6(b). The Commission adopted the DSM rules providing guidelines for DSM cost recovery. The DSM rules were specifically designed to assist the Commission in its administration of the Utility Powerplant Construction Act, Indiana Code ch. 8-1-8.5, and to facilitate increased use of DSM as part of the utility resource mix. As further set forth in 170 IAC 4-8-3(a), the purpose of the DSM rules is to:

> (a) . . . [provide] a regulatory framework that allows a utility an incentive to meet long term resource needs with both supply-side and demand-side resource options in a least-cost manner and ensures that the financial incentive offered to a DSM program participant is fair and economically justified. The regulatory framework attempts to eliminate or offset regulatory or financial bias against DSM, or in favor of a supply-side resource, a utility might encounter in procuring least-cost resources. The commission, where appropriate, will review and evaluate the existence and extent of regulatory or financial bias.
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> (c) To ensure a utility's proposal is consistent with acquiring the least-cost mix of demand-side and supply-side resources to reliably meet the long term electric service requirements of the utility's customers, the commission, where appropriate, will review and evaluate, as a package, the proposed DSM programs, DSM cost recovery, lost revenue, and shareholder DSM incentive mechanisms.

This regulatory framework acknowledges the possibility of financial bias against DSM, recognizes the need to evaluate the extent of any bias, and provides ways for the Commission to eliminate any bias through adoption of a package of cost recovery and incentive mechanisms designed to facilitate the use of DSM to meet the long-term resource needs of customers.

Indiana Code ch. 8-1-8.5, the statutory authority for the Commission's DSM rules, establishes a least-cost standard for issuances of certificates of public convenience and need prior to construction of electric generation facilities. We have previously defined "least-cost planning" as a "planning approach which will find the set of options most likely to provide utility services at the lowest cost once appropriate service and reliability levels are determined." *PSI Energy, Inc. and Cincap VII, LLC,* Cause No. 42145, 2002 Ind. PUC LEXIS 544, at *10 (IURC December 19, 2002)(quoting *Southern Indiana Gas & Electric Co.,* Cause No. 38738, 1989 Ind. PUC LEXIS 378, at *10 (IURC October 25, 1989)). Public utilities are to exercise reasonable judgment as to how best to meet the obligation to serve within the context of the least cost-standard. *See PSI Energy, Inc.*, Cause No. 39175, 1992 Ind. PUC LEXIS 251, at *34 (IURC May 13, 1992).

B. Commission Order in Cause No. 42693, Phase II. As noted previously, on December 9, 2009, the Commission issued its Phase II Order in Cause No. 42693. Pursuant to the Commission's Order, the utilities must achieve an annual energy savings goal of 2% within ten years, with annual stepped savings targets, for years one through nine. In the Phase II Order, the Commission also found that jurisdictional electric utilities, of which DEI is one, are required to offer certain Core Programs to all customer classes and market segments. The Core Programs are to include the following: (1) Home Energy Audit Program, (2) Low Income Weatherization Program, (3) Residential Lighting Program, (4) Energy Efficient Schools Program, and (5) Commercial and Industrial Program. Phase II Order at 36. To implement these programs, electric utilities are required to pursue coordinated marketing, outreach and consumer education strategies on a statewide basis. Further, the utilities were required to implement and manage any additional programs needed (Core Plus Programs) to achieve the energy savings goals established.

The Commission also determined that an independent TPA should be utilized by the electric utilities to oversee the administration and implementation of the Core Programs. In addition, a DSMCC was required to be formed to address DSM Core program oversight generally within the State of Indiana. The Commission found that a single statewide evaluation protocol was necessary in order to track achievement with DSM goals. Consequently, jurisdictional electric utilities were required to contract with an independent entity to conduct EM&V with respect to the Core Programs. Finally, the Commission found that the ratemaking and cost recovery issues associated with an electric utility's DSM programs should be addressed on a case-by-case basis in individual utility proceedings such as this Cause.

It is against the backdrop of the Commission's rules and the requirements of the Phase II Order that we consider the DSM programs and ratemaking proposals made by DEI in this Cause.

C. <u>DEI's Proposed Core Plus Programs and EM&V</u>. DEI's proposal includes eleven Core Plus Programs (DEI removed the Home Energy House Call Retrofit program from its proposed portfolio in its rebuttal testimony): (1) Combined Online Home Energy Calculator and Personalized Energy Report; (2) Smart Saver for Residential Customers; (3) Agency CFLs – Low Income Services (Agency Assistance Portal & CFLs); (4) Refrigerator and Freezer Recycling; (5) Property Manager CFL; (6) Tune and Seal; (7) Home Energy Comparison Report; (8) Power Manager; (9) Smart Saver for Non-Residential Customers; (10) Nonresidential Energy Assessments; and (11) PowerShare CallOption. Power Manager and PowerShare CallOption are demand response programs that under DEI's proposal would be included as part of their Core Plus portfolio based on the concept of deferring or eliminating the need for building new peaking capacity as determined by the Commission in Cause No. 41448 S1. Based on the evidence presented in this case, we find that DEI's proposed portfolio of Core Plus Programs is cost-effective and reasonably designed to meet the requirements of the Phase II Order, and should be approved, subject to other determinations made throughout this Order.

a. <u>*Home Energy Comparison Report.*</u> We agree with the OUCC that the proposed Home Energy Comparison Report ("HECR") program is primarily customer education based. For this type of program, we prefer at least one year's worth of supporting data demonstrating the savings persistence. Therefore, consistent with the Commission's Order in *Indiana Michigan Power Company*, Cause No. 43959, 2011 Ind. PUC LEXIS 117, *41 (IURC April 27, 2011), DEI is authorized to pilot the program, without shareholder performance incentives, for at least one year. This will allow EM&V to be performed and provide an opportunity for analysis of the results. Once EM&V is complete, if DEI decides to continue the HECR program, DEI shall file a request with the Commission.

b. *Demand Response Programs.* PowerShare CallOption has been in place and operating as part of Rider 70 for approximately seven years and appears to benefit DEI, participants and non-participants. However, the record of this proceeding does not support moving PowerShare CallOption from Rider 70 to Rider EE because moving PowerShare CallOption would change the cost allocation. The cost allocation methodology for recovering PowerShare CallOption costs through Rider 70 was set in DEI's last rate case. We are relunctant to change the methodology outside of a base rate case, especially given that the evidence in this proceeding demonstrates that PowerShare CallOption has minimal or no energy savings attributable to it. Therefore, we reject DEI's proposal to move the PowerShare CallOption program from Rider 70 to Rider EE. Thus, the program is not approved as a Core Plus Program and not considered in calculating DEIs energy savings.

The Phase II Order at pages *87-88, states that "Load management and direct load control initiatives, including peak shaving, which result in net energy savings will count toward the efficiency goals." *Commission Investigation*, Cause No. 42693, 2009 Ind. PUC LEXIS 482 (IURC December 9, 2009). However, the evidence in this proceeding demonstrates that Power Manager has minimal or no energy savings attributable to it. *See* DEI's Exhibits K-1 and S-1. Given the lack of net energy savings, the Commission finds that the Power Manager program will not count towards the Commission's savings goals and the costs shall not be included in the calculation for performance incentives.

Additionally, since Rider 66 is going to be discontinued, DEI shall continue to recover Power Manager program costs, but through Rider EE.

c. *DEI's Proposed EM&V.* The evidence demonstrates that DEI has submitted an EM&V program that meets the Commission's requirements under 170 IAC 4-8-4. Additionally, DEI will use the same EM&V vendor that will be performing EM&V for the Core Programs, which should provide consistency for DEI's Core and Core Plus Programs. The Commission therefore approves DEI's proposed EM&V protocols.

D. Cost Recovery. The DSM rules provide that the Commission will determine the cost recovery mechanism for a DSM program when the DSM program is submitted for Commission approval. DEI proposed Rider 66-A for the purpose of facilitating cost recovery for all Core and Core Plus Programs. DEI's proposed updated Rider 66 is intended to effectuate reconciliation of the existing DSM tracking mechanism. Therefore, DEI's Rider 66-A and proposed updated Rider 66, as reflected in the rebuttal testimony and exhibits of Diana L. Douglas are approved subject to other determinations made throughout this Order.

E. Lost Revenues. 170 IAC 4-8-6 authorizes the Commission to consider the recovery by a utility of lost revenues as a result of the implementation of a DSM program, and sets out certain criteria that must be met in order to qualify for lost revenue recovery:

> (a) The commission may allow the utility to recover the utility's lost revenue from the implementation of a demand-side management program sponsored or instituted by the utility. The calculation of lost revenue must account for the following:
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> (1) The impact of free-riders.

(2) The change in the number of DSM program participants between base rate changes and on the revised estimate of a program specific load impact that result from the utility's measurement and evaluation activities under sections 4 and 5(e) of this rule.

(b) A utility seeking recovery of lost revenue shall propose for commission review a methodology or process for incorporating a lost revenue recovery mechanism which includes the following:

(1) The level of free-riders in a DSM program.

(2) A revised estimate of a DSM program specific load impact resulting from regular utility measurement and evaluation activities.

(c) The commission may periodically review the need for continued recovery of the lost revenue as a result of a utility's DSM program, and the approval of a lost revenue recovery mechanism shall not constitute approval of specific dollar amount, the prudence or reasonableness of which may be debated in a future proceeding before the commission.

In this proceeding, DEI proposes to collect lost revenues for the shorter of: the first three years of program participation, regardless of whether lost revenues continue to accrue beyond that time, or the life of the measure. As to the calculation of DEI's estimated lost revenues, Ms. Ossege explained that DEI used the relevant electric rate for each group of customers and multiplied that by the estimated level of impacts that have been reduced for free riders. DEI used the rate for secondary service for Rate LLF as a proxy for the combined rate for the non-residential group. She stated that the base electric rate, net of variable O&M and fuel costs, is used in conjunction with the estimated energy efficiency impacts to compute the estimated lost revenues.

Ms. Douglas testified regarding the lost revenue true up process, and stated that the calculation uses the lost revenue rate for the period by taking the actual billed base revenues minus the base cost of fuel and variable O&M expense and customer charges, the result of which is divided by billed sales to determine the average fixed charge realization rate. The updated kWh reduction and lost revenue rate will then be multiplied to arrive at the actual lost revenue amount, which will then be used in the reconciliation process. This calculation is planned to be done for the residential group and the non-residential group as a whole, as participation and kWh impacts are not planned to be tracked by rate class. The reconciliation process will reflect the results of the EM&V evaluation on a prospective basis, as approved above, which incorporates the level of free-ridership, as required by the Commission's rules. DEI's proposal for the recovery of lost margins allows it to recover net lost revenues based upon the number of measures installed and the calculated energy savings, and is also based upon DEI's base rates approved in Cause No. 42359.

The Industrial Group, Kroger and Nucor all opposed DEI's recovery of lost revenues. Mr. Phillips testified that utility sponsored DSM programs, coupled with incentives and lost margin recovery as requested by DEI were not necessarily the best means of promoting energy efficiency efforts for all customers. Mr. Higgins argued that DEI is projecting load growth through 2014, and thus, does not need lost revenue recovery. Mr. Heid raised two objections to DEI's proposed recovery of lost revenues. Mr. Heid argued that DEI has not adequately explained how the lost revenue calculation would work or how the calculation can be confirmed. Further, Mr. Heid stated that he believed DEI had used the wrong rate schedule for purposes of pricing at least a portion of its lost revenues. In response, Ms. Douglas provided a reasonably detailed description of how DEI intends to calculate actual lost revenues, which will be used to reconcile with estimated lost revenues. Ms. Douglas further responded to Mr. Heid's objections by stating that the details of the methodology and calculations used by DEI will be presented in testimony and exhibits in the first EE Rider reconciliation proceeding.

As our rules and our previous orders indicate, we have generally concluded that a utility may seek compensation for lost revenues when energy efficiency programs result in a reduction in sales. *See, e.g., Indiana Michigan Power Company*, Cause No. 43827, 2011 Ind. PUC LEXIS 343 (IURC November 22, 2011); *Southern Indiana Gas & Elec. Co.,* Cause No. 43938, 2011 Ind. PUC 255 (IURC August 31, 2011); *Indiana Michigan Power Company*, Cause No. 43959, 2011 Ind. PUC LEXIS 117 (IURC April 27, 2011); *Duke Energy Indiana. Inc.*, Cause No. 43374, 2010 Ind. PUC LEXIS 50 (IURC February 10, 2010) (subsequently withdrawn); *Indianapolis Power & Light Co.,* Cause No. 39672, 1993 Ind. PUC LEXIS 370 (IURC September 8, 1993); *Southern Indiana Gas & Elec. Co.,* Cause No. 39201, 1991 Ind. PUC 360 (IURC October 23, 1991); *PSI Energy, Inc.,* Cause No. 38986, 1991 Ind. PUC LEXIS 368 (IURC October 16, 1991). In addition, we have not foreclosed lost revenue recovery where the calculation is based upon reasonably accurate inputs that fairly reflect the utility's present operating system. *See Indianapolis Power & Light Co.,* Cause No. 43623, 2010 Ind. PUC LEXIS 53 (IURC February 10, 2010); *NIPSCO*, Cause No. 43912, 2011 Ind. PUC LEXIS 215 (IURC July 27, 2011).

With respect to the specific lost revenue recovery mechanism proposed, we find that it appears to have been generally designed to reasonably estimate and collect the revenues that are likely to be lost due to its implementation of Core and Core Plus Programs, and that the proposed mechanism meets the requirements of our DSM rules discussed above. As to the non-Duke parties' concerns with the calculation of lost revenues, Ms. Douglas stated that DEI plans to explain the methodology it used for the calculation of actual lost revenues for the true-up through testimony, exhibits and/or workpapers in its subsequent Rider EE reconciliation proceedings. Thus, the Commission and the other parties will be able to fully review the details at that time. Based on the evidence presented, we find that DEI should be authorized to recover net lost revenues associated with its Core and Core Plus Programs as discussed above, through its Rider EE. We further find that DEI should be granted all necessary accounting authority to effectuate such recovery.

Ms. Paronish recommended the Commission allow deferral of lost margins on Core and Core Plus programs to commence from the date a Commission order is issued in this proceeding. The Commission notes that Core programs became publicly available January 2, 2012. To adhere to the OUCC position means that DEI is being harmed for implementing a program it was required by Commission order to participate in. Nor is this outcome consistent with the rationale for allowing recovery of lost revenues – to remove a disincentive for a utility to participate in and implement energy efficiency programs. Accordingly, we find that DEI should be authorized to recover net lost revenues associated with Core and Core Plus programs as discussed above, through its Rider EE, effective the date of this Order for Core Plus programs and January 2, 2012 for Core Programs.

F. Performance Incentives. The Commission's DSM rules at 170 IAC 4-8-7(a) recognize the usefulness of financial incentives for energy efficiency; these rules authorize shareholder incentives and state that, "[w]hen appropriate, the commission may provide the utility with a shareholder incentive to encourage participation in and promotion of a demand side management program."

DEI has proposed a performance-based shareholder incentive mechanism. The proposed incentive mechanism is based on the performance of the Core Plus Programs in terms of their actual energy savings, as compared to various energy savings targets, with achievement of more savings resulting in a higher level of incentive earned. DEI proposes a graduated, performance-based incentive percentage mechanism that includes the possibility of positive and negative returns. The mechanism is based on gross savings as opposed to net savings. An independent third party must measure and verify the savings in order for DEI to earn an incentive.

DEI also proposed a second tier of incentives for future programs. These incentives were also calculated using gross savings and did not incorporate DEI's expected energy-savings targets. This second tier increased incentives and contained no negative incentives. As we understand DEI's proposal, this tier might apply to virtually every future DEI-proposed DSM program. At the hearing, and in rebuttal testimony, DEI offered to withdraw its proposed second tier in exchange for an increase in the first tier from 15% to 17% for programs exceeding 110% performance.

The non-Duke parties took issue with DEI's proposal for performance incentives. Ms. Paronish argued that the Phase II Order's energy efficiency targets will be measured for compliance based on gross savings and therefore, DEI should only be rewarded with a shareholder incentive on energy actually saved. Mr. Phillips testified that the proposed incentive mechanism would allow DEI to impose regular rate increases on customers in order to recover the associated financial rewards. Mr. Phillips stated that the magnitude of the rate increase would fluctuate and that this uncertainty would expose customers to more financial risk, increasing the difficulty of budgeting and planning. Mr. Goins recommended that the Commission modify the incentive mechanism so that DEI suffers a penalty if it achieves less than sixty percent (60%) of its targets. Mr. Higgins stated that a performance-based approach is appropriate, but that the proposed structure is too favorable to DEI.

Under traditional regulation, investor-owned utilities are provided an opportunity to earn returns on capital invested in generation, transmission, and distribution. There is a clear financial incentive to prefer investment in supply-side assets, given that these investments contribute to enhanced shareholder value, unless given the opportunity to earn a return from energy efficiency investments.

We are also aware that the National Association of Regulatory Utility Commissioners ("NARUC") issued Joint Resolutions that support the modification and use of regulatory ratemaking practices in order to align utility incentives for the promotion of cost-effective energy efficiency opportunities, including incentives for aggressive pursuit of DSM.[1] The NARUC Resolutions on energy efficiency recognize that current ratemaking structures may act as a disincentive to pursuing energy efficiency and that merely removing disincentives may be insufficient to sustain a substantive commitment to promoting DSM. Additionally, the National Action Plan for Energy Efficiency ("NAPEE") noted the possible need for the adoption of performance incentives in order to promote aggressive and sustained investments in energy efficiency.[2] In the Energy Independence and Security Act of 2007 ("EISA"), Congress similarly required state regulatory bodies to consider whether to provide utility incentives for the "successful management of energy efficiency programs."[3]

Based on the discussion above and the evidence presented in this proceeding, we approve DEI's proposed first tier of incentives, as they were originally proposed (the incentive structure which includes a 15% performance inventive for programs which exceed 110% performance). In response to the Commission's July 12, 2011 Docket Entry, DEI stated that the incentive result would be the same whether or not the targets are based on a gross basis or on a net basis. Accordingly, the Commission finds that the impact of free-riders will be effectively excluded from the incentive calculation, and therefore, DEI's proposal complies with 170 IAC 4-8-7(g). Thus, the Commission approves DEI's proposal to utilize incentive thresholds that are at a gross level. We further find that DEI should be granted all necessary accounting authority to effectuate such recovery.

Dr. Goins proposed that the performance incentive be capped at 10% of Core Plus program costs and that the positive incentive should only apply if DEI has achieved 100% of the annual energy savings target. He also proposed that a penalty be applied for achieving less than 60% of the annual target. The shareholder incentive mechanism proposed by DEI for its first tier of incentives is essentially the same as that approved by the Commission in *Indianapolis Power & Light Co.,* Cause No. 43623, 2010 Ind. PUC LEXIS 53, at *167-171 (IURC February 10, 2010). The main objective of a shareholder incentive for energy efficiency is to put DSM activities by a utility on a more equal footing with supply-side resources which have an opportunity to earn a return on the capital investment. The shareholder incentive proposed by DEI does this in a reasonable manner.

However, we reject DEI's proposed second tier of incentives. Indiana investor-owned electric utilities do not require a "super incentive" to develop new programs. Furthermore, we also reject DEI's alternative proposal to increase its first tier incentives from 15% to 17% for programs exceeding 110%.

Finally, consistent with our prior decision in *Southern Indiana Gas and Elec. Co.*, Cause No. 43427, 2009 Ind. PUC LEXIS 495, at *100 (IURC December 16, 2009), and the reasons set forth therein, we reject DEI's proposal to exclude shareholder incentive amounts from FAC earnings test calculations.

G. Rider EE Allocation Issues. As a general matter, other than the substantive issues discussed herein, the OUCC and Intervenors did not take issue with the basic structure of the tariff and its mechanics. The following issues are in dispute: (1) whether DEI's proposed combination of direct assignment to residential and non-residential rate groups, followed by allocation of

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[1] *See* NARUC's July 14, 2004 Resolution on Gas and Electric Energy Efficiency and NARUC's August 2, 2006 Resolution Supporting the National Action Plan on Energy Efficiency.
[2] *See*, November 2007 NAPEE Report, *Aligning Utility Incentives with Investments in Energy Efficiency.*
[3] 16 U.S.C. §2621(d)(17).

conservation-oriented programs based on energy and demand response programs based on demand, should be approved or whether direct assignment to the customer class level should be mandated; (2) alternatively, if direct assignment to the customer class level is not mandated, whether Nucor's alternative proposal to allocate all energy efficiency charges, including charges related to conservation-oriented programs based on the 12 CP demand basis, should be approved; (3) whether, if an energy allocator is used to allocate conservation-oriented programs, line loss adjustments should be required, as proposed by Nucor; and (4) whether special contract customers' interruptible loads should be allocated any energy efficiency charges.

With regard to the issue of direct assignment to rate groups followed by allocation, versus direct assignment to customer classes, we are persuaded that DEI's proposal to directly assign energy efficiency charges to the residential and non-residential rate groups, and then to allocate costs within those rate groups based upon energy (for conservation-oriented programs) and demand (for demand response programs) is reasonable and should be approved. This proposed allocation methodology recognizes that participating customers and customer classes, as well as the system (and customers) as a whole, benefit from a utility's energy efficiency programs. We recognize that this is a slight deviation from the current allocation methodology. However, that allocation methodology was approved pursuant to a settlement agreement in Cause No. 39584 and as Mr. Freeman has testified, there have been changes since that time, including the Commission's previous determinations denying an opt-out for large customers that require a current review of the allocation methodology. As Mr. Freeman pointed out, we note that under Nucor's proposal, it is possible that special contract customers would not pay for any energy efficiency costs for their firm load if they choose not to participate in programs, despite the fact that these customers will benefit from energy efficiency programs.

With respect to Nucor's alternative proposal that all energy conservation charges should be allocated on a 12 CP demand basis, we are convinced that conservation-oriented energy program costs should be allocated on an energy or kWh basis. The primary purpose of conservation-oriented programs is to reduce energy usage. Further, the evidence in the case demonstrates that DEI's conservation-oriented programs are focused on the reduction of energy rather than demand, and that the reduction of energy is the primary driver behind such programs. We agree that the primary impact, not the secondary impact, of a program should dictate which allocation methodology should be used to allocate program-related costs.

With regard to Nucor's line loss adjustment proposal, we agree that a customer metered at a higher voltage level requires fewer kilowatt hours input to the system at the generator than a customer metered at a lower voltage. However, we do not agree that this line loss differentiation should be implemented in this case. Not only would such a change be inconsistent with the current FAC methodology for DEI, which implicates a much larger amount of revenues, it could also create a negative impact on certain rate groups if implemented outside of a general rate case. In addition, the impact of implementing the line loss adjustment proposal to non-residential customers will be less because DEI has effectively separated residential and non-residential customers through its initial direct assignment of energy efficiency charges to such groups. Accordingly, we decline to require such line loss differentiation at this time. The Commission finds that consideration of this issue would be more appropriate in a general rate case.

With respect to whether any energy efficiency charges should be allocated to special contract customers' interruptible loads, we agree with DEI that interruptible customers do benefit from having both environmentally-compliant and reliable capacity and energy available to serve their needs approximately 98% of the hours of the year. These benefits include the deferral of or lower cost of having such environmentally-compliant capacity available to serve most of their needs, as well as lower marginal fuel costs resulting from energy efficiency impacts moving DEI down on the dispatch curve for its generation. The lower-fuel cost will be reflected in DEI's FAC filings which apply to Nucor and SDI's firm and interruptible load. Finally, we note that the energy from interruptible loads is included in our calculation of energy usage for determination of meeting the energy savings goals. Consequently, we agree with DEI that it would not make sense to exclude those loads from energy efficiency charges. For all of these reasons, we find that, unless explicitly excluded by the terms of contracts, special contract customers' interruptible loads should be allocated energy efficiency charges.

As to the OUCC's request that future special contracts be precluded from including language that releases special contract customers from sharing energy efficiency costs, we find that this issue should be addressed on a case-by-case basis in the context of the special contract when it is presented for approval by the Commission. As we noted in *Indiana Michigan Power Co.,* Cause No. 43959, 2011 Ind. PUC LEXIS 117, at *44-45 (IURC April 27, 2011), utilities and customers have been advised that we look upon these types of clauses with disfavor and the inclusion of such clauses in future contracts will require sufficient justification of the reasonableness of such provisions.

Therefore, DEI's proposal for Rider EE cost allocation is approved, with the exception of DEI's proposal to move PowerShare CallOption to Rider EE as previously discussed. The OUCC recommended that DEI submit Rider EE charge estimates and other information prior to DEI's June 2012 Rider EE filing. However, given the current date, the Commission will not require DEI to file any reports prior to the June 2012 Rider EE filing. To the extent such data is available, DEI shall include it in the June 2012 Rider EE filing.

H. Self-Directed Programs. Various commercial and industrial parties recommended the adoption of a self-directed plan for large customers who can demonstrate a commitment to pursue energy efficiency programs outside of utility-directed programs. The Commission determined in the Phase II Order that all customers, including large commercial and industrial customers, should initially participate in utility-directed DSM programs. Further, the Commission previously addressed various proposals by commercial and industrial parties to either opt-out of utility-sponsored programs or self-direct their own programs in *Duke Energy Indiana, Inc.*, Cause No. 43374, 2010 Ind. PUC LEXIS 50, at *180–181 (IURC February 10, 2010); *NIPSCO*, Cause No. 43912, 2011 Ind. PUC LEXIS 215, at *68-70 (IURC July 27, 2011); and *Indianapolis Power & Light Co.*, Cause No. 43960, 2011 Ind. PUC LEXIS 344, at *119-121 (IURC November 22, 2011).

As stated in these previous proceedings, the Commission believes 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 fully implement the Core Programs, which includes commercial and industrial programs, throughout the State. Accordingly, the request for the adoption of self-directed programs is denied at this time. Nevertheless, we recognize an evolution in the nature of requests from large commercial and industrial customers, from initial proposals to opt out of participation in the statewide DSM program during the Phase II Order proceedings, to more recent proposals to participate in a utility's efforts to achieve the DSM goals through self-directed programs. The Commission is not permanently foreclosing consideration of a cooperative self-directed program proposal by a utility and its large commercial and industrial customers, supported by sufficient evidence and designed to be consistent with the Commission's goals and objectives in the Phase II Order.

I. DEI Oversight Board. The Commission has previously approved oversight boards to oversee and monitor energy efficiency programs for both gas and electric utilities. *See, e.g. Indiana Michigan Power Co.,* Cause No. 43959, 2011 Ind. PUC LEXIS 117 (IURC April 27, 2011); *Southern Indiana Gas and Elec. Co.*, Cause No. 43427, 2009 Ind. PUC LEXIS 495 (IURC December 16, 2009); *NIPSCO*, Cause No. 43912, 2011 Ind. PUC LEXIS 215 (IURC July 27, 2011). Neither DEI nor any other party to this proceeding opposed the formation of an oversight board to oversee DEI's Core Plus Programs. The Commission therefore finds that establishment of an oversight board is appropriate. Having reviewed OUCC's Exhibit AMP-1, we find that it sets forth a framework consistent with previously approved DSM Oversight Boards. While we agree with Mr. Goldenberg that collaboration should always be the goal of such groups, we specifically reject his proposal that the Oversight Board eschew a formal voting process. Therefore, DEI shall work with the OUCC to establish membership and responsibilities for the Oversight Board consistent with the framework set forth in the OUCC's Exhibit AMP-1 and file either an agreed upon membership process or request Commission resolution of any disagreement of same within three months of this Order. Given the unique circumstances in this case, namely that DEI has already retained an EM&V consultant that it uses in all of its jurisdictions, and who also is the EM&V consultant for the Core Programs, we decline to require DEI to utilize the Oversight Board to select an EM&V vendor for its Core Plus programs. However, consistent with existing Oversight Boards, DEI's EM&V vendor shall report to, and take direction from the Oversight Board, not exclusively from DEI.

J. Deferral Accounting Authority. In its Petition, DEI sought authority to defer costs associated with Core and Core Plus Programs, including Core Program start-up and implementation costs, until such time as the costs are included in rates and for the use of deferred accounting on an ongoing basis to ensure proper matching of expenses with the rate recovery of such expenses through the proposed Rider. This request for Core Programs was considered in Cause No. 42693 S1. On January 26, 2011, the Commission issued its Order on Cost Deferral in Cause No. 42693 S1, approving deferral, for subsequent recovery through rates, the start-up and operation costs and any additional costs reasonably and appropriately assessed by the TPA and EM&V Administrator after Commission approval of the selected TPA and EM&V Administrator, but prior to the individual utility's cost recovery.

Accordingly, we approve DEI's request for authority to defer and subsequently recover costs associated with Core and Core Plus programs, including start-up and implementation costs, and authority to use deferred accounting on an ongoing basis.

K. Pilot Programs. DEI requests authority to defer and subsequently recover costs associated with pilot program costs until such time as the costs are included in rates, and authority to use deferred accounting on an ongoing basis to ensure proper matching of expenses with the rate recovery of such expenses through the proposed Rider EE. Upon successful completion of a pilot program, DEI will file for approval of the program, program cost recovery, lost revenues, and incentives associated with both the pilot and the program going forward. Mr. Duff stated that the aggressive impacts mandated in the Phase II Order will require DEI to innovate and develop new programs, and that, in order to get the necessary new pilots to market quickly, it will be critical to expedite or eliminate the regulatory approval required for pilots. The OUCC objected to this proposal. Ms. Paronish stated, "The public interest is not well-served by granting DEI an open checkbook to incur and defer pilot costs without guidelines and protections built into the process." In rebuttal, Mr. Duff emphasized, "Under Duke Energy Indiana's proposal, the Company would defer the costs of the pilot and if, and only if, it was a successful pilot that leads us to a full scale commercial program would it seek to recover the costs of the pilot. At the time the Company files for approval for the commercialization of a full-scale version of the program that was piloted, the Commission would be able to review the pilot results and the deferred costs to ensure cost effectiveness and determine whether the pilot costs were prudently incurred." Based on this clarification, DEI's request to utilize deferred accounting for pilot programs is approved, except in regard to deferral to account for incentives. Similar to the ruling made above regarding the HECR pilot, the Commission denies DEI's request to recover any shareholder incentive associated with pilots. Cost recovery of deferred costs from pilot programs is contingent on approval by the Commission. If the program is not found reasonable or cost effective, then the pilot program costs will not be recoverable.

6. **Confidential Information.** DEI filed a Motion for Protection of Confidential and Proprietary Information, which was supported by an affidavit showing documents to be submitted to the Commission were trade secret information within the scope of Indiana Code § 5-14-3-4(a)(4) and Indiana Code § 24-2-3-2. The Presiding Officers issued docket entries and made rulings from the bench finding such information to be preliminarily confidential, after which such information was submitted under seal. Accordingly, we find that all such information should continue to be held confidential pursuant to Indiana Code § 5-14-3-4 and Indiana Code § 24-2-3-2.

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

1. DEI's Three Year DSM Plan, including Core Plus Programs, proposed budgets and EM&V plans, shall be and hereby is approved as modified above.

2. DEI's request for Core and Core Plus Program cost recovery, including EM&V costs and third party administrator costs, via Rider EE shall be and hereby is approved as modified above, effective as of July 27, 2011 for Core Program costs, and effective as of the date of this Order for Core Plus Program costs.

3. DEI's request for recovery of lost revenues associated with its Core and Core Plus Programs shall be and hereby is approved.

4. DEI's proposed performance-based shareholder incentive mechanism shall be and hereby is approved, as discussed and modified above. Specifically, we approve DEI's original, first tier incentive proposal as presented in its direct testimony.

5. DEI's proposal to exclude shareholder incentives from the FAC earnings test is hereby denied.

6. DEI's Rider EE and proposed updated Rider 66 shall be and hereby is approved, consistent with our determinations herein. DEI is directed to file with the Commission's Electricity Division revisions of Rider 66-A and the updated Rider 66 consistent with the findings in this Order.

The revised Riders will go into effect upon approval by the Commission's Electricity Division. By June 29, 2012, DEI shall submit to the Commission updated Rider EE charge estimates for the remainder of the approved three year DSM Plan, along with a reconciliation of the existing DSM Rider 66. Further, by June 29, 2012, DEI shall submit an updated bill impact analysis.

7. DEI shall coordinate with the OUCC to establish an Oversight Board. The OUCC and DEI shall make a joint informational filing in this Cause within three months of the Order notifying the Commission of Oversight Board membership and responsibilities, or request Commission resolution of any disagreement relating thereto.

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

ATTERHOLT, BENNETT, LANDIS, MAYS AND ZIEGNER CONCUR:

APPROVED: MAR 21 2012

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

Brenda A. Howe

Brenda A. Howe
Secretary to the Commission