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NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION

June 19, 2009

FILED
JUN 19 2009
Clerk's Office
N.C. Utilities Commission

Ms. Renné C. Vance, Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4325

Re: Docket No. E-7, Sub 831

Dear Ms. Vance:

In connection with the above-captioned docket, I transmit herewith for filing on behalf of the Public Staff, twenty-one (21) copies of the Testimony of James S McLawhorn, Director, Electric Division.

By copy of this letter, I am forwarding a copy to all parties of record.

Sincerely,

Kendrick C. Fentress
Staff Attorney

Attachment

cc: Parties of Record

clerk
AG
7 Comm
Bennink
Kirby
Watson
Hoyer
Kitt
Hilburn
Jone
Bessons
Encson

Executive Director
733-2435

Communications
733-2810

Economic Research
733-2902

Legal
733-6110

Transportation
733-7766

Accounting
733-4279

Consumer Services
733-9277

Electric
733-2267

Natural Gas
733-4326

Water
733-5610

JUN 19 2009**DUKE ENERGY CAROLINAS, LLC, DOCKET NO. E-7, SUB 831****Clerk's Office
N.C. Utilities Commission****TESTIMONY OF JAMES S. MCLAWHORN ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION****June 19, 2009**

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND PRESENT**
2 **POSITION.**

3 **A.** My name is James S. McLawhorn. My business address is 430 North Salisbury
4 Street, Raleigh, North Carolina. I am Director of the Electric Division of the
5 Public Staff of the North Carolina Utilities Commission (Public Staff), which is
6 representing the using and consuming public in this proceeding.
7

8 **Q. HOW LONG HAVE YOU BEEN EMPLOYED BY THE PUBLIC STAFF?**

9 **A.** I have been employed by the Public Staff since November 1988. I have been
10 Director of the Electric Division since October 2006.
11

12 **Q. WHAT ARE YOUR DUTIES?**

13 **A.** I am responsible for providing supervision over the Electric Division and making
14 policy recommendations in all electric utility matters pending before the
15 Commission.
16

17 **Q. PLEASE DISCUSS YOUR EDUCATION AND EXPERIENCE.**

18 **A.** A summary of my education and experience is attached to my testimony as
19 Appendix A.

1 **Q. HAVE YOU PREVIOUSLY BEEN INVOLVED IN THE SAVE-A-WATT**
2 **PROCEEDING?**

3 A. In my role as Director of the Electric Division of the Public Staff, I have been
4 involved in the review and analysis of the save-a-watt proposal since it was filed
5 in May 2007 by Duke Energy Carolinas, LLC (Duke or the Company).
6

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

8 A. On June 12, 2009, Duke, the Southern Environmental Law Center, the
9 Environmental Defense Fund, the Natural Resources Defense Council, and the
10 Southern Alliance for Clean Energy (collectively, the Environmental Intervenors),
11 and the Public Staff filed with the Commission an Agreement and Joint
12 Stipulation of Settlement (Settlement Agreement), which included Exhibit A
13 (procedural history), Exhibit B (the settlement terms), and Exhibit C (the list of
14 issues addressed). The purpose of my testimony is to address key components
15 of this Settlement Agreement and describe specific benefits achieved by it and
16 highlighted by Exhibit C. The key components that my testimony addresses
17 include the following: (1) the Settlement Agreement as a pilot program of limited
18 duration; (2) the Settlement Agreement's provisions for the limited recovery of
19 incentive amounts, including net lost revenues, by the Company; (3) the
20 Settlement Agreement's provision of a more transparent cost and incentive
21 recovery than the save-a-watt model as initially filed; and (4) the Settlement
22 Agreement's protection of ratepayers from the risks of tying revenue recovery for

1 energy efficiency and demand-side management (DSM) programs to future
2 avoided supply-side costs.

3
4 **LIMITED COST RECOVERY PERIOD**

5
6 **Q. PLEASE BRIEFLY DESCRIBE THE PUBLIC STAFF'S CONCERNS WITH THE**
7 **INITIAL SAVE-A-WATT MODEL'S COST RECOVERY PERIOD, INCLUDING**
8 **LOST REVENUE COLLECTION.**

9 A. The Public Staff was concerned that the initial save-a-watt model potentially
10 would have resulted in the Company earning an excessive incentive to
11 implement DSM and energy efficiency programs for an indefinite period with
12 limited opportunity for review and modification by the Commission.

13
14 **Q. PLEASE DISCUSS HOW THE SETTLEMENT AGREEMENT ADDRESSES**
15 **THIS CONCERN?**

16 A. The Settlement Agreement has a term of four years, and it is a pilot program. At
17 the conclusion of four-year period, actual avoided costs savings will be compared
18 to the targeted avoided costs savings in a true-up proceeding. This limited
19 duration of the terms and conditions of this Settlement Agreement is similar to
20 the Public Staff's earlier recommendations in this proceeding. In the Public
21 Staff's proposed cost and incentive mechanism, presented in the testimony of its
22 witness, Richard F. Spellman, the Public Staff recommended a regulatory review

1 of incentive amounts after a period of three years to ensure that the incentive
2 amounts remained appropriate. Furthermore, the Public Staff also
3 recommended in that same proposal that net lost revenues be recovered for
4 three years after a measure was installed. This Settlement Agreement contains
5 comparable time limits. These terms limit the exposure of the parties to
6 unintended consequences that can result from a novel regulatory approach.

7
8 In addition, with regard to net lost revenues, the Settlement Agreement
9 recognizes the Public Staff's view that revenues that are "lost" due to an energy
10 efficiency program do not continue in perpetuity, but are offset in time by revenue
11 gains, resulting, for example, from customer growth or other increases in
12 demand. Furthermore, under the Settlement Agreement, recovery of net lost
13 revenues will end prior to the expiration of the 36 months upon Commission
14 approval of an alternative recovery mechanism, or the implementation of new
15 rates in a general rate case or other comparable proceeding to the extent those
16 rates are set to recover net lost revenues.

17 ¶

18 The Public Staff believes that 36 months is a reasonable amount of time for the
19 recovery of net lost revenues and notes that this limited time period is similar to
20 one contained in the Agreement and Stipulation of Partial Settlement, filed by the
21 Public Staff, Progress Energy Carolinas, Inc., and Wal-Mart Stores East, L.P. in
22 Docket No. E-2, Sub 931, and approved by the Commission by Order dated June

1 15, 2009. Additionally, the settlement between Duke and the Office of Utility
2 Consumer Counselor (OUCC) in the save-a-watt proceeding in Indiana contains
3 a similar time-limit on the recovery of net lost revenues.
4

5 **LIMITED INCENTIVE AMOUNTS**
6

7 **Q. PLEASE DESCRIBE THE PUBLIC STAFF'S CONCERNS REGARDING THE**
8 **AMOUNT OF INCENTIVES THAT DUKE COULD RECOVER WITH THE**
9 **INITIAL SAVE-A-WATT PETITION.**

10 **A.** The Public Staff believed that the Company's initial proposal to recover 90% of
11 the avoided costs achieved by its proposed energy efficiency and DSM
12 programs, for a period of up to 20 years, would have resulted in excessive
13 earnings by Duke and insufficient savings on energy by ratepayers. In addition,
14 the 90% of avoided cost recovery included, implicitly, the recovery of net lost
15 revenues, which the Commission considers to be an incentive for implementing
16 energy efficiency and DSM programs.
17

18 **Q. HOW DOES THE SETTLEMENT AGREEMENT ADDRESS THESE**
19 **CONCERNS?**

20 **A.** The Settlement Agreement provides that the Company's revenues are now to be
21 recovered on the basis of separate percentages of avoided costs for DSM and
22 energy efficiency programs. These percentages of avoided costs include 75% of

1 avoided capacity costs for DSM programs and 50% of the net present value
2 (NPV) of avoided energy costs plus 50% of the NPV of avoided capacity costs for
3 energy efficiency programs. The recovery of these percentages of avoided costs
4 is intended by Duke to cover its costs for adopting and implementing DSM and
5 energy efficiency programs, along with providing a financial incentive for doing
6 so.

7
8 Unlike the initial save-a-watt approach, Duke's revenues to be recovered are
9 subject to an earnings cap under the Settlement Agreement. They are limited to
10 the amount necessary to produce after-tax returns on program costs of 5% to
11 15%, depending on Duke's success in reaching a targeted aggregate energy
12 efficiency and DSM avoided costs savings level. In determining Duke's
13 performance in reaching certain targets, the Settlement Agreement contains the
14 provision that Duke must show, through measurement and verification, the actual
15 energy and capacity savings it achieved through its energy efficiency and DSM
16 programs at the conclusion of the four-year term.

17
18 In addition, the Settlement Agreement defines net lost revenues consistently
19 within Commission Rule R8-68 and recognizes that net lost revenues are net of
20 any increases in revenues resulting "from any activity by the Company's public
21 utility operations that cause a customer to increase demand or energy
22 consumption, whether or not that activity has been approved pursuant to R8-68."

1 The Settlement Agreement further provides that Duke bears the burden of
2 showing its actual net lost revenues through measurement and verification.
3

4 **Q. DOES THE SETTLEMENT AGREEMENT PROVIDE ANY OTHER**
5 **SAFEGUARD AGAINST THE COMPANY OVEREARNING?**

6 A. Yes. The Settlement Agreement shields ratepayers from the risk of Duke
7 collecting revenues for its DSM and energy efficiency programs in excess of what
8 is allowed under the Settlement Agreement by providing for the true-up and
9 return, with interest, of any over-collections.
10

11 **Q. WHAT IS THE INTEREST RATE ON THIS RETURN TO CUSTOMERS?**

12 A. The interest rate on customer refunds remains unresolved at this time. The
13 Commission will determine that rate at a later proceeding. The initial save-a-watt
14 petition, however, had no provision for a return to customers of overearnings with
15 interest.
16

17 **Q. YOU HAVE TESTIFIED ABOUT THE PUBLIC STAFF'S CONCERN THAT THE**
18 **INITIAL SAVE-A-WATT MODEL ALLOWED DUKE TO EARN EXCESSIVE**
19 **INCENTIVES WHEN COMPARED TO THE PROJECTED SAVINGS AND HOW**
20 **THE SETTLEMENT AGREEMENT LIMITS THOSE INCENTIVES. DOES THE**
21 **SETTLEMENT AGREEMENT ALSO ADDRESS THE PUBLIC STAFF'S**

**CONCERN REGARDING THE AMOUNT OF ENERGY SAVINGS
PROJECTED?**

A. Yes. The Settlement Agreement provides for increased energy savings targets when compared to the initial save-a-watt model. Measures implemented in each vintage year of this Settlement Agreement are expected to continue to operate and produce energy savings throughout its four-year term. Thus, the overall energy savings percentage for each settlement year during the four-year term is cumulative. This results in the energy savings percentage for the fourth year of the settlement being equal to the sum of the energy savings from all four of the vintage year measures operating in that year, or 1.9% of retail sales forecast for year four. This represents about a 50% increase in projected savings over the initial save-a-watt model. Therefore, considering the increase in the projected energy savings, the Public Staff believes that the incentives that Duke has the opportunity to recover under the Settlement Agreement are more reasonable than those proposed in the initial save-a-watt model.

TRANSPARENCY

**Q. PLEASE DESCRIBE THE PUBLIC STAFF'S CONCERNS REGARDING THE
LACK OF TRANSPARENCY IN THE INITIAL SAVE-A-WATT PETITION.**

A. The initial save-a-watt model based Duke's recovery on simply a percentage of avoided cost savings, so it was not readily evident what portions of the revenues

1 were compensating the Company for incurred DSM and energy efficiency
2 program costs, net lost revenues, and additional incentives (the revenues
3 collected in excess of incurred costs and net lost revenues). Moreover, the initial
4 model as filed did not clearly establish Duke's obligations regarding requirements
5 of Commission Rules R8-68 and R8-69.

6
7 **Q. PLEASE DISCUSS HOW THE SETTLEMENT AGREEMENT ADDRESSES**
8 **THIS CONCERN.**

9 **A.** The Settlement Agreement sets forth the estimated net lost revenues for its four-
10 year term. These net lost revenues are now subject to measurement and
11 verification and are recovered separately from program costs and bonus
12 incentives. Moreover, the Settlement Agreement provides that Duke is still
13 obligated under Commission Rules R8-68 and R8-69, as well as the
14 Commission's February 26, 2009 Order in this docket, to provide certain
15 information when seeking approval of new DSM and energy efficiency programs
16 or measures and when adjusting its avoided cost savings targets with regard to
17 customers who "opt-out" of participating in new DSM or energy efficiency
18 programs. The Settlement Agreement also provides that Duke will provide
19 information related to its developing of energy efficiency and DSM programs to
20 stakeholders participating in its Regional Efficiency Advisory Group in a
21 transparent manner.

LOCKING IN AVOIDED COSTS

Q. PLEASE DESCRIBE THE PUBLIC STAFF'S CONCERNS ABOUT THE COMPANY'S RECOVERY BEING BASED ON AVOIDED SUPPLY-SIDE COSTS IN THE INITIAL SAVE-A-WATT PETITION.

A. In the initial save-a-watt petition, the Company proposed to tie its revenue recovery for implementing energy efficiency and DSM programs to its avoided supply-side costs. Avoided costs can vary over time due to changes in the predictions of: (1) future load growth, (2) future resource mixes, and (3) changes in projected fuel prices. Thus, they are difficult to predict with precision. At the evidentiary hearing in this matter, Public Staff witness Richard F. Spellman described this problem with the initial save-a-watt model, testifying that if avoided supply-side costs increased from one year to the next, ratepayers would pay for that increase, even if they were not receiving any additional energy efficiency or demand reduction savings from Duke-sponsored programs.

Q. HOW DOES THE SETTLEMENT AGREEMENT ADDRESS THIS CONCERN?

A. The avoided costs savings target cannot be met merely through an increase in avoided costs. The Settlement Agreement shields ratepayers from this risk by "locking in", for the term of the agreement, the per MWh and per MW-Year avoided costs, except in certain limited circumstances. The avoided cost rate for capacity is based on the PURPA avoided capacity cost rates filed with the

Commission, using a 1.2 performance adjustment factor, and will be set for four years. The avoided costs for energy are based on the avoided energy costs per the Company's integrated resource plan, using a comparable methodology as applied in the PURPA avoided energy costs rates approved by the Commission. In addition, the Company will use the same values for per MWh and per MW for avoided costs rates when determining targeted avoided costs savings and actual avoided cost savings for the four-year term of the Settlement Agreement.

OTHER BENEFITS TO THE SETTLEMENT AGREEMENT

Q. ARE THERE OTHER PROVISIONS OF THE SETTLEMENT AGREEMENT THAT THE PUBLIC STAFF BELIEVES ARE IMPROVEMENTS TO THE SAVE-A-WATT APPROACH AS INITIALLY FILED?

A. Yes. The Settlement Agreement provides that no more than 35% of the target may be met by DSM programs, providing an emphasis on energy efficiency programs that the initial save-a-watt model lacked.

1 In addition, the initial save-a-watt model appeared to limit participation by low-
2 income customers by focusing on the physical housing unit as opposed to the
3 resident of the unit. This Settlement Agreement contains a provision that
4 requires Duke to make residential programs available to customers without
5 regard to whether they own or rent their homes. The Settlement Agreement also
6 contains a commitment by Duke to pursue partnerships with third party agencies
7 to implement programs and offer assistance to low-income customers.

8
9 **CONCLUSION**

10
11 **Q. DID THE SETTLEMENT AGREEMENT RESOLVE ALL OUTSTANDING**
12 **ISSUES AMONG THE PARTIES?**

13 **A.** No. In addition to the later determination of the interest rate to be applied to
14 customer refunds that I have already mentioned, two issues remain outstanding.
15 First, the issue of the allocation of costs between the wholesale jurisdiction and
16 the retail jurisdiction remains unresolved. Duke and the Environmental
17 Intervenors have proposed that only retail customers pay the costs associated
18 with DSM and energy efficiency programs. The Public Staff disagrees with this
19 proposal, contending that the costs and benefits of DSM and energy efficiency
20 programs should be allocated to both the wholesale and retail jurisdictions. The
21 Stipulating Parties have agreed that Duke and the Environmental Intervenors will
22 present testimony on this issue in their filing in support of the Settlement

1 Agreement. By Commission order issued June 18, 2009, in this docket, the
2 Public Staff will respond with its position on this issue in its testimony to be filed
3 on July 2, 2009. In this way, the Stipulating Parties will present this issue to the
4 Commission to determine.

5
6 The second issue is the determination of the appropriate allocation method for
7 assigning costs to customer classes. As with the jurisdictional allocation issue,
8 Duke and the Environmental Intervenors agree on this class allocation issue and
9 will present their position in the testimony that they file supporting the Settlement
10 Agreement. As directed by the Commission's June 18, 2009 order, the Public
11 Staff will present its position on this issue in responsive testimony filed on July 2,
12 2009.

13
14 **Q. OTHER THAN THE UNRESOLVED ISSUES, DO YOU BELIEVE THAT THE**
15 **TERMS AND CONDITIONS OF THIS SETTLEMENT AGREEMENT**
16 **ADEQUATELY ADDRESS THE CONCERNS THAT THE PUBLIC STAFF**
17 **IDENTIFIED IN ITS PREVIOUS ANALYSIS OF THE COMPANY'S PROPOSED**
18 **SAVE-A-WATT MODEL AS FILED?**

19 **A. Yes, I do.**

1 **Q. WHAT DOES THE PUBLIC STAFF RECOMMEND?**

2 **A. The Public Staff recommends that the Commission approve the Settlement**
3 **Agreement in its entirety.**

4

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes, it does.

APPENDIX A

James S. McLawhorn

I graduated with honors from North Carolina State University with the degree of Bachelor of Science in Industrial Engineering in May of 1984. I received the degree of Master of Science in Management with a finance concentration from North Carolina State University in December of 1991. While an undergraduate, I was selected for membership in both Tau Beta Pi and Alpha Pi Mu engineering honor societies.

I began my employment with the Public Staff Communications Division in June of 1984. While with the Communications Division, I testified before the Commission in general rate proceedings regarding matters of telephone quality of service.

In September of 1987, I was employed by GTE-South as an engineer in the Capital Recovery Department. I was responsible for analysis and recommendations to Company management regarding appropriate depreciation rates for recovery of the Company's capital investments.

I began my employment with the Electric Division of the Public Staff in November of 1988. I have testified before the Commission in numerous general rate proceedings regarding matters of rates, rate design, customer growth, cost-of-service methodology, demand-side management, energy efficiency, and depreciation.

I assumed my present position as Director of the Electric Division in October of 2006. It is my responsibility to provide supervision of and make policy recommendations on all electric utility matters pending before the Commission.