

PLACE: Dobbs Building, Raleigh, North Carolina

DATE: August 19, 2009

DOCKET NO.: E-7, Sub 831

TIME IN SESSION: 9:00 A.M. TO 12:25 P.M.

BEFORE: Chairman Edward S. Finley, Jr. Presiding  
Commissioner Lorinzo L. Joyner  
Commissioner Robert V. Owens, Jr.  
Commissioner William T. Culpepper, III

IN THE MATTER OF:

Duke Energy Carolinas, LLC: Petition for Approval of  
Save-a-Watt Approach, Energy Efficiency Rider and  
Portfolio of Energy Efficiency Programs

VOLUME I

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P R O C E E D I N G S

CHAIRMAN FINLEY: Let's come on the record, please. Good morning. My name is Edward S. Finley, Jr, and with me today are Commissioners Robert B. Owens, Jr, Lorenzo L. Joyner, and William T. Culpepper, III. I now call for hearing Docket No. E-7, Sub 831, which is the matter of Duke Energy Carolinas Application for Approval of the Save-a-watt Approach, Energy Efficiency Rider, and Portfolio of Energy Efficiency Programs filed on May 7, 2007.

In compliance with the requirements of Chapter 1, 38(a) and the State Government Ethics Act, I remind all members of the Commission of their duty to avoid conflicts of interest and inquire whether any member of the Commission has a known conflict of interest with regard to any of the matters coming before us this morning.

(No response.)

CHAIRMAN FINLEY: There appearing to be none, we will proceed.

On February 26, 2009, the Commission issued it's order in this docket resolving certain issues, requiring information on unsettled matters,

1 and allowing the proposed rider to become effective  
2 subject to refund. Also, on February 26, 2009 an  
3 errata order was issued replacing the supplemental  
4 information section of the February 26 order  
5 beginning on page 60 and ending on page 63.

6 On June 12, 2009 the stipulating parties  
7 -- Duke Energy Carolinas, LLC, Southern Alliance  
8 for Clean Energy, Environmental Defense Fund,  
9 Natural Resources Defense Council, Southern  
10 Environmental Law Center, and the Public Staff  
11 filed an Agreement and Joint Stipulation of  
12 Settlement.

13 On June 18, 2009, the Commission issued  
14 an order scheduling a hearing to consider the  
15 Agreement and Joint Stipulation of Settlement  
16 August 12, 2009.

17 On July 2, 2009, the Commission issued an  
18 order rescheduling hearing to August 19 of 2009 and  
19 granting extensions of time to file testimony of  
20 nonstipulated interveners to July 27, 2009 and  
21 rebuttal testimony not later than Monday, August  
22 10, 2009.

23 On June 9, 2009, testimony was filed by  
24 James S. McLawhorn of the Public Staff, John E.

1 Wilson on behalf of the Environmental Defense Fund,  
2 Natural Resources Defense Council, Southern  
3 Alliance for Clean Energy, and the Southern  
4 Environmental Law Center; and J. Danny Wiles,  
5 Theodore E. Schultz, and Stephen M. Farmer on  
6 behalf of Duke Energy Carolinas.

7 On July 2, 2009 testimony and exhibits  
8 were filed by Michael C. Maness, Public Staff. On  
9 July 27, 2009 Roger D. Colton filed supplemental  
10 testimony on behalf of the North Carolina Justice  
11 Center, AARP, NC Council of Churches, and Legal Aid  
12 of North Carolina. On August 10, 2009 Raiford L.  
13 Smith filed rebuttal testimony on behalf of Duke  
14 Energy Carolinas, which was very short.

15 On July 30, 2009 the Commission issued  
16 its pre-hearing order requiring verified  
17 information in this docket. On August 10, 2009  
18 Duke Energy filed its response to the Commission  
19 pre-hearing order. On August 14, 2009 the  
20 Commission issued its second pre-hearing order  
21 requiring verified information and requesting the  
22 environmental interveners and the Public Staff to  
23 file verified statements not later than Tuesday,  
24 August 18, 2009, which state whether those parties



1 are in agreement with the information filed by Duke  
2 on August 10, 2009.

3 I believe that brings us up to the  
4 present. It's good to see everybody. We were here  
5 about a year ago, so everybody's a year older and,  
6 hopefully, a year wise. Let's take appearances  
7 beginning with the Company.

8 MR. KAYLOR: Thank you, Mr. Chairman and  
9 Members of the Commission. Robert Kaylor appearing  
10 on behalf of Duke Energy Carolinas.

11 MS. HEIGEL: Good morning, Mr. Chairman  
12 and members of the Commission. Katherine Heigel  
13 appearing on behalf of Duke Energy Carolinas as  
14 well.

15 MS. NICHOLS: Good morning. Laura  
16 Nichols also on behalf of Duke Energy Carolinas.

17 MR. MCDONALD: This end? Good morning.  
18 I'm Ralph McDonald for the Carolina Industrial  
19 Group for Fair Utility Rates III and Air Products  
20 and Chemicals.

21 MR. OLSON: Good morning. I'm Kurt  
22 Olson. I'm with the North Carolina Sustainable  
23 Energy Association.

24 MS. THOMSON: Good morning, Mr. Chairman,

1 members of the Commission. I'm Gudran Thompson  
2 appearing on behalf of Environmental Defense Fund,  
3 Natural Resources Defense Council, Southern  
4 Alliance for Clean Energy and the Southern  
5 Environmental Law Center.

6 MR. HOLTZMAN: Good morning. My name is  
7 Jack Holtzman. I'm with the North Carolina Justice  
8 Center appearing today on behalf of the North  
9 Carolina Justice Center, AARP, Council of Churches,  
10 and Legal Aid.

11 MR. RUNKLE: John Runkle for the North  
12 Carolina Waste Awareness and Reduction Network, NC  
13 WARN.

14 MR. GREEN: Good morning. I'm Len Green  
15 with the Attorney General's office appearing on  
16 behalf of the consumers.

17 MS. FENTRESS: Good morning. I'm  
18 Kendrick Fentress with the Public Staff appearing  
19 on behalf of the using and consuming public.

20 CHAIRMAN FINLEY: Welcome everyone. Any  
21 preliminary matters we need to address before we  
22 get started?

23 MR. KAYLOR: Thank you, Mr. Chairman.  
24 Just a couple for Duke. First of all, we'd like to

1 ask that Duke Energy Carolinas responses to the  
2 August 10 order be marked as Duke Energy Carolinas'  
3 Hearing Exhibit No. 1.

4 (DUKE HEARING EXHIBIT NO. 1  
5 WAS MARKED FOR IDENTIFICATION.)

6 CHAIRMAN FINLEY: Without objection it  
7 shall be so marked.

8 MR. KAYLOR: And we would also like to  
9 announce to the Commission and the parties that Dr.  
10 Stevie is here. He is not sponsoring testimony,  
11 but he is familiar with a lot of the information  
12 that went into the testimony and into the entire  
13 effort. And he is available if the Commission or  
14 any of the parties need to call him to ask any  
15 questions in the form of cross examination.

16 CHAIRMAN FINLEY: Very well. He's a  
17 brave man to be here. Thank you.

18 MS. HEIGEL: He also sponsored several of  
19 the answers to the responses that we've marked as  
20 Hearing Exhibit 1.

21 CHAIRMAN FINLEY: Very well. Anything  
22 else?

23 MS. FENTRESS: The Public Staff would  
24 make a similar motion with regard to Mr. Maness

1           when we present his supplemental testimony.

2                   CHAIRMAN FINLEY: Very well. All right.  
3           Duke?

4                   MS. HEIGEL: Thank you. At this time we  
5           would call our first witness, Mr. Ted Schultz.

6                   CHAIRMAN FINLEY: I think you probably  
7           have already been sworn in this proceeding, but  
8           just to make sure we'll swear everybody in.

9           (WHEREUPON, THEODORE E. SCHULTZ, WAS CALLED AS A  
10   WITNESS, DULY SWORN, AND TESTIFIED AS FOLLOWS:)

11   DIRECT EXAMINATION BY MS. HEIGEL:

12   Q.       Mr. Schultz, would you please state your name and  
13           business address for the record?

14   A.       Yes. Theodore Schultz, 526 South Church Street,  
15           Charlotte, North Carolina.

16   Q.       And by whom are you employed and in what capacity?

17   A.       Duke Energy. I'm vice president of marketing and  
18           energy efficiency.

19   Q.       Have you previously caused testimony to be filed in  
20           this docket?

21   A.       Yes, I have.

22   Q.       And did you cause to be prefiled most recently in  
23           this docket settlement supporting testimony  
24           consisting of 10 pages and Schultz Settlement

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1 Exhibit No. 1 consisting of 34 pages?

2 A. Yes, I have.

3 Q. And can you please identify for the Commission what  
4 Exhibit 1 to your settlement testimony is?

5 A. Exhibit 1 is the Settlement Agreement.

6 Q. Thank you. And do you have any changes or  
7 corrections to your testimony at this time?

8 A. I do not.

9 MS. HEIGEL: Mr. Chairman, at this time I  
10 would move that Mr. Schultz's prefiled settlement  
11 testimony be entered into the record as if given  
12 orally from the stand and that his exhibit,  
13 Settlement Exhibit No. 1 be marked for  
14 identification.

15 CHAIRMAN FINLEY: Mr. Schultz's direct  
16 prefiled testimony of June 9, 2009 shall be copied  
17 into the record as if given orally from the stand  
18 and his exhibit shall be marked for identification  
19 as premarked in the file.

20 (THE PREFILED SETTLEMENT TESTIMONY OF THEODORE  
21 SCHULTZ WILL BE COPIED INTO THE RECORD AS IF GIVEN  
22 ORALLY FROM THE WITNESS STAND AND SCHULTZ  
23 SETTLEMENT EXHIBIT NO. 1 WAS MARKED FOR  
24 IDENTIFICATION.)

**I. INTRODUCTION AND PURPOSE**

1 **Q. PLEASE STATE YOUR NAME, ADDRESS, AND POSITION WITH DUKE**  
2 **ENERGY BUSINESS SERVICES, LLC.**

3 **A. My name is Theodore E. Schultz, and my business address is 526 South Church**  
4 **Street, Charlotte, North Carolina. I am Vice President – Energy Efficiency for Duke**  
5 **Energy Business Services, LLC, a service company affiliate of Duke Energy**  
6 **Carolinas, LLC (“Duke Energy Carolinas” or the “Company”) and am responsible for**  
7 **leading energy efficiency initiatives across all retail markets served by Duke Energy**  
8 **Corporation (“Duke Energy”), including Duke Energy Carolinas’ service territory. I**  
9 **am also responsible for Duke Energy’s customer strategy and the development and**  
10 **implementation of new products and services for the retail market.**

11 **Q. ARE YOU THE SAME THEODORE E. SCHULTZ THAT PREVIOUSLY**  
12 **SPONSORED TESTIMONY IN THIS PROCEEDING?**

13 **A. Yes, I am.**

14 **Q. WHAT IS THE PURPOSE OF YOUR SETTLEMENT TESTIMONY?**

15 **A. The purpose of my testimony is to: (1) provide an overview of the Agreement and**  
16 **Joint Stipulation, dated June 12, 2009 (the “Agreement” or the “Settlement**  
17 **Agreement”) entered into by and among Duke Energy Carolinas and Southern**  
18 **Alliance for Clean Energy, Environmental Defense Fund, Natural Resources Defense**  
19 **Council, and Southern Environmental Law Center (collectively, the “Environmental**  
20 **Intervenors”), and the Public Staff of the North Carolina Utilities Commission (the**  
21 **“Public Staff”) (collectively, the “Settling Parties”); (2) explain certain features of the**  
22 **Agreement in detail; (3) compare and contrast those features to our initial proposal as**

presented in previously filed testimony; and (4) provide my view as to why this Agreement is in the public interest.

## II. THE AGREEMENT AND JOINT STIPULATION TERMS

**Q. PLEASE DESCRIBE SCHULTZ SETTLEMENT EXHIBIT NO.1.**

**A. Schultz Settlement Exhibit No. 1 is a copy of the Agreement.**

**Q. PLEASE DESCRIBE THE PROVISIONS OF THE AGREEMENT.**

**A. Exhibit C to the Agreement provides a "road map" of the positions of Duke Energy Carolinas as filed in its Application and direct testimony and exhibits in this proceeding, the positions of the Environmental Intervenors and the Public Staff as represented in their direct testimony and exhibits, and the resulting resolution of the issues between the Company and the Environmental Intervenors and the Public Staff. The substantive provisions of the comprehensive Agreement reached by the Settling Parties are contained in the Settlement Terms (Exhibit B to the Agreement). In summary, the Agreement proposes to provide even greater benefits to consumers than the Company's original filing by offering:**

1. More energy savings – By increasing the energy efficiency targets within a number of programs, the Company expects total energy savings to be more than 50% higher than the original proposal.

2. Greater transparency – The Company will recover lost revenues separate from the percentage of avoided cost payment.

3. Lower percentage of avoided cost – To address the Environmental Intervenors' and the Public Staff's concerns about profitability as well as to reflect the carve-out of net lost revenue recovery, the Company will be compensated on the basis of a lower percentage of avoided cost for energy efficiency and demand-side management programs. Under this modified save-a-watt proposal, the Company's compensation will vary for demand-side management and energy efficiency programs as follows:

Demand-Side Management % of Avoided Costs	Energy Efficiency % of Net Present Value ("NPV") of Avoided Costs
75%	50%

1                   4. Performance targets and earnings caps – Under the settlement, the  
2 Company is eligible to receive a higher level of incentive based on how well it  
3 performs. In addition, the Company's earnings opportunity is capped and is  
4 tied to the percentage of the target energy and capacity savings achieved. The  
5 performance targets and earnings caps are as follows:

% of Target Achievement	Earnings Cap (after taxes)
≥ 90%	15%
80% to 89%	12%
60% to 79%	9%
<60%	5%

6                   5. Greater stakeholder involvement – The Agreement provides for the  
7 creation of a Regional Efficiency Advisory Committee to review the  
8 measurement and verification process, collaborate on new program ideas, and  
9 review changes to existing programs.

10   Q.    HAVE ESSENTIAL ELEMENTS OF THE COMPANY'S ORIGINAL  
11       PROPOSAL BEEN PRESERVED?

12   A.    Yes. The Agreement continues several core concepts embodied in the Company's  
13 save-a-watt plan as filed in its original Application and direct testimonies and  
14 exhibits. First, the Agreement preserves the important goal of providing an incentive  
15 to the Company and its customers to be aggressive in developing new energy  
16 efficiency and demand-side management programs. The result is that the "saved  
17 watts" from the Company's Energy Efficiency Plan will enable the Company to  
18 address a portion of its capacity and energy requirements while simultaneously  
19 reducing environmental impacts and lowering customer bills. Second, the Agreement



1 continues the basic premise that the Company will only get paid for implementing  
2 programs that produce actual energy and capacity savings, as measured and verified  
3 by an independent third party. Under the Settlement Agreement, Duke Energy  
4 Carolinas continues to assume the risk of recovering its energy efficiency and  
5 demand-side management program costs or any management incentive based upon its  
6 performance. Finally, the Agreement reflects the concept that compensation for  
7 successful implementation of energy efficiency programs will be predicated on a  
8 discount to the "avoided costs" of a power plant to place energy efficiency and  
9 demand-side management on a level playing field with supply-side resources. Under  
10 the Settlement Agreement, Duke Energy Carolinas continues to assume the risk of  
11 recovering its energy efficiency and demand-side management program costs or any  
12 management incentive based upon its performance.

13 **Q. MR. SCHULTZ, IN YOUR OPINION IS THE SETTLEMENT AGREEMENT**  
14 **IN THE PUBLIC INTEREST?**

15 **A. Yes. The Agreement provides increased energy savings for customers, reduces green**  
16 **house gas emissions, and offers a fair earnings opportunity for shareholders for**  
17 **investments in energy efficiency and demand-side management investments. Further,**  
18 **the Agreement creates greater transparency to the Company's earnings opportunity by**  
19 **making lost revenues a direct recovery component of the rider and true-up**  
20 **calculations. Finally, there are performance targets tied to earnings caps that will**  
21 **ensure the Company's profits are just and reasonable. Duke Energy Carolinas**  
22 **believes the Agreement is an important step forward in transforming North Carolina**  
23 **to a more energy efficient economy.**

**III. AVOIDED COST-BASED COMPENSATION FOR RESULTS**

**Q. PLEASE EXPLAIN THE CALCULATION OF AVOIDED COSTS IN THE SETTLEMENT AGREEMENT, AND COMPARE THAT CALCULATION TO THE COMPANY'S INITIAL PROPOSAL.**

**A. The basic calculations of avoided capacity and energy costs are the same as initially proposed. Avoided capacity costs will be based on Duke Energy Carolinas' filed avoided cost rate, as the Company initially proposed, with one modification. Instead of updating the avoided costs with the bi-annual filed avoided cost rates, the avoided capacity costs under the Agreement will remain fixed using the 2007 approved avoided costs in Docket No. E-100, Sub 106. The calculation of the avoided energy costs will be the same as initially proposed by the Company. The avoided energy costs will be based on the avoided energy costs per the Company's Integrated Resource Plan, as described in the direct testimony of Company Witness Dr. Stevie. The avoided cost rates will not be otherwise updated during the term of the Agreement unless the filed biennial avoided capacity and energy cost rates change by more than 25%.**

**Q. PLEASE DESCRIBE THE CHANGES MADE TO THE AVOIDED COST PERCENTAGES USED FOR THE REVENUE REQUIREMENTS AND THE ULTIMATE COMPENSATION TO THE UTILITY.**

**A. The Company initially proposed that revenue requirements reflect 90% of the avoided capacity and energy costs produced by both demand-side management and energy efficiency programs – as compensation for program costs, lost revenues, and a management incentive. Three primary changes were made in the Settlement**

1 Agreement to the avoided cost percentage originally proposed by the Company.  
2 First, separate avoided cost percentages were developed for demand-side  
3 management and energy efficiency programs to ensure that the Company would be  
4 indifferent to implementation of either kind of program relative to the portfolio's  
5 overall profitability. Second, the recovery of lost revenues was carved out of the  
6 avoided cost compensation and treated as a direct recovery cost. And third, the  
7 percentages were lowered from 90% to 75% (avoided capacity costs) for demand-side  
8 management achievements, and to 50% (NPV of avoided lifetime capacity and  
9 energy costs) for energy efficiency programs. These percentages were lowered to  
10 address the Environmental Intervenors' and the Public Staff's concerns about  
11 profitability as well as to reflect the carve-out of net lost revenue recovery.

12 **IV. PERFORMANCE TARGETS AND EARNINGS CAPS**

13 **Q. PLEASE EXPLAIN THE SETTLEMENT AGREEMENT'S PERFORMANCE**  
14 **TARGETS AND EARNINGS CAPS, AND COMPARE THOSE TO THE**  
15 **COMPANY'S INITIAL PROPOSAL.**

16 **A.** The initial proposal contained neither performance targets nor earnings caps,  
17 reflecting the Company's belief that compensation for energy efficiency results, *i.e.*  
18 pay for performance, based on discounted avoided costs was a "win-win" proposition  
19 for both customers and the utility, and that such a model would sufficiently provide  
20 incentives to the utility to both control costs and achieve significant demand and  
21 energy savings. The Agreement, however, contains both performance targets and  
22 earnings caps, as additional assurances for customers. In addition, the Agreement  
23 reflects substantially increased efficiency results. The targeted savings achievement

1 of \$754 million (nominal system dollars) from programs implemented during the four  
 2 year term of the Agreement is based on the following targeted MW and cumulative  
 3 MWh savings:

<b>System Portfolio Impacts</b>					
<b>100% Participation</b>					
<b>Year</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>Beyond Year 4</b>
<b>MWh</b>	234,132	490,634	872,548	1,439,742	6,833,078
<b>MW</b>	368	548	735	844	259
<b>Note: Beyond Year 4 is just the EE impacts associated with Vintages 1 - 4</b>					

4 Based on these targeted portfolio savings, the Agreement contains tiered earnings  
 5 caps based upon varying levels of performance. Specifically:

<b>% of Target Achievement</b>	<b>Earnings Cap</b>
≥ 90%	15%
80% to 89%	12%
60% to 79%	9%
<60%	5%

6 Program costs will include marketing and advertising expenses, incentives paid to  
 7 customers, and the costs of impact evaluation studies. The return on program costs  
 8 will be simply a calculation of the percent return on investment on such portfolio  
 9 program costs on a nominal dollar basis after tax.

#### **V. REGIONAL EFFICIENCY ADVISORY COMMITTEE**

10 **Q. PLEASE EXPLAIN THE SETTLEMENT AGREEMENT PROVISIONS**  
 11 **RELATING TO THE REGIONAL EFFICIENCY ADVISORY COMMITTEE.**

12 **A.** As in our initial proposal, the Agreement recognizes that the successful development  
 13 and implementation of energy efficiency programs requires constant monitoring and  
 14 modification, and that an advisory group is helpful in that regard. Specifically, the  
 15 Agreement specifies that a Regional Advisory Committee will be established for the

1 term of this Agreement. The role of the advisory group is to collaborate on new  
2 program ideas, review modifications to existing programs, ensure greater public  
3 understanding of the programs and funding, and review the measurement and  
4 verification process. The regional efficiency advisory group will meet at least twice  
5 each year and may establish working groups on specific topics. The Settling Parties  
6 envision that the advisory group will be comprised of a broad spectrum of regional  
7 stakeholders that represent balanced interests in the programs, as well as national  
8 energy efficiency advocates and experts. A third party will facilitate the advisory  
9 group's discussions.

## 10 VI. CONCLUSION

11 Q. PLEASE SUMMARIZE WHY YOU BELIEVE THE SETTLEMENT  
12 AGREEMENT IS GOOD FOR CUSTOMERS AND SHOULD BE ACCEPTED  
13 BY THE COMMISSION.

14 A. The Agreement is good for customers for a number of reasons. First and foremost,  
15 the Agreement sets an aggressive target for the Company to deliver \$754 million of  
16 avoided future generation costs. This is a dramatic increase in results from energy  
17 efficiency and demand-side management programs for the Carolinas. Energy  
18 efficiency and demand-side management programs (1) create avoided future  
19 generation costs for all customers, (2) meet customer demand for electricity with a  
20 zero-emission resource, and (3) lower usage and bills for customers who participate  
21 in Duke Energy Carolinas' programs. These results reflect Duke Energy's core save-  
22 a-watt vision – a utility-sponsored approach to energy efficiency and demand-side  
23 management that will stimulate investment and innovation in products and services,

1 on the one hand, and widespread customer participation on the other. The Settlement  
2 Agreement maintains incentives for the Company to pursue energy efficiency and  
3 demand-side management comparable to the incentives utilities have to pursue  
4 supply-side investments; a revenue stream based on discounted avoided supply-side  
5 costs; and pay for performance, based on independently verified results. At the same  
6 time, through negotiation and compromise, the Agreement contains a number of  
7 customer protections, such as performance targets and earnings caps. For these  
8 reasons, I believe the Settlement Agreement is in the public interest and should be  
9 accepted by the Commission as a fair and reasonable resolution of the issues in this  
10 proceeding.

11 **Q. IS THE COMPANY PRESENTING TESTIMONY OF OTHER WITNESSES**  
12 **IN SUPPORT OF THE SETTLEMENT?**

13 **A.** Yes, Duke Energy Carolinas' Witnesses Farmer and Wiles also are presenting  
14 testimony in support of the settlement. Witness Farmer discusses changes to Rider  
15 EE (NC) necessitated by the settlement and Witness Wiles discusses the accounting  
16 and reporting implications of the settlement on the Company's original filing.

17 **Q. DOES THIS COMPLETE YOUR SETTLEMENT TESTIMONY?**

18 **A.** Yes, it does.

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1 Q. Mr. Schultz, do you have a summary of your  
2 settlement testimony?

3 A. Yes, I do.

4 Q. Would you please provide that at this time?

5 (THE SUMMARY OF THE PREFILED TESTIMONY OF THEODORE  
6 SCHULTZ WILL BE COPIED INTO THE RECORD AS GIVEN  
7 ORALLY FROM THE WITNESS STAND.)

**DUKE ENERGY CAROLINAS, LLC**  
**Docket No. E-7, Sub 831**  
**SUMMARY OF SETTLEMENT TESTIMONY OF**  
**THEODORE E. SCHULTZ**

1           The purpose of my testimony is to provide an overview of the Agreement and Joint  
2   Stipulation, dated June 12, 2009, entered into by and among Duke Energy Carolinas and  
3   Southern Alliance for Clean Energy, Environmental Defense Fund, Natural Resources  
4   Defense Council, and Southern Environmental Law Center, and the Public Staff. In my  
5   settlement testimony, I explain certain features of the modified "save-a-watt" incentive  
6   model outlined in the Agreement and compare and contrast those features to our initial  
7   proposal as presented in previously filed testimony in this docket. In addition, I state my  
8   view as to why this Agreement is in the public interest.

9           In summary, the Agreement proposes to provide even greater benefits to consumers  
10   than the Company's original filing by offering more energy savings, greater transparency,  
11   performance targets and earnings caps, and greater stakeholder involvement.

12           Despite some differences from the Company's original proposal, the Agreement  
13   continues several core concepts embodied in the Company's save-a-watt plan as filed in its  
14   original Application and direct testimonies and exhibits. Specifically, the Agreement  
15   preserves the important goal of providing an incentive to the Company and its customers to  
16   be aggressive in developing new energy efficiency and demand-side management programs.  
17   Second, the Agreement continues the basic premise that the Company will only get paid for  
18   implementing programs that produce actual energy and capacity savings, as measured and  
19   verified by an independent third party. Finally, the Agreement reflects the concept that  
20   compensation for successful implementation of energy efficiency programs will be



1 predicated on a discount to the "avoided costs" of a power plant to place energy efficiency  
2 and demand-side management on a more level playing field with supply-side resources.

3 In my opinion, the Settlement Agreement is in the Public Interest for a number of  
4 reasons. First and foremost, the Agreement sets an aggressive target for the Company to  
5 deliver \$754 million of avoided future generation costs, which represents an increase in  
6 projected energy savings for customers over the Company's original filing. The Agreement  
7 also creates greater transparency to the Company's earnings opportunity by making net lost  
8 revenues a direct recovery component of the rider and true-up calculations. Finally, the  
9 Agreement specifies certain earnings caps levels that are tied to the Company's performance  
10 that will ensure the Company's profits are just and reasonable. For these reasons, I believe  
11 the Settlement Agreement is in the public interest and should be accepted by the Commission  
12 as a fair and reasonable resolution of the issues in this proceeding.

13 This concludes the summary of my settlement testimony.

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1 MS. HEIGEL: Mr. Schultz is now available  
2 for cross examination.

3 CHAIRMAN FINLEY: Cross examination?

4 MS. FENTRESS: No questions from the  
5 Public Staff.

6 MR. GREEN: Thank you, Mr. Chairman.

7 CROSS EXAMINATION BY MR. GREEN:

8 Q. Good morning, Mr. Schultz.

9 A. Good morning, Mr. Green.

10 Q. On page 4 and 5 of your testimony beginning on line  
11 19 you state, "The second -- the agreement --  
12 second, the Agreement continues the basic premise  
13 that the Company will only get paid for  
14 implementing programs that produce actual energy  
15 and capacity savings as measured and verified by an  
16 independent third party." Is that correct?

17 A. That's correct.

18 Q. By that testimony are you saying that the  
19 measurement and verification procedures are the  
20 same under the original SAW proposal and the  
21 Settlement Agreement?

22 A. The process for the measurement and verification is  
23 the same as the original proposal with I believe  
24 one modification in the Settlement Agreement having

1 to do with free ridership.

2 MR. GREEN: May I approach the witness?

3 CHAIRMAN FINLEY: Yes, sir.

4 Q. What I've handed you are pages 26, 27, and 28 of  
5 Dr. Stevie's initial testimony here. I would like  
6 to ask you to read a few lines of that testimony.  
7 First, if you'll read on pages 27 and 28 beginning  
8 on line 18 through line 5 of 28.

9 A. Page 27, line 18. "The timing of the availability  
10 of participant and load impact results has  
11 implications for the reconciliation and true-up  
12 process. I expect that the first true-up process  
13 the Company will have actual participant  
14 information and possibly some load impact results,  
15 most likely for demand response programs unless the  
16 timing of the true-up filing is during or  
17 immediately after the summer period. Load impact  
18 results for all programs will not be available  
19 until completion of the second year of program  
20 implementation. At that point, a true-up of load  
21 impacts can be undertaken from the beginning of the  
22 program through the second year."

23 Q. And on through lines 4 and 5 also. I'm sorry.

24 A. "In general, the Company anticipates that the

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1 participant results would be reconciled each year  
2 and load impact results every other year. However,  
3 updates to the load impact results would only be  
4 reconciled back to the previous impact evaluation,  
5 not to the beginning of the program."

6 Q. Based on Dr. Stevie's testimony and particularly  
7 lines 4 and 5 on page 28, didn't the Company say in  
8 the initial SAW proposal that participant results  
9 would be reviewed and adjusted every year during  
10 the programs?

11 A. Yes.

12 Q. And further, didn't the companies say that the load  
13 impacts of the SAW programs, meaning the energy  
14 efficiency savings, would be reviewed and adjusted  
15 every year?

16 Q. Yes. But I don't think -- I take that back. We --  
17 I think we provided a measurement and verification  
18 schedule so any load impact studies that were done  
19 would be factored into the evaluation of the  
20 programs annually.

21 Q. Okay. And would you also read Dr. Stevie's  
22 testimony on page 26, lines 5 and 6?

23 A. Twenty-six, lines 5 and 6. "Duke Energy Carolinas  
24 estimates that 5 percent of total program cost will

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1           be required to adequately and efficiently perform  
2           evaluations, monitoring, and verification."

3   Q.       What percentage of the total program cost does Duke  
4           estimate will be required to perform the  
5           evaluations, monitoring, and verification of the  
6           programs under the Settlement Agreement?

7   A.       5 percent.

8   Q.       Would you look at page 18 of the Settlement  
9           Agreement, which is Schultz Exhibit B?

10  A.       I'm there.

11  Q.       All right. Would you read the last sentence of the  
12           second paragraph under section two?

13  A.       "For purposes of this agreement, avoided cost  
14           savings related to the energy efficiency programs  
15           incorporate savings through the entire life of  
16           measures installed during the four-year term of the  
17           agreement. Avoided cost savings related to demand  
18           side measures include only savings experienced  
19           during the same term."

20  Q.       The word term as used in the agreement means the  
21           four-year term of the plan, is that correct?

22  A.       That's correct.

23  Q.       What that statement says is that energy efficiency  
24           programs -- for those programs energy efficiency

1 savings that Duke will be paid for will include  
2 energy savings for the life of the programs for  
3 energy efficiency measure, not just for the four  
4 years of the pilot SAW program. Is that correct?

5 A. That is correct.

6 Q. On the other hand, for demand side management  
7 programs the incentives and so forth will be paid  
8 only for the four-year term of the SAW program. Is  
9 that correct?

10 A. Yes. As part of the Settlement Agreement we split  
11 out demand side management programs from energy  
12 efficiency programs. The demand side management  
13 programs we looked at as a one-year term so they  
14 are paid just for a single year. The energy  
15 efficiency program, you look at the benefits of  
16 those programs and present value goes back. That's  
17 how it's determined.

18 Q. So for the energy efficiency programs, if you have  
19 a program life of say eight years, then the  
20 incentives that the Company will receive will be  
21 based on energy efficiency savings over the eight-  
22 year life of the program?

23 A. That's correct.

24 Q. But the only verification of those savings will be

1           at the four-year end of the term of the Settlement  
2           Agreement. Is that correct?

3   A.       Correct. The measurement and verification true-up  
4           process will be at the end of the four years. The  
5           measurement and verification process takes place  
6           all four years.

7   Q.       And after those four years, for example, if there  
8           is an eight-year program, then the savings that the  
9           Company's incentives and payments are based on for  
10          the following four years are what are called  
11          presumed savings. Is that correct?

12   A.       Correct. They are based on the M and V studies and  
13          best practices. Those would be the savings  
14          projected for that for the next four years also.

15   Q.       For example, if a consumer installs a compact  
16          fluorescent light bulb or CFL under the save-a-watt  
17          program, then Duke will receive compensation based  
18          on energy savings for the life of the CFL, not just  
19          for the four years of the pilot program. Is that  
20          correct?

21   A.       That is correct. They receive benefit for the  
22          useful life of that particular product, which is  
23          five years.

24   Q.       The useful life of a CFL is five years?

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1 A. That's what we have in our estimates is five years.  
2 That's correct.

3 Q. What is the annual kilowatt hour savings of a CFL,  
4 do you know?

5 A. I don't know off the top of my head. Dr. Stevie is  
6 here to -- and glad to go into great detail.

7 Q. Just assume that it saves 20-kilowatt hours a year.  
8 I don't know whether that's accurate or not, but  
9 just for our purposes if you would make that  
10 assumption. Under the Settlement Agreement, if the  
11 monitoring and verification process confirmed that  
12 the CFL installed by customer A would save  
13 20-kilowatt hours per year, then Duke would receive  
14 compensation for that CFL based on the total of 100  
15 kilowatt hours saved. Is that accurate?

16 A. Present valued back to today. That's correct.

17 Q. That's the 20-kilowatt hours saved plus the -- or  
18 times the five years of the program life?

19 A. Correct.

20 Q. Verification of that 20-kilowatt hours per year  
21 would occur when under the -- under the proposed  
22 agreement?

23 A. Again, they'd have to go back. Dr. Stevie in his  
24 original testimony actually provided a schedule for



1 every one the programs. So CFL's were laid out in  
2 there, and I don't remember the exact schedule.  
3 But I assume it would be the year after. CFLs  
4 happen to be one that's very well measured and  
5 verified and with pretty solid results. They don't  
6 change a whole lot these days.

7 Q. What would happen if the energy savings were  
8 presumed to continue for five years but the  
9 customer replaced the CFL with an LED after three  
10 years?

11 A. What would happen if the customer replaced the CFL  
12 with an LED after three years?

13 MS. HEIGEL: Mr. Chairman, I'm going to  
14 object to the line of questioning because this --  
15 the M and V protocols as filed by Dr. Stevie in his  
16 original testimony have not changed with the one  
17 exception that Mr. Schultz noted as part of the  
18 settlement. And if he would like to ask these  
19 questions, we would be more than happy to put Dr.  
20 Stevie back up to the extent that he wishes to make  
21 some points relative to those issues.

22 CHAIRMAN FINLEY: Have you got the right  
23 witness here, Mr. Green?

24 MR. GREEN: I mean, he testified that the

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1           -- it continues the basic premise that the Company  
2           will only get paid for implementing programs that  
3           produce actual energy and capacity savings as  
4           measured and verified by an independent third  
5           party. So that --

6                   CHAIRMAN FINLEY: All right. I'll  
7           overrule the objection. Mr. Schultz, answer as  
8           best you can. But you think you're getting into  
9           something that is best answered by Mr. Stevie, you  
10          let Mr. Green know that if you don't mind.

11                   THE WITNESS: Okay.

12   Q.        (By Mr. Green) Let me restate the question. If the  
13           customer who has participated in the CFL program  
14           replaces the CFL bulb with an LED light after three  
15           years, then wouldn't there be two years of presumed  
16           savings that Duke would receive payment for that  
17           don't actually occur?

18   A.        Yes. Assuming the LED is more efficient than the  
19           CFL, then there would be greater efficiency than  
20           what we're being paid for. Correct.

21                   MR. GREEN: Those are all my questions,  
22           Mr. Chairman.

23                   CHAIRMAN FINLEY: All right. Mr. Runkle?

24   CROSS EXAMINATION BY MR. RUNKLE:

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- 1 Q. Good morning, Mr. Schultz.
- 2 A. Good morning.
- 3 Q. Looking at your -- the Exhibit B that's on page 18,
- 4 which is the -- I think it was numbered the first
- 5 time as part of the stipulation's settlement terms.
- 6 Do you have that in front of you?
- 7 A. I do.
- 8 Q. All right. Looking at paragraph three, which is
- 9 the program year in energy savings?
- 10 A. Is there a letter? A.3?
- 11 Q. 3.A. is energy efficiency.
- 12 A. Page 16?
- 13 Q. Page 18.
- 14 A. Page 18. Yes.
- 15 Q. So we are looking at vintage one with energy
- 16 savings of .31 percent.
- 17 A. Yes, .31 percent.
- 18 Q. Okay. What is the first vintage year?
- 19 A. The first -- first vintage year -- oh, let me -- as
- 20 laid out in this Settlement Agreement, and I think
- 21 it's on the next page, if you go to page 19, the
- 22 second paragraph will say at the end of the second
- 23 paragraph, last line, "Vintage year one may be more
- 24 than 12 months as a result." So assuming there's

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1 an approval in 2009, vintage year one would be  
2 what's remaining in 2009 through 2010.

3 Q. Okay. And so the .31 percent energy savings is a  
4 percentage of what, now? What was the -- what was  
5 the base measure for that number?

6 A. 2010.

7 Q. It's 2010 what? Is it total sales of retail sales  
8 or --

9 A. Total retail sales.

10 Q. Okay. So that's -- is that Duke's retail sales in  
11 North Carolina?

12 A. It is a system number, so it's done on a system  
13 basis. The planning for its North Carolina system  
14 plan is .31 percent of the system.

15 Q. And is that -- does Duke have that same arrangement  
16 now in South Carolina?

17 A. We have no arrangement right now in South Carolina.

18 Q. So after the -- the four vintage years -- so 2010,  
19 11, 12, and 13 -- starting in 2014 what happens?

20 A. I think as the settlement term agreement points  
21 out, at the end of the four-year term, again, we'd  
22 would have to go forward and provide a proceeding  
23 for what happens after the four-year term is up.  
24 Assuming great results, I would expect something

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1 similar.

2 Q. Now, I understand from reading some of the other  
3 testimony that you're looking at a 1 percent a year  
4 savings after 2014?

5 A. That's correct.

6 Q. And so I'm talking -- as somebody -- as a --  
7 representing a party that was not party to the  
8 settlement discussions, I'm trying to determine  
9 what Duke's commitment is here. Are -- is Duke  
10 committed to the -- the first four vintage years of  
11 .31 to .75 percent?

12 A. Two different things. The long-term performance is  
13 actually on page 21, which lays out the 1 percent  
14 of 2009 sales per year. It's in item E. on 21. So  
15 our -- our commitment is to go after all  
16 cost-effective energy efficiency. This agreement  
17 is for four years. Over those four years we are --  
18 have set targets to hit avoided cost of \$754  
19 million, which are made up of energy efficiency  
20 savings which were determined by the percentages  
21 you see here plus demand side management savings to  
22 total 754 million for the four years.

23 Q. Is -- is that the -- you know, looking at -- based  
24 on your knowledge of energy efficiency programs and

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1           then Duke Energy's potential, are you going to meet  
2           those target goals?

3   A.       Well, those target goals are aggressive. And our  
4           intent is, obviously, to meet those goals. So it  
5           will take -- it will require innovation and new  
6           programs. It's been two years since we originally  
7           filed. I have the utmost confidence in my team's  
8           ability to understand customers and to deliver the  
9           results. But it will take new programs. Let's be  
10          clear.

11   Q.       And so what is the minimum amount that Duke can do  
12           under this Settlement Agreement? Is it zero a  
13           year? I mean these are target goals, aren't they?  
14           I mean, it's not -- they're not something that  
15           you're mandated to accomplish. They're -- they're  
16           just target goals.

17   A.       Well, again, in the save-a-watt model we're paid on  
18           results. So if we want to lose a lot of money we  
19           could get no results and go after energy  
20           efficiency. So yeah, these are -- meet our  
21           interest. Again, save-a-watt model is meant to put  
22           energy efficiency on an equivalent playing field  
23           with supply-side resources. We believe this  
24           agreement does that, are we are committed to a

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1           fairly aggressive target to go after all  
2           cost-effective energy efficiency.

3   Q.       But if you spent no money on energy efficiency you  
4           don't get any penalties; you don't get any profit.  
5           Is that correct?

6   A.       If we spent no money on energy efficiency --

7   Q.       You'd have no cost, you'd have nothing to recover,  
8           you'd get no profits on it.

9   A.       If we didn't -- if we didn't do anything on energy  
10          efficiency, then several of us would have to leave  
11          the Company, but there would be no cost.

12   Q.       Exactly.

13   A.       And then you'd be where you need to be.

14   Q.       So I'm trying to -- I'm trying to determine what  
15          actually is -- has the Company committed to under  
16          this stipulation agreement. You're going to try --  
17          you said we have this commitment. We're going to  
18          try to reach these goals. If we meet the goals we  
19          can recover our costs, we can get our incentives,  
20          we can, you know, make some profit on this. You  
21          keep your job. But it's a commitment, is it not?  
22          I'm trying to figure out how -- how -- you know, is  
23          it -- this is a discretionary commitment. It's  
24          something you're going to try to do, but you don't

1 have to do it, do you, under this agreement?

2 A. Our intent in this agreement is to go after 754  
3 million with everything we've got. So I think you  
4 heard Mr. Rogers in the initial discussion. I  
5 mean, this is -- our commitment is to go after it.  
6 This is a framework. You know, why wouldn't we go  
7 after it? I mean, that's the whole intent of this  
8 agreement is to set up a framework that puts it on  
9 an equal playing field with supply-side resources  
10 and to go after all cost-effective that we can get.  
11 We believe this agreement does that.

12 Q. And you feel it's aggressive, but do you feel it's  
13 also something that Duke can accomplish in the  
14 first four years?

15 A. Yes. I mean, it will take some innovation. My  
16 team has been working very hard, and we've got some  
17 really, really great programs under development  
18 that I think will -- will help us get there.

19 Q. Would the -- would the Company, then, since it --  
20 it seems to be a fairly strong commitment by the  
21 Company to have this Commission mandate that in the  
22 first four years you will accomplish these goals?

23 A. Well, I think we have taken a different tack from  
24 the mandate approach to create something that



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1 really aligns all parties and their interests. And  
2 again, we've agreed with the environmentalist  
3 groups, the Public Staff. The whole idea was to  
4 get alignment so we're all working together.

5 So, again, mandates typically set you at  
6 a -- you know, are you going to hit a minimum  
7 threshold. The whole intent here was to get all of  
8 our interests aligned, to work together and to do  
9 things that we haven't done before. And we think  
10 this accomplishes that.

11 Q. Well, in your position as -- as vice president of  
12 marketing and energy efficiency, would a -- would a  
13 strong statement from the Commission help you meet  
14 these goals or are you just -- you know, if the  
15 Commission says you will do this will that help you  
16 accomplish that or is it just -- it just doesn't  
17 mean anything to you?

18 A. Well, obviously, any order from the Commission we  
19 will do our best to comply with. But the fact is,  
20 you have to get these numbers in the market. So we  
21 have to produce programs that customers value and  
22 they're willing to participate in. So whether a  
23 mandate or an incentive or any structure,  
24 ultimately the decision is made by customers

1 purchasing and participating in the program. And  
2 that process is going to be the same. We are going  
3 after all of it.

4 Q. Now, inside the Company there would -- there are  
5 other ways that the Company has cost and make  
6 profits, are there not? I mean, building new power  
7 plants, for one. Certainly, there's a lot of  
8 costs. There could be potential profits in that in  
9 additional -- excuse me, profits in additional  
10 sales of electricity to customers?

11 A. Yes, there are other ways that -- that we make  
12 money. And this agreement sets us on a playing  
13 field to have the investments in energy efficiency  
14 compete with those on the supply side.

15 Q. Now, in your -- in your position as vice president  
16 of marketing and the energy efficiency, what  
17 happens if, you know, there is another project --  
18 you've got coal plants being considered, nuclear  
19 power plants being considered. Do you make the --  
20 do you personally make the decision to go with this  
21 energy efficiency programs or just -- who makes the  
22 decisions on whether to go with an aggressive  
23 energy efficiency program or, you know, building  
24 new plants?

1 A. There's probably two things there. My -- my  
2 directive is to get all the energy efficiency and  
3 demand-side management resources that we can get  
4 that are cost effective. And that's an input into  
5 our integrated resource plan. The integrated  
6 resource plan determines which plants are needed  
7 and get built and when.

8 Q. And part of that would be how much potential profit  
9 the Company can make on those decisions. Is that  
10 correct?

11 A. I am not part of the integrated resource plan. My  
12 -- again, my role in the plan is very simple. I  
13 input the energy efficiency and demand-side  
14 resources to be considered in that plan and what  
15 they cost to do.

16 Q. Okay. Do you have in front of you Mr. Wilson's  
17 testimony, particularly his Exhibit No. 2, which is  
18 a chart, Cumulative Energy Savings Impact of Energy  
19 Efficiency Programs Assuming Targets and Agreements  
20 Are Achieved and Maintained?

21 A. Can you give me the page number, please?

22 Q. It's Exhibit 2. It's after his resume at the end  
23 of his testimony.

24 A. Yes, I do.

1 Q. And if you'd just look at that and --

2 MR. RUNKLE: Mr. Chairman, may I approach  
3 the witness?

4 CHAIRMAN FINLEY: Yes, sir.

5 MR. RUNKLE: And rather than for all of  
6 us to dig this out, it's NC WARN Rogers Cross  
7 Exhibit 1.

8 Q. This exhibit was admitted into evidence. It's NC  
9 WARN Rogers Cross Exhibit 1, which started with Ms.  
10 Hager's Supplemental Exhibit No. 2 which shows the  
11 energy it -- efficiency impacts, the bottom line is  
12 the save-a-watt is filed. The next line with the -  
13 - the little rectangles is the save-a-watt that's  
14 in the IRP.

15 And then the -- the line with the squares  
16 going up to the right is the -- what Mr. Rogers  
17 characterized as a commitment to the National  
18 Energy Efficiency Association. Were you here for  
19 his testimony or are you familiar with this  
20 exhibit?

21 A. I wouldn't say I'm familiar with it, but I remember  
22 this exhibit. I haven't studied it or anything.

23 Q. And then the -- the one on the left is an exhibit I  
24 actually had, was -- was Dr. Blackburn's

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1 recommendation of a 10 percent goal over ten years  
2 starting in 2008, which -- we're now looking at a  
3 vintage year of 2010. And that's why I wanted to --  
4 - to also have you look at Mr. Wilson's Exhibit No.  
5 2, which is actually a middle line in here between  
6 Dr. Blackburn's recommendation and the national  
7 commitment, is it not?

8 A. Let's see. I haven't plotted that line, but it  
9 looks like it would -- let's see --

10 Q. Looking at a 2010 --

11 A. (Witness performs calculations.) It looks like it  
12 would be between those two.

13 Q. With a four-year ramp up. I think that would be a  
14 way to characterize those first four vintage years,  
15 and then with a goal of 1 percent a year after  
16 that. Is that correct?

17 A. Correct.

18 Q. So in looking at Mr. Rogers' testimony of last year  
19 with a national commitment, basically what Duke has  
20 done is just move that national commitment up a  
21 couple of years, is it not?

22 A. No. The national commitment hasn't changed at all.  
23 It's still starting in 2015 and 1 percent a year.  
24 Starting in -- 1 percent of 2009 sales starting in

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1           2015 and every year thereafter.

2   Q.       And is that part of -- is that same national  
3           commitment part of Duke's target goals under the  
4           Settlement Agreement?

5   A.       The Settlement Agreement targets are a ramp-up  
6           towards achieving that 1 percent per year.

7   Q.       Okay. So again, after the first four-year ramp-up  
8           is Duke still committed to the 1 percent a year  
9           savings?

10   A.      Again, the 1 percent a year savings are subject to  
11           approval of save-a-watt. So assuming that  
12           save-a-watt was in place, that commitment would  
13           still -- would stand.

14   Q.      Okay. And again, as we talked about the -- after  
15           the four-year ramp-up, how strong of a commitment  
16           is that from Duke? Is this something that Duke is  
17           going to do or is it just looking out, you know,  
18           over the next decade and saying that's our goal?

19   Q.      No. Duke is clearly committed long term. I think  
20           in, you know, something as -- you know, it's an  
21           innovative new approach to go after energy  
22           efficiency. And all the parties agreed that after  
23           four years let's look at it. What did we learn?  
24           What should we be doing going forward? If we're

1           very successful and it's working very well, then I  
2           would expect something like that going forward.  
3           But it didn't limit our commitment to energy  
4           efficiency in any way, shape, or form. It was for  
5           all of us to learn together and to come back and  
6           say what should we do following the four years.  
7           It's one of those things that -- what if we're  
8           right?

9   Q.       So the -- the -- so -- let me get this straight now  
10           since -- again, my client wasn't part of these  
11           discussions. Duke has a fairly firm commitment  
12           over the first four years of the ramp-up. You say  
13           that the goals are ambitious, but it's something  
14           that you feel strongly that Duke can accomplish.  
15           Would that be a fair characterization?

16   A.       Yes.

17   Q.       And then after the -- after the four years you will  
18           come back to the Commission and say we think at  
19           that time we need to reassess, but looking at  
20           August 2009 we think we can do 1 percent a year.  
21           And -- I mean, is that where you are right now?

22   A.       We are designing our programs to go after all  
23           cost-effective energy efficiency and striving  
24           towards the commitments that are here in this

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1 four-year plan and our national commitment assuming  
2 we still have the save-a-watt mechanism in place at  
3 1 percent a year.

4 Q. I have some questions about net lost revenues.  
5 Would Mr. Farmer probably be better to ask about  
6 those kind of specifics in part of the program?

7 A. I believe Dr. Stevie depending on whether it's an  
8 accounting issue or a conceptual issue. He filed -  
9 - he supported the -- the responses that we filed  
10 on net lost revenues.

11 Q. I think it was in Mr. Farmer's testimony. Let me  
12 ask Mr. Farmer when he -- when he comes up. We'll  
13 see if we can do it from there so --

14 MR. RUNKLE: I have no further questions  
15 for the witness, Your Honor.

16 CHAIRMAN FINLEY: Further questions of  
17 interveners?

18 MR. HOLTZMAN: No, sir.

19 MS. THOMPSON: No, thank you, Mr.  
20 Chairman. No questions.

21 MR. OLSON: We have no questions.

22 MR. MCDONALD: No questions.

23 MR. PAGE: Would I be allowed to ask the  
24 witness just about three or four questions?



1 CHAIRMAN FINLEY: Always, Mr. Page.

2 CROSS EXAMINATION BY MR. PAGE:

3 MR. PAGE: Let me first of all identify  
4 myself for the record. I apologize for being late,  
5 but I had it on my calendar for 9:30. I am Bob  
6 Page of the Raleigh law firm Crisp, Page & Currin.  
7 I represent Carolina Utility Customer Association.

8 Q. Good morning, Mr. Schultz. How are you doing?

9 A. Good. How are you?

10 Q. I know it's a little early for lunch, but I want to  
11 ask you to go along with me to the cafeteria line.  
12 Can we do that just for a couple of minutes this  
13 morning?

14 A. Sure.

15 Q. You will recall that one of the positions of my  
16 client, that is a group of large industrial  
17 customers, some of Duke's largest users, has taken  
18 is that the save-a-watt proposal originally, and as  
19 we understand it in the supplement, is an all-or-  
20 nothing proposition for industrial users. That is,  
21 if they come into it, they pay for every one of the  
22 programs; if they stay out of it, they pay for  
23 nothing. Is that a correct statement?

24 A. That's correct.

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1 Q. All right. Does Duke have any plans to offer  
2 energy efficiency and demand-side management  
3 programs to industrial customers where they can  
4 select only those and pay for only those that would  
5 benefit them and not pay for the other parts of the  
6 program?

7 A. We do not have a cafeteria style where you select  
8 individual programs.

9 Q. All right. Is that one of the issues that,  
10 depending on the results of the pilot program, Duke  
11 would be willing to revisit?

12 A. I think the place to look for what could work would  
13 be what we did in Indiana with the industrial  
14 customers. I think that the difficulty here is  
15 Senate Bill 3 is pretty clear on the rules and the  
16 opt-out. In Indiana we did separate demand-side  
17 management from energy efficiency working directly  
18 with the industrial customers.

19 Q. All right. You can certainly understand the  
20 reluctance of an industrial customer who is already  
21 implementing three or four of the programs that  
22 Duke is offering to sign up for one program that  
23 might benefit that customer and end up paying for  
24 all of them.

1 A. Yes.

2 MR. PAGE: Thank you. That's all I have.

3 CHAIRMAN FINLEY: Redirect?

4 MS. HEIGEL: Yes.

5 REDIRECT EXAMINATION BY MS. HEIGEL:

6 Q. Mr. Schultz, could you explain to the Commission  
7 why you believe it's appropriate to capture the net  
8 present value of energy efficiency savings in the  
9 year in which the Company makes it spent on those  
10 programs?

11 A. Yeah, they -- we spend the money up front on energy  
12 efficiency. All the costs are actually incurred in  
13 the first year. There's a stream of benefits, and  
14 it's appropriate from our point of view to bring  
15 those benefits back to present value and  
16 essentially in that vintage year, in the year in  
17 which the program was installed. What it does is  
18 at the end of the four years, since it's a  
19 four-year agreement, you have the fifth year of  
20 true-up that you go through. But you're --  
21 essentially, you've closed the books at the end of  
22 that fifth year on the four-year -- all the  
23 programs. So it keeps it very clean and very  
24 simple.

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1 Q. But energy efficiency creates future benefits; and  
2 depending on the measure involved, it may be a  
3 varying number of years. Isn't that your  
4 testimony?

5 A. Yes. Energy efficiency creates benefits for five  
6 to 15 years. And quite frankly, it's unlikely that  
7 the replacement would ever go backwards. So I  
8 think it's more a perpetuity investment for which  
9 we take a useful life of five or 15 years depending  
10 on the measure.

11 Q. Now, demand-side management programs, on the other  
12 hand, do those create future benefits?

13 A. No. Demand-side management programs are a benefit  
14 for the year in which they incur. So, in other  
15 words, they're equivalent to a peaking station. So  
16 every year you can look at those and they're either  
17 there or they're not. And if they're there, they  
18 have benefit for the year that they're there.

19 Q. So the -- oh, I'm sorry. Go ahead.

20 A. So the -- so there's no continuing automatic  
21 benefit like energy efficiency programs, which have  
22 a useful life. Now, we may keep that for ten  
23 years, but every year it's a decision whether you  
24 have it or not.

1 Q. All right. So the right to interrupt -- the  
2 Company's right to interrupt is year by year?

3 A. That's correct.

4 Q. You stated in response to Mr. Green's questioning  
5 that the measurement verification process was an  
6 ongoing process. Can you elaborate a little bit  
7 more on that?

8 A. Yes. There was actually a schedule in Dr. Stevie's  
9 original testimony that laid out each of the  
10 programs. So we -- we come into this with  
11 measurement verification on some measures that we  
12 have in other states. We use experts from outside,  
13 and then we continue that process. So we will put  
14 different programs in. It'll be measured  
15 throughout the course of those four years. Every  
16 time we do a measurement and verification in a  
17 given year, we go back and look at the programs and  
18 update them for cost effectiveness and what they  
19 look like going forward. So we never get way out  
20 of balance, so to speak.

21 Q. Okay. And do you recall -- does the Company's  
22 measurement and verification process measure  
23 persistence?

24 A. Yes, it does.

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1 Q. So under Mr. Green's example of a CFL been switched  
2 out after three years, would that be captured in  
3 the Company's M and V result?

4 A. Yes, it would. Persistence is does that measure  
5 stay in place.

6 Q. Mr. Runkle had asked you a question in regards to  
7 the system benefits of the Company's proposal. Has  
8 the Company made a new proposal in South Carolina  
9 similar to the settlement here in North Carolina?

10 A. Yes, we have made a similar proposal to what's the  
11 settlement here in North Carolina.

12 Q. You also had a number of exchanges with Mr. Runkle  
13 about our targets and the Company's commitment to  
14 those targets. Does the Company bear risk if it  
15 doesn't meet its targets?

16 A. Yes. The Company still is paid on results, so we  
17 bear the risk if those targets are not achieved.  
18 And again, this is the model that, you know, if we  
19 don't hit the -- the targets, don't do it in a  
20 cost-effective manner, program cost, then we end up  
21 losing money.

22 Q. And has Duke begun to implement any energy  
23 efficiency programs?

24 A. Yes, we have. We started on June 1.

1 Q. And so I would assume from that that the Company  
2 has begun to spend money?

3 A. Yes, we have.

4 Q. Are the Company's results dependent upon Company or  
5 customer acceptance of the Company's programs?

6 A. Yes. I think I tried to make that pretty clear.  
7 If customers don't participate in the programs,  
8 then there are no results.

9 Q. So as it relates to the Company's commitment that's  
10 set forth in the Settlement Agreement, a  
11 substantial portion of the Company's ability or all  
12 of the Company's ability to meet their targets is  
13 really customer dependent?

14 A. Yes.

15 Q. In terms of whether you have a mandate or a  
16 commitment to meet these results, does the Company  
17 rely upon -- has the Company relied upon or will  
18 the Company rely upon results that we have targeted  
19 for purposes of its integrated resource planning  
20 process?

21 A. Could you repeat that please?

22 Q. Are these targets reflected in the Company's  
23 integrated resource planning process?

24 A. Yes. The integrated resource planning process will

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1           have a base and then it will have a sensitivity.  
2           And in that sensitivity would be this aggressive  
3           case that is in this settlement.

4   Q.       So in your estimation, what would the repercussions  
5           be if the Company were not to aggressively pursue  
6           the targets set forth in the Settlement Agreement?

7   A.       Well, if we did not go after those aggressive  
8           targets that are in the Settlement Agreement, then  
9           it would have implications on our resource plan  
10          overall and what resources are required and would  
11          put us in a -- in a spot, you know. It's tough to  
12          build a plant in that kind of a time frame, so  
13          you'd end up in the short term, you know, looking  
14          at some alternative regarding purchase power.

15   Q.       And in terms of the Company's decision as to  
16           whether to pursue energy efficiency versus a plant  
17           resource, is that also factored or determined by  
18           the IRP process?

19   A.       The IRP process determines which of the resources,  
20           the cost-effectiveness of those resources are all  
21           put into the -- the mix, and the IRP determines  
22           which resources you should be pursuing.

23   Q.       And is that process based on the principles of  
24           least cost planning?



1 A. It is.

2 MS. HEIGEL: I have nothing further.

3 CHAIRMAN FINLEY: Questions by the  
4 Commission? Mr. Culpepper?

5 COMMISSIONER CULPEPPER: Would you flip  
6 over to page 20 of your Schultz Settlement Exhibit  
7 No. 1, which I also understand is the Settlement  
8 Agreement? The numbers of the pages are the same,  
9 I think. Page 20.

10 THE WITNESS: Yes, I'm there.

11 COMMISSIONER CULPEPPER: You're there?  
12 Do you see number six there, getting there kind of  
13 down to the bottom where you've got a chart there  
14 that says System Portfolio Impacts?

15 THE WITNESS: Yes.

16 COMMISSIONER CULPEPPER: I want to talk  
17 with you a little bit about that. I just want to  
18 look at year one. You've got megawatt hours. I'm  
19 assuming this is not confidential since it's  
20 sitting right here in the open.

21 THE WITNESS: Correct.

22 COMMISSIONER CULPEPPER: That figure  
23 there, that 234,132, I'm assuming that includes  
24 both residential and nonresidential. Is that

1 correct?

2 THE WITNESS: That is correct.

3 COMMISSIONER CULPEPPER: All right. Can  
4 you tell me how much of that is residential?

5 THE WITNESS: I can't off the top of my  
6 head.

7 COMMISSIONER CULPEPPER: Is it engulfed  
8 in some work papers and it's not -- it's not laid  
9 out? I can't find it laid out in any piece of  
10 paper that we've -- we've seen here as an exhibit  
11 in the case. Do you know of anywhere where it  
12 might be?

13 THE WITNESS: If not, we can definitely  
14 get it. But I don't know.

15 COMMISSIONER CULPEPPER: You got any  
16 idea? I'm not going to hold it to you. You got  
17 any idea about approximately how much of that would  
18 be residential and nonresidential? And if you  
19 don't, say so.

20 THE WITNESS: If I recall, it's at a --  
21 boy. The res/nonres? I'm honestly not sure.

22 COMMISSIONER CULPEPPER: Well, that's the  
23 --

24 THE WITNESS: I think it's about a 60-40

1 slip.

2 COMMISSIONER CULPEPPER: -- that's the  
3 answer sometimes. You don't know the answer.

4 THE WITNESS: I'm not sure -- the split.

5 COMMISSIONER CULPEPPER: Okay. Well, is  
6 all of that same true for the megawatt figure there  
7 in 368? That's residential and nonresidential?

8 THE WITNESS: That's correct.

9 COMMISSIONER CULPEPPER: Okay. And I  
10 take it you don't know the breakdown on that  
11 either, do you?

12 THE WITNESS: No.

13 COMMISSIONER CULPEPPER: All right.  
14 Okay, let me ask you this. The megawatts that are  
15 avoided per this -- this chart here, it ramps up to  
16 844 megawatts in year four. Is that correct?

17 THE WITNESS: That's correct.

18 COMMISSIONER CULPEPPER: All right.  
19 Would that be year 2013?

20 THE WITNESS: Yes, assuming we --  
21 assuming vintage year one is --

22 COMMISSIONER CULPEPPER: If everything  
23 goes the way everybody wants it to go other than  
24 some of the parties in this case. If everything

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1 goes the way the parties to the Settlement  
2 Agreement want it to go, would that year be 2013?

3 THE WITNESS: Yes.

4 COMMISSIONER CULPEPPER: So in year 2013,  
5 if everything goes right, the Company would be able  
6 to avoid in -- in 2013 844 megawatts of generation?

7 THE WITNESS: That's correct.

8 COMMISSIONER CULPEPPER: Okay. Why does  
9 the figure reduce -- it goes down by about 600  
10 megawatts when you get beyond year four?

11 THE WITNESS: Beyond year four is just  
12 the energy efficiency programs, their capacity  
13 component. So beyond year four -- there's two  
14 components that are embedded in the 844. There's  
15 peaking, which is 585 of those megawatts -- so  
16 they're offsetting peaking plants. The two --  
17 about 260 megawatts of that is really base load  
18 coming from energy efficiency programs. So that --  
19 that's the -- the megawatts that are beyond 2013.  
20 The peaking assets would still be there and  
21 callable.

22 COMMISSIONER CULPEPPER: I'm just trying  
23 to figure why the peaking assets go away in this  
24 chart here. I mean --

1 THE WITNESS: I don't think they -- they  
2 go away. We're just trying to show what was beyond  
3 year four that would carry over. They really --  
4 we're just trying to show the benefits of the  
5 megawatt hours and the megawatts that are beyond  
6 year four from the programs that were completed in  
7 those four years.

8 COMMISSIONER CULPEPPER: But do I  
9 understand you to say that although they're not  
10 reflected in this chart here, the peaking assets  
11 would still be there?

12 THE WITNESS: Yes.

13 COMMISSIONER CULPEPPER: So the company  
14 would be able to avoid 844 megawatts in year 2014?

15 THE WITNESS: Yes.

16 COMMISSIONER CULPEPPER: Thank you.

17 CHAIRMAN FINLEY: Mr. Schultz, would you  
18 look at the top of page 4?

19 THE WITNESS: Yes.

20 CHAIRMAN FINLEY: I want to ask you about  
21 the percentages at which you are -- the avoided  
22 cost percentages at which you are compensated under  
23 the model. You've got up at the top there in the  
24 chart 75 percent of avoided costs for demand-side

1 management and 50 percent energy efficiency  
2 percentage net present value. Right?

3 THE WITNESS: That's correct.

4 COMMISSIONER CULPEPPER: And in the  
5 Commission's order of February 26, 2009 approving  
6 programs, it asked the Company to address a number  
7 of scenarios with different percentages. Do you  
8 recall that?

9 THE WITNESS: Yes.

10 CHAIRMAN FINLEY: And some of the  
11 scenarios that the Commission modeled its questions  
12 on had to do with a settlement that had been  
13 entered into in Indiana at that time. Remember  
14 that?

15 THE WITNESS: Yes.

16 CHAIRMAN FINLEY: And in the Indiana  
17 proposal, the percentages were higher for demand-  
18 side management than for energy efficiency as in  
19 the case here, right?

20 THE WITNESS: That's correct.

21 CHAIRMAN FINLEY: And in the scenarios  
22 that the Commission asked the Company to consider  
23 it reversed that so that the energy efficiency was  
24 higher and the demand-side management was lower on

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1 the theory that the way the Commission interpreted  
2 Senate Bill 3 was that we felt the legislature  
3 deemed energy efficiency to be of higher value than  
4 demand-side management. Was our interpretation of  
5 the priorities of Senate Bill 3 consistent with  
6 Duke's? In other words, do you believe that Senate  
7 -- that the Senate Bill 3, the expression of the  
8 legislative intent, places a greater premium on  
9 energy efficiency than demand-side management?

10 THE WITNESS: I can't speak to the intent  
11 of Senate Bill 3 and which one was more important  
12 between demand-side management and energy  
13 efficiency. Our intent here was to put them on a  
14 level playing field so that they're -- as part of  
15 the Settlement Agreement, they both earn a similar  
16 return.

17 CHAIRMAN FINLEY: Could you expand upon  
18 that a little bit, since one is 75 percent and one  
19 is 50 percent how they're on a level playing field?  
20 A. Yes. One -- one is a one-year useful life or net  
21 present value in the current year. So if you look  
22 at the 75 percent applied to the portfolio for  
23 demand-side management resources, you're going to  
24 get a return per the Settlement Agreement --

1           they're set at about the maximum -- the maximum cap  
2           of 15 percent after tax for program cost.

3                     The same thing is applied, even though  
4           optically it looks lower at the 50 percent. You've  
5           got to remember it's the present value of all those  
6           benefits coming back and lost margins are separated  
7           out. So lost margins occur with energy efficiency  
8           programs. They're treated separately, which would  
9           lower the avoided cost percentage. And then that  
10          50 percent again will return about a 15 percent  
11          after tax return on the program cost.

12                    CHAIRMAN FINLEY: So over time the  
13          avoided cost, 75 percent for demand-side management  
14          and 50 percent for energy efficiency are supposed  
15          to be comparable or equivalent?

16                    THE WITNESS: That's correct.

17                    CHAIRMAN FINLEY: That's all I have.  
18          Thanks. Any questions on the Commission's  
19          questions?

20                    MS. HEIGEL: Duke has none.

21                    CHAIRMAN FINLEY: Very well. Thank you,  
22          Mr. Schultz.

23                    THE WITNESS: Thank you.

24                               (WITNESS EXCUSED)



1 MS. NICHOLS: We now call Danny Wiles.

2 (WHEREUPON, J. DANNY WILES WAS CALLED AS A WITNESS,  
3 DULY SWORN, AND TESTIFIED AS FOLLOWS:)

4 DIRECT EXAMINATION BY MS. NICHOLS:

5 Q. Mr. Wiles, please state your full name and business  
6 address for the record?

7 A. My name is James Danny Wiles, and my business  
8 address is 526 South Church Street, Charlotte,  
9 North Carolina.

10 Q. And by whom are you employed and in what capacity?

11 A. I am employed by Duke Energy Business Services, LLC  
12 as vice president, franchise electric and gas  
13 accounting. I am an officer of Duke Energy  
14 Carolinas, LLC.

15 Q. Have you previously presented testimony in this  
16 docket?

17 A. Yes.

18 Q. And did you cause to be prefiled in this docket  
19 settlement supporting testimony consisting of six  
20 pages?

21 A. I did.

22 Q. Do you have any changes or corrections to your  
23 settlement testimony?

24 A. I do not.

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1 MS. NICHOLS: Mr. Chairman, I would move  
2 that the settlement testimony of Mr. Wiles be  
3 reproduced into the record as if given orally from  
4 the stand.

5 CHAIRMAN FINLEY: Mr. Wiles' direct  
6 prefiled testimony will be copied into the record  
7 as though given orally from the stand.

8 MS. NICHOLS: Oh. And we would also at  
9 this point move Mr. Schultz's Exhibit 1 into the  
10 record.

11 CHAIRMAN FINLEY: Without objection,  
12 Schultz Exhibit 1 is entered into the record.  
13 (THE PREFILED SETTLEMENT TESTIMONY OF J. DANNY  
14 WILES WILL BE COPIED INTO THE RECORD AS IF GIVEN  
15 ORALLY FROM THE WITNESS STAND AND SCHULTZ  
16 SETTLEMENT EXHIBIT 1 IS ADMITTED INTO EVIDENCE.)

1 I. INTRODUCTION AND PURPOSE

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is J. Danny Wiles and my business address is 526 South Church Street,  
4 Charlotte, North Carolina.

5 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 A. I am employed by Duke Energy Business Services LLC as Vice President,  
7 Franchised Electric & Gas Accounting. I am an officer of Duke Energy  
8 Carolinas, LLC ("Duke Energy Carolinas" or the "Company").

9 Q. DID YOU PREVIOUSLY CAUSE TO BE PRE-FILED IN THIS DOCKET  
10 CERTAIN DIRECT AND REBUTTAL TESTIMONIES ON BEHALF OF  
11 DUKE ENERGY CAROLINAS?

12 A. Yes, I did.

13 Q. WHAT IS THE PURPOSE OF YOUR SETTLEMENT TESTIMONY IN  
14 THIS PROCEEDING?

15 A. The purpose of my testimony is to describe changes to the accounting and  
16 reporting treatment requested by the Company in my direct testimony as a result  
17 of the Agreement and Joint Stipulation of Settlement (the "Agreement") entered  
18 into between Duke Energy Carolinas, LLC ("Duke Energy Carolinas" or the  
19 "Company") and the Southern Alliance for Clean Energy, Environmental Defense  
20 Fund, Natural Resources Defense Council, and the Southern Environmental Law  
21 Center (collectively, the "Environmental Intervenors").

1 Q. MR. WILES, WHAT HAS BEEN THE FOCUS OF YOUR TESTIMONIES  
2 IN THIS PROCEEDING?

3 A. My testimonies in this proceeding have focused on the proposed deferral of  
4 program costs and amortization of such costs over the life of the applicable  
5 program and the proposal to treat the earnings stream produced under the "save-a-  
6 watt" Energy Efficiency Plan similarly to that which would have been produced  
7 by a generating plant investment for reporting purposes.

8 **II. REPORTING AND ACCOUNTING ISSUES**

9 Q. AS A RESULT OF THE AGREEMENT REACHED WITH THE  
10 ENVIRONMENTAL INTERVENORS AND THE COMMISSION'S  
11 ORDER, DATED FEBRUARY 26, 2009, PLEASE EXPLAIN HOW THE  
12 COMBINED RECOVERY OF PROGRAM COSTS AND THE  
13 MANAGEMENT INCENTIVE WILL BE HANDLED IN FUTURE ES-1  
14 REPORTS.

15 A. In accordance with the Commission's *Order Resolving Certain Issues, Requesting*  
16 *Information on Unsettled Matters, and Allowing Proposed Rider to Become*  
17 *Effective Subject to Refund*, dated February 26, 2009, the Company will (1)  
18 include actual program revenues<sup>1</sup> and actual program costs for purposes of  
19 calculating and reporting its regulated earnings to the Commission in its quarterly

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<sup>1</sup> The management incentive (or, level of profit) that the Company ultimately will realize under the Agreement is not fixed or known in advance, but rather, is dependent on a number of variables and factors. The Company will be compensated based solely on its ability to achieve verified avoided cost savings on behalf of customers. The maximum rate of return on program costs that may be earned (i.e., earnings cap) declines as the Company's achievement of avoided cost savings relative to target declines. Although the level of revenues collected by the Company can be reported on a quarterly basis, the determination of the level of management incentive that may be retained by the Company will not be known for certain until the measurement and evaluation study is completed, which will not occur until after the four-year settlement term has ended.

1 ES-1 reports; (2) provide supplementary schedules setting forth the Company's  
2 jurisdictional earnings excluding the effects of its energy efficiency and demand-  
3 side management programs; and (3) provide schedules separately stating the costs  
4 associated with each program or activity, and actual revenues received from the  
5 demand-side and energy efficiency programs. Duke Energy Carolinas will also  
6 provide detailed calculations supporting the foregoing, including schedules or  
7 calculations that show (a) actual revenues (as qualified by footnote 1 above), (b)  
8 expenses, (c) taxes, (d) operating income, (e) rate base, including components,  
9 and (f) applicable capitalization ratios and cost rates, including overall rate of  
10 return and return on common equity. *Order* at 60 (Feb. 26, 2009).

11 **Q. PLEASE EXPLAIN ANY PERTINENT FINANCIAL ACCOUNTING**  
12 **ISSUES THAT RELATE TO THE ENERGY EFFICIENCY PLAN.**

13 **A.** Accounting rules and regulations require that the Company monitor, on an  
14 ongoing basis, the difference between financial results applicable to the save-a-  
15 watt programs that are expected ultimately to be realized based on the terms of the  
16 Agreement and the financial results recorded on the Company's books that result  
17 from the recovery of costs via Rider EE (NC). The Company will record a  
18 regulatory asset on its books, subject to the guidelines included in promulgated  
19 accounting literature, if it appears that the level of revenues that will ultimately be  
20 recoverable based on the terms and provisions of the Agreement, are greater than  
21 the level of revenues billed via Rider EE (NC). On the other hand, the Company  
22 will record a regulatory liability if the level of revenues billed customers is in  
23 excess of the level of revenues that is estimated to be ultimately recoverable.

1 Q. DOES THIS ACCOUNTING TREATMENT FOLLOW GENERALLY  
2 ACCEPTED ACCOUNTING PRINCIPLES ("GAAP")?

3 A. Yes. Guidance on this issue can be found in various accounting pronouncements,  
4 most notably, Emerging Issues Task Force ("EITF") Issue No. 92-7 (Accounting  
5 by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue  
6 Programs). Practically speaking, there is little need to address the accounting for  
7 situations in which the Company owes customers. In those situations, the  
8 Company will record a reduction to revenues in recognition of the fact that the  
9 Company has an obligation to return the over-collected amounts to customers.  
10 EITF 92-7 addresses the issue of accounting for amounts owed the utility (as  
11 opposed to amounts owed customers) under alternative rate recovery plans  
12 including demand-side management and similar energy efficiency plans.  
13 Basically, the EITF reached consensus that once specific events have occurred  
14 that provide for future customer billings, then, the utility can recognize the  
15 additional revenues if the following conditions are met:

- 16 1. The program is established by an order from the utility's regulatory  
17 commission that allows for the automatic adjustment of future  
18 rates. Verification of the adjustment to future rates by the  
19 regulatory commission would not preclude the adjustment from  
20 being considered automatic.
- 21 2. The amount of additional revenues for the period is objectively  
22 determinable and is probable of recovery.
- 23 3. The additional revenues will be collected within 24 months

1 following the end of the annual period in which they are  
2 recognized.

3 **Q. WILL THE COMPANY REQUIRE ANY COMMISSION ASSURANCES**  
4 **OR ACTIONS IN ORDER TO IMPLEMENT THE ACCOUNTING**  
5 **GUIDELINES PRESENTED ABOVE?**

6 **A.** Arguably, the terms of the Agreement meet the requirement of EITF 92-7.  
7 However, a Commission order approving the Agreement should acknowledge  
8 clearly that future rates may be adjusted in accordance with the provisions set out  
9 in paragraph one of my prior answer.

10 **Q. WILL THE COMPANY'S REQUEST THAT IT BE AUTHORIZED TO**  
11 **DEFER PROGRAM COSTS STILL BE NEEDED?**

12 **A.** No. The terms of the Agreement are intended to provide for the recovery of  
13 program costs as they are incurred; therefore, the request for program cost  
14 deferral is not needed from a GAAP accounting practice viewpoint. However,  
15 because of Commission rule R8-27(a)(2), Duke Energy Carolinas does request  
16 that the Commission include in its order in this proceeding an ordering paragraph  
17 for regulatory accounting purposes authorizing the Company to use a regulatory  
18 asset and a regulatory liability account for the purposes mentioned above.

19 **Q. DOES THIS CONCLUDE YOUR PRE-FILED SETTLEMENT**  
20 **TESTIMONY?**

21 **A.** Yes.

1 Q. Sorry, Mr. Wiles. Do you have a summary of your  
2 settlement testimony?

3 A. Yes, I do.

4 Q. Can you please give that summary to the Commission?

5 A. Yes, I will.

6 (THE SUMMARY OF THE PREFILED TESTIMONY OF JAMES  
7 DANNY WILES WILL BE COPIED INTO THE RECORD AS GIVEN  
8 ORALLY FROM THE WITNESS STAND.)



**DUKE ENERGY CAROLINAS, LLC**  
**Docket No. E-7, Sub 831**  
**SUMMARY OF SETTLEMENT TESTIMONY OF**  
**J. DANNY WILES**

1           My direct and rebuttal testimony in this proceeding focused on the proposed  
2   deferral of program costs and amortization of such costs over the life of the applicable  
3   program and the proposal to treat the earnings stream produced under the "save-a-watt"  
4   Energy Efficiency Plan similarly to that which would have been produced by a  
5   generating plant investment for reporting purposes. The purpose of my settlement  
6   testimony is to describe changes to the accounting and reporting treatment requested by  
7   the Company in my direct testimony as a result of both the Commission's February 26,  
8   2009 Order and the Agreement and Joint Stipulation of Settlement entered into among  
9   the Company, Public Staff, and the Environmental Intervenors.

10           As a result of the Agreement and the Commission's Order, the Company will  
11   include actual program revenues and actual program costs for purposes of calculating and  
12   reporting its regulated earnings to the Commission in its quarterly ES-1 reports. It will  
13   provide supplementary schedules setting forth the Company's jurisdictional earnings  
14   excluding the effects of its energy efficiency and demand-side management programs.  
15   The Company also will provide schedules separately stating the costs associated with  
16   each program or activity, and actual revenues received from the demand-side and energy  
17   efficiency programs. Duke Energy Carolinas will provide detailed calculations  
18   supporting these as schedules.

19           Accounting rules and regulations require that the Company monitor, on an  
20   ongoing basis, the difference between financial results applicable to the save-a-watt  
21   programs that are expected ultimately to be realized based on the terms of the Agreement

1 and the financial results recorded on the Company's books that result from the recovery  
2 of costs through Rider EE. When certain timing requirements are met, the Company will  
3 record a regulatory asset on its books if it appears that the level of revenues that will  
4 ultimately be recoverable based on the terms and provisions of the Agreement are greater  
5 than the level of revenues billed under the rider. On the other hand, the Company will  
6 record a regulatory liability if the level of revenues billed customers is in excess of the  
7 level of revenues that is estimated to be ultimately recoverable.

8 The terms of the Agreement are intended to provide for the recovery of program  
9 costs as they are incurred and, therefore, the request for program cost deferral that was  
10 referenced in my direct and rebuttal testimony is no longer needed.

11 Based on Commission Rule R8-27(a)(2), Duke Energy Carolinas requests that the  
12 Commission include in its order in this proceeding an ordering paragraph for regulatory  
13 accounting purposes authorizing the Company to use a regulatory asset and a regulatory  
14 liability account for the purposes I describe in my settlement testimony.

15 This concludes the summary of my pre-filed settlement testimony.

1 MS. NICHOLS: Thank you. Mr. Wiles is  
2 available for cross examination.

3 CHAIRMAN FINLEY: Cross?

4 MS. FENTRESS: No questions from the  
5 Public Staff.

6 MR. GREEN: No questions.

7 MR. RUNKLE: No questions.

8 MR. HOLTZMAN: No questions.

9 MS. THOMPSON: No questions.

10 MR. OLSON: We have no questions.

11 CHAIRMAN FINLEY: All right. Any  
12 questions of Mr. Wiles from the Commission?

13 (No response.)

14 CHAIRMAN FINLEY: You get a pass, Mr.  
15 Wiles. Congratulations.

16 THE WITNESS: Thank you.

17 MS. NICHOLS: That's what you get for  
18 having such scintillating testimony.

19 THE WITNESS: No problem.

20 (WITNESS EXCUSED)

21 MS. HEIGEL: Thank you. At this time,  
22 Mr. Chairman, we would call Steve Farmer to the  
23 stand.

24 (WHEREUPON, STEPHEN M. FARMER, WAS CALLED AS A

1 WITNESS, DULY SWORN, AND TESTIFIED AS FOLLOWS:)

2 THE WITNESS: I'm sorry, Your Honor. I  
3 didn't realize Danny would be on and off quite that  
4 quick.

5 DIRECT EXAMINATION BY MS. HEIGEL:

6 Q. Mr. Farmer, would you please state your full name  
7 and business address for the record?

8 A. My name is Stephen Farmer. My business address is  
9 1000 East Main Street, Plainfield, Indiana 46168.

10 Q. And by whom are you employed and in what capacity?

11 A. I'm currently self-employed. I'm a former employee  
12 of Duke Energy Services.

13 Q. The retiree we won't quite let go of. Have you  
14 previously filed testimony in this docket?

15 A. I have.

16 Q. And did you also caused to be prefiled settlement  
17 supporting testimony in this docket consisting of  
18 19 pages plus four exhibits?

19 A. I did.

20 Q. And do you have any changes or corrections to your  
21 testimony or exhibits at this time?

22 A. (Nods affirmatively)

23 Q. Would you please provide those?

24 A. I do have changes. I need to clarify some of this

1 testimony as it relates to the difference in  
2 opinion between the Public Staff and the Company as  
3 to the allocation of costs between residential and  
4 nonresidential customers.

5 Q. Would you please provide that clarification?

6 A. Yes. My testimony states that the Public Staff was  
7 opposed to separating revenue requirements from  
8 residential customers as a group and nonresidential  
9 customers as a group. My testimony said that  
10 Public Staff -- we thought the Public Staff wanted  
11 to break the nonresidential customer group down by  
12 customer class basis. We are not in disagreement  
13 on that -- that point. We are both in agreement.

14 Now, there is a difference of opinion on  
15 how energy-efficiency costs should be allocated  
16 within the North Carolina jurisdiction. The Public  
17 Staff believes that the allocation of energy  
18 efficiency costs within the North Carolina  
19 jurisdiction should be based on relative  
20 residential and nonresidential kilowatt hour sales  
21 within the North Carolina jurisdiction.

22 The Company believes that the residential  
23 customers of North Carolina should pay the cost of  
24 the residential programs in North Carolina and that

1 the nonresidential customers ought to pay for the  
2 nonresidential programs. Now, that change in  
3 allocation or changes in the methodology results in  
4 a significant difference in the revenue requirement  
5 assigned to the residential and nonresidential  
6 customers of North Carolina.

7 MS. HEIGEL: Mr. Chairman, at this time I  
8 would move that the prefilled direct testimony of  
9 Mr. Farmer be copied into the record as if given  
10 orally from the stand, and that his Exhibits 1  
11 through 4 be marked.

12 CHAIRMAN FINLEY: Farmer's supplemental  
13 testimony shall be copied into the record as if  
14 given orally from the stand, and his exhibits shall  
15 be marked 1 through 4 as premarked and filed.

16 MS. NICHOLS: Thank you.

17 (THE PREFILED DIRECT TESTIMONY OF STEPHEN M.  
18 FARMER, AS CORRECTED, WILL BE COPIED INTO THE  
19 RECORD AS IF GIVEN ORALLY FROM THE WITNESS STAND,  
20 AND FARMER EXHIBITS 1 THROUGH 4 ARE MARKED FOR  
21 IDENTIFICATION.)

**I. INTRODUCTION AND PURPOSE**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A. My name is Stephen M. Farmer, and my business address is 1000 East Main**  
 3 **Street, Plainfield, Indiana.**

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 **A. I am a former employee of Duke Energy Shared Services, Inc. On December 31,**  
 6 **2006, I retired as an employee of Duke Energy Shared Services, Inc. after serving**  
 7 **Duke Energy Indiana, Inc. and its predecessor companies for over thirty-one**  
 8 **years. I am currently self-employed and provide rate and regulatory consulting**  
 9 **services as an independent contractor. I have been retained by Duke Energy**  
 10 **Corporation as a consultant in the area of rates.**

11 **Q. DID YOU PREVIOUSLY CAUSE TO BE PRE-FILED IN THIS DOCKET**  
 12 **CERTAIN DIRECT AND REBUTTAL TESTIMONIES ON BEHALF OF**  
 13 **DUKE ENERGY CAROLINAS?**

14 **A. Yes, I did.**

15 **Q. WHAT IS THE PURPOSE OF YOUR SETTLEMENT TESTIMONY IN**  
 16 **THIS PROCEEDING?**

17 **A. The purpose of my testimony is to explain and support certain provisions of the**  
 18 **Agreement and Joint Stipulation of Settlement (the "Agreement") among Duke**  
 19 **Energy Carolinas, LLC ("Duke Energy Carolinas" or the "Company") and the**  
 20 **Southern Alliance for Clean Energy, Environmental Defense Fund, Natural**  
 21 **Resources Defense Council, and the Southern Environmental Law Center**  
 22 **(collectively, the "Environmental Intervenors"), and the Public Staff of the North**

1 Carolina Utilities Commission (the "Public Staff") (collectively referred to as the  
2 "Stipulating Parties"). In particular, I will discuss certain provisions of the  
3 Settlement Terms attached to the Agreement as Exhibit B and certain aspects of  
4 Exhibit C, which sets out the various areas of compromise between the parties.  
5 My testimony includes calculations that quantify the customer rate impacts that  
6 are projected to occur as a result of the recovery of energy efficiency costs, lost  
7 revenues and incentives. The testimony of Mr. Theodore E. Schultz filed in  
8 support of the Agreement includes a more detailed discussion of the terms  
9 included in Exhibits B and C of the Settlement Agreement. As Mr. Schultz and I  
10 discuss, the Agreement includes several areas of compromise by the Stipulating  
11 Parties that affect the determination of costs to be recovered from customers.

12 **Q. MR. FARMER, WHAT HAS BEEN THE FOCUS OF YOUR**  
13 **TESTIMONIES IN THIS PROCEEDING?**

14 **A.** My testimonies in this proceeding have focused on the development of the  
15 proposed jurisdictional revenue requirements applicable to Duke Energy  
16 Carolinas' save-a-watt proposal and the development of ratemaking principles  
17 and provisions included in Rider EE (NC), which is the Company's proposed  
18 energy efficiency cost recovery mechanism.



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A. Yes. Farmer Settlement Exhibit Nos. 1 through 3 include summaries and comparisons of the annual jurisdictional revenue requirement and rate impacts that reflect the various provisions and terms of the Agreement. Farmer Settlement Exhibit No. 1 includes a side-by-side comparison of annual jurisdictional revenues that would have been collected during the first four years of the Company's save-a-watt proposal as originally filed (amounts shown in columns B through D) and the annual jurisdictional revenues that will be billed to North Carolina customers for the same period assuming the Commission approves the Agreement (amounts shown in columns E through I). Farmer Settlement Exhibit No. 1 shows that the sum of the jurisdictional revenue requirement based on the terms and provisions of the Agreement is \$27.4 million (8.0%) less than the Company's original filing over the four-year recovery period. As explained below, there are a number of factors that contribute to the net change in revenue requirement.

1 Q. PLEASE EXPLAIN THE REASONS WHY THE CUMULATIVE  
2 JURISDICTIONAL REVENUE REQUIREMENT PROVIDED FOR IN  
3 THE AGREEMENT IS LESS THAN THE REVENUE REQUIREMENT  
4 UNDER THE COMPANY'S ORIGINAL SAVE-A-WATT PLAN OVER  
5 THE FOUR-YEAR COST RECOVERY PERIOD.

6 A. There are a number of factors to consider when comparing the jurisdictional  
7 revenue requirement based on the terms and provisions of the Agreement to the  
8 jurisdictional revenue requirement under the Company's originally filed Energy  
9 Efficiency Plan. First, as originally filed, the save-a-watt proposal provided for  
10 the recovery of lost revenues and program costs spread out over the life of the  
11 energy efficiency and demand-side management programs that gave rise to  
12 avoided cost savings. For example, if an energy efficiency program had a life of  
13 ten years, the recovery of program costs would have occurred over ten years. In  
14 contrast, under the provisions of the Agreement, the recovery of program costs  
15 applicable to a particular vintage of energy efficiency programs will occur during  
16 the program vintage year. The revenue streams under both plans are intended to  
17 provide the Company the opportunity, but not a guarantee, of program cost  
18 recovery. The recovery of net lost revenues, which also would have occurred  
19 over the life of approved energy efficiency program under the Company's original  
20 proposal, will now be limited to the level of estimated net lost revenues that are  
21 expected to occur during the 36-month period that begins as of each initial vintage  
22 year of customer participation in Company sponsored programs. The Agreement  
23 provides that the recovery of net lost revenues applicable to vintage years three

1 and four energy efficiency programs will extend two-years beyond the initial  
2 four-year cost recovery period assuming such recovery is not reduced or  
3 terminated as a result of the explicit or implicit recovery of net lost revenues as  
4 part of a general rate case or comparable proceeding. The Company estimates  
5 that the combined sum of net lost revenues subject to recovery by North Carolina  
6 customers in years five and six will total approximately \$54 million at 85% of  
7 targeted achievement levels, if not reduced or terminated earlier.

8 The Stipulating Parties have agreed to mitigate any potential overbilling of  
9 costs to customers by initially billing customers at a rate that assumes the  
10 Company will achieve 85% of its targeted avoided cost savings goals (revenues  
11 under the Company's original proposal assumed the Company would achieve  
12 100% of its targeted goals). The Agreement provides for an annual true-up  
13 process in order to adjust jurisdictional revenue requirement to reflect historical  
14 customer participation levels in addition to any changes or updates to forecasted  
15 customer participation levels. In addition, the Agreement provides for a true-up  
16 after the end of the four-year period that will capture differences, not only due to  
17 actual versus projected customer participation levels, but also differences that  
18 may arise due to projected versus verified program impacts. Finally the end-of-  
19 period true-up will capture any adjustment that may result from the cap on  
20 Company earnings provided for in the Agreement. The Settlement Agreement  
21 jurisdictional revenue requirement shown on Farmer Settlement Exhibit Nos. 1  
22 through 3 assumes the Company achieves 85% of the avoided cost savings  
23 targeted across the Duke Energy Carolinas' system. Any difference between

1 amounts due the Company based on actual avoided cost savings realized by  
2 customers and amounts billed customers at 85% of target achievement will be  
3 collected from or refunded to customers as part of the annual and/or end of period  
4 true-up.

5 As explained by Mr. Schultz, the Settlement Agreement provides for a  
6 significant increase in the level of kilowatt-hour savings compared to the  
7 Company's original filing. For example, energy efficiency programs applicable  
8 to the third and fourth vintage years have been scaled up to achieve customer  
9 kWh savings of 0.5% and 0.75% of sales, respectively. These customer savings,  
10 which represent increases of over 80% and 150% when compared to the  
11 Company's original Energy Efficiency Plan, will result in an increase in the level  
12 of jurisdictional revenue requirement.

13 **Q. MR. FARMER, WHAT ARE SOME OF THE OTHER DRIVERS OF THE**  
14 **DIFFERENCE BETWEEN JURISDICTIONAL REVENUE**  
15 **REQUIREMENTS UNDER THE COMPANY'S PLAN AS ORIGINALLY**  
16 **FILED AND JURISDICTIONAL REVENUE REQUIREMENTS UNDER**  
17 **THE AGREEMENT?**

18 **A.** The Agreement includes a number of other changes and modifications, which will  
19 impact the recovery of jurisdictional revenue requirement. For example, as  
20 explained by Mr. Schultz, Section C of the Settlement Terms states that when  
21 developing jurisdictional revenue requirement, the Company will utilize 75% of  
22 avoided capacity costs applicable to demand response programs and 50% of the  
23 net present value of avoided capacity and energy costs applicable to energy

1 conservation programs. Jurisdictional revenues in the Company's original filing  
2 were based on 90% of estimated avoided capacity and energy cost savings. The  
3 Stipulating Parties agreed to limit the effect that potential increases in future  
4 avoided capacity and energy cost rates might have on the calculation of  
5 jurisdictional revenue requirement by fixing the MWh and MW-per-year avoided  
6 energy cost and avoided capacity cost rates at the onset of the plan subject to  
7 certain limited adjustments. The Agreement includes other provisions that limit  
8 the recovery of energy efficiency and demand-side management costs as outlined  
9 in the testimony of Mr. Schultz. For example, after-tax earnings on actual  
10 program costs will be capped at graduated percentage return levels based on the  
11 percentage achievement of targeted avoided cost savings. Finally, revenue  
12 requirement determinations do not reflect the revenue reshaping provisions  
13 included in the original filing. The changes in concepts and terms discussed  
14 above are implicitly included in the Agreement through the calculation of the  
15 projected system avoided cost savings of \$754 million.

16 **Q. DOES THE SETTLEMENT CHANGE THE COMPANY'S ALLOCATION**  
17 **OF COSTS AND BENEFITS OF DEMAND-SIDE MANAGEMENT**  
18 **PROGRAMS TO NORTH CAROLINA RETAIL CUSTOMERS?**

19 **A.** Yes. As part of the Settlement, the Environmental Intervenors and Duke Energy  
20 Carolinas agreed to make a change to the way costs associated with demand-side  
21 management costs are allocated. For purposes of determining the North Carolina  
22 retail revenue requirement, Duke Energy Carolinas and the Environmental  
23 Intervenors agree that for demand-side management programs, inputs will be

1 allocated between the North Carolina and South Carolina retail jurisdictions based  
2 on contributions to system retail peak demand by all system retail customers  
3 based on the Company's cost of service study. The save-a-watt proposal, as  
4 originally filed, provided that for demand-side management programs inputs  
5 would be allocated between the North Carolina and South Carolina retail  
6 jurisdictions based on kWh sales to system retail customers. For energy  
7 efficiency programs and net lost revenues, inputs will be assigned to the North  
8 Carolina and South Carolina retail jurisdictions based on kWh sales to system  
9 retail customers from the cost of service study. Program costs applicable to  
10 energy efficiency and demand-side management programs will be allocated  
11 between North Carolina and South Carolina jurisdictions on the same basis as  
12 revenue requirement.

13 **Q. MR. FARMER, DUKE ENERGY CAROLINAS AND THE**  
14 **ENVIRONMENTAL INTERVENORS HAVE AGREED THAT REVENUE**  
15 **REQUIREMENT WILL BE ALLOCATED TO NORTH CAROLINA AND**  
16 **SOUTH CAROLINA RETAIL CUSTOMERS ONLY AND THAT NO**  
17 **PORTION OF THE SETTLEMENT AGREEMENT REVENUE**  
18 **REQUIREMENT WILL BE ALLOCATED TO WHOLESALE**  
19 **CUSTOMERS. PLEASE EXPLAIN THE RATIONALE FOR THIS**  
20 **DECISION.**

21 **A.** Because the Company's energy efficiency and demand-side management  
22 programs included in the portfolio of programs approved in this proceeding are  
23 programs directed specifically to Duke Energy Carolinas' retail customers, the

1       Company believes it is appropriate to recover the costs of such programs only  
 2       from these customers. Like Progress Energy Carolinas and the Commission,  
 3       Duke Energy Carolinas interprets N.C. Gen. Stat. § 62-133.9(e) to mean that costs  
 4       of new energy efficiency and demand-side management programs should “be  
 5       recovered only from those customer classes eligible to participate in the program  
 6       and to which the program is targeted.” *Order Approving Agreement and*  
 7       *Stipulation of Partial Settlement, Subject to Certain Commission-Required*  
 8       *Modifications*, Docket No. E-2, Sub 931, at 30 (June 15, 2009).

9       **Q. DO YOU DISPUTE THE FACT THAT ALL CUSTOMERS LIKELY WILL**  
 10       **RECEIVE INDIRECT BENEFITS FROM THE COMPANY’S ENERGY**  
 11       **EFFICIENCY PROGRAMS?**

12       **A.** No, I am simply making the point that to comply with N.C. Gen. Stat. § 62-  
 13       133.9(e) the costs of a program or measure should be recovered from those  
 14       customers eligible to participate in the program. Duke Energy Carolinas believes  
 15       its allocation methodology is more consistent with the North Carolina General  
 16       Assembly’s use of the words “only” and “directly” in this statute, which provides  
 17       that:

18               The Commission shall determine the appropriate assignment of  
 19               costs of new demand-side management and energy efficiency  
 20               measures for electric public utilities and shall assign the costs of  
 21               the programs *only* to the class or classes of customers that  
 22               *directly* benefit from the programs. [Emphasis added.]

23  
 24       N.C. Gen. Stat. § 62-133.9(e).

1    **Q.    DOES THE PUBLIC STAFF SUPPORT THE METHOD AGREED TO BY**  
2       **DUKE ENERGY CAROLINAS AND THE ENVIRONMENTAL**  
3       **INTERVENORS FOR ALLOCATING THE REVENUE REQUIREMENT**  
4       **TO NORTH CAROLINA RETAIL CUSTOMERS?**

5    **A.    No. The Public Staff did not agree to this proposed method and the Stipulating**  
6       **Parties have agreed to present the issue of the appropriate jurisdictional allocation**  
7       **method to the Commission through testimony.**

8    **Q.    HAVE THE STIPULATING PARTIES ACCEPTED THE ALLOCATION**  
9       **OF ENERGY EFFICIENCY AND DEMAND-SIDE MANAGEMENT**  
10      **REVENUE REQUIREMENT BETWEEN NORTH CAROLINA AND**  
11      **SOUTH CAROLINA JURISDICTIONS BASED ON KILOWATT-HOURS**  
12      **SALES AND CONTRIBUTION TO PEAK DEMAND, RESPECTIVELY?**

13   **A.    Yes, the Stipulating Parties accept the allocation of energy efficiency and**  
14      **demand-side management revenue requirement to the North Carolina and South**  
15      **Carolina jurisdictions based on kilowatt-hour sales and contribution to peak**  
16      **demand. The only remaining item of contention is that the Public Staff believes it**  
17      **would be more appropriate to allocate revenue requirement on a class-by-class**  
18      **basis rather than on a "residential" and "non-residential" basis as proposed by**  
19      **Duke Energy Carolinas and as accepted by the Environmental Intervenors.**

20   **Q.    IS THE COMPANY PROPOSING ANY CHANGES FROM ITS**  
21      **ORIGINAL FILING TO HOW IT ALLOCATES ENERGY EFFICIENCY**  
22      **AND DEMAND-SIDE MANAGEMENT REVENUE REQUIREMENT**  
23      **AMONG NORTH CAROLINA RETAIL CUSTOMERS?**



1     A.     No. Under the Company's allocation proposal, residential and non-residential  
2           customers will pay their respective share of energy efficiency and demand-side  
3           management program costs, lost revenues, and incentives based on the percentage  
4           of system kilowatt-hour sales consumed and peak demands contributed by  
5           residential and non-residential customers, respectively.

6     **Q.     DOES THE PUBLIC STAFF SUPPORT THE COMPANY'S**  
7           **ALLOCATION OF ENERGY EFFICIENCY AND DEMAND-SIDE**  
8           **MANAGEMENT REVENUE REQUIREMENT AMONG NORTH**  
9           **CAROLINA RETAIL CUSTOMER GROUPS?**

10    A.     No, the Public Staff opposes the Company's combination of non-residential retail  
11           customers into one group for purposes of allocating the revenue requirement. The  
12           Company chose to combine non-residential customers into one class in  
13           recognition of the fact that programs offered within the non-residential classes cut  
14           across various rate groups. In addition, the Company's goal was to reduce  
15           complexity when administering the Rider.

16    **Q.     HAVE YOU PREPARED EXHIBITS THAT PROVIDE ESTIMATES OF**  
17           **THE CHANGE IN RATES THAT WOULD OCCUR AS A RESULT OF**  
18           **THE RECOVERY OF ENERGY EFFICIENCY AND DEMAND-SIDE**  
19           **MANAGEMENT COSTS AFTER REFLECTING THE EFFECTS OF THE**  
20           **SETTLEMENT AGREEMENT?**

21    A.     Yes. Farmer Settlement Exhibit No. 2 shows the estimated percentage change in  
22           retail rates for residential and non-residential customers that would occur during  
23           the four-year cost recovery period based on the terms of the Agreement. In

1           addition, Farmer Settlement Exhibit No. 3 includes calculations of monthly billing  
2           factors for residential and non-residential customers that can be used to evaluate  
3           the impact of the recovery of energy efficiency costs by individual customers. As  
4           shown on Farmer Settlement Exhibit No. 2, residential and non-residential rates  
5           will increase by 1.47% and 0.68%, respectively, during the first year of the four-  
6           year cost recovery period when compared to 2008 annual jurisdictional revenues.  
7           Residential and non-residential rates will increase by 4.93% and 2.14%,  
8           respectively, during the fourth year. It is important to keep in mind that  
9           customers who participate in programs offered by the Company will likely,  
10          depending on the level of participation, reduce their net bill below the level that  
11          would have been incurred had the Company's energy efficiency and demand-side  
12          management programs not been in place. Customers who do not participate in  
13          programs offered by the Company will benefit to the extent the Company's  
14          energy efficiency and demand-side management programs lower the marginal  
15          cost of energy and capacity below the level that would have been incurred had the  
16          Company not been able to realize avoided cost savings. The rate impacts shown  
17          on Farmer Settlement Exhibit Nos. 1 and 2 do not include the savings discussed  
18          above that will be realized by customers who participate in Company sponsored  
19          programs. In addition, the impacts of customers "opting out" of Rider EE (NC)  
20          are not included in the exhibit. The percentage change in individual customer  
21          rates caused by the implementation of Rider EE (NC) will be dependent on the  
22          level of power consumed by the individual customer.

1           As shown on Farmer Settlement Exhibit No. 3, the monthly billing factor  
2           for a residential customer taking service under Rate RS is estimated to be  
3           \$0.001206 per kWh during the first year of the four-year cost recovery period.  
4           The estimated monthly billing factor increases to \$0.004207 per kWh in the last  
5           year of the four-year cost recovery period. The monthly bill of a typical  
6           residential customer using 1,000 kilowatt-hours will increase by \$1.21 and \$4.03,  
7           respectively during the first and fourth years.

8                                   **III.   NET LOST REVENUES**

9   **Q.   MR. FARMER, DO THE SETTLEMENT TERMS PROVIDE FOR THE**  
10   **RECOVERY OF NET LOST REVENUES?**

11   **A.   Yes, the various provisions relating to the recovery of net lost revenues are set out**  
12   **in Exhibit B, Section G of the Agreement. Section G includes a table that shows**  
13   **the projected annual level of net lost revenues that is expected to occur during the**  
14   **six-year recovery period provided for in the Agreement. As shown on this table,**  
15   **the estimated amount of net lost revenues to be collected from North Carolina**  
16   **customers totals \$151 million at 85% achievement. The recovery of net lost**  
17   **revenues will be subject to adjustment (either up or down) based on the level of**  
18   **verified kW and kWh reductions actually realized. At a savings level that equals**  
19   **100% of target achievement the recovery of lost revenues would total**  
20   **approximately \$178 million. As explained earlier in my testimony, the recovery**  
21   **of net lost revenues applicable to energy efficiency programs for vintage years**  
22   **three and four will extend two-years beyond the initial four-year cost recovery**  
23   **period assuming such recovery does not terminate or is not reduced as a result of**

1 approval of a decoupling or alternative recovery mechanism or an order in a  
2 general rate proceeding that provides for the recovery of net lost revenues.

3 **Q. HOW WILL THE COMPANY CALCULATE NET LOST REVENUES**  
4 **UNDER THE AGREEMENT?**

5 **A.** The calculation of net lost revenues (sometimes referred to as lost margins) was  
6 estimated by multiplying the portion of the Company's tariff rates that represent  
7 the recovery of fixed costs by the estimated kW and kWh reductions applicable to  
8 energy efficiency programs. The calculation of net lost revenues does not apply  
9 to demand-side management programs. The Company calculated the portion of  
10 retail tariff rates representing the recovery of fixed costs by deducting the  
11 recovery of fuel costs from its tariff rates.

12 **Q. DID THE COMPANY'S ORIGINAL SAVE-A-WATT PROPOSAL CALL**  
13 **FOR THE EXPLICIT RECOVERY OF NET LOST REVENUES?**

14 **A.** No. There was no explicit recognition or recovery of net lost revenues. The  
15 recovery of net lost revenues was embedded in the revenue requirement  
16 calculations that were based on 90% of estimated avoided capacity and energy  
17 costs included in the Company's original filing. The reduced percentages of  
18 avoided costs used to determine revenue requirement set forth in Section C of  
19 Exhibit B of the Agreement, were calculated recognizing that net lost revenues  
20 would be recovered separately.

21 **IV. TRUE-UP**

22 **Q. DO THE SETTLEMENT TERMS PROVIDE FOR A TRUE-UP**  
23 **PROCESS?**

1     A.     Yes. As explained above, the Settlement Agreement provides for series of annual  
2           true-ups that will be conducted to update revenue requirements based on actual  
3           customer participation results. Revenues will be collected from customers based  
4           on the annual participation true-up results plus an updated forecast of customer  
5           participation in the Company's energy efficiency and demand-side management  
6           programs. A final true-up process, based on independently measured and verified  
7           results will take place after the evaluation of the program results when the four-  
8           year period is complete. At that time, amounts due the Company based on the  
9           terms of the Agreement will be compared to revenues collected from customers.  
10          Any difference will be flowed through to customers or will be collected from  
11          customers, as the case may be. If there are amounts owed to customers, such  
12          amounts will be refunded with interest at a rate to be determined by the  
13          Commission in the first true-up proceeding in which an over collection occurs.  
14          Net lost revenues will be included in the final true-up process at the end of the  
15          four-year plan. The outstanding balance of net lost revenues will be adjusted  
16          based on the actual measured and verified lost revenues determined in the final  
17          true-up process.

18                 The true-up process will capture the effects of a number of reconciliations.  
19                 For example, the true-up process will capture the difference between revenues  
20                 billed customers based on 85% of targeted energy efficiency program avoided  
21                 cost savings billed customers (revenue requirement calculated based on 50% of  
22                 life-time net present value savings) and 85% of targeted demand-side  
23                 management program avoided cost savings billed customers (revenue requirement

1       calculated based on 75% of nominal dollar savings over the four-year recovery  
2       period) and revenues due the Company based on the applicable percentage of  
3       verified energy efficiency and demand-side management avoided cost savings  
4       actually realized. The true-up process will capture the difference between lost  
5       revenues billed customers and the recovery of net lost revenues owed the  
6       Company based on verified MW and MWh savings. The true-up process also will  
7       include calculations that ensure that the level of compensation recovered by the  
8       Company is capped so that the after-tax rate of return on actual program costs  
9       applicable to energy efficiency and demand-side management programs does not  
10      exceed the predetermined earnings cap levels set out in the Agreement.

11   **Q.   PLEASE SUMMARIZE THE PROCESS THAT WILL BE USED TO**  
12       **ENSURE THAT COMPANY EARNINGS APPLICABLE TO THE SAVE-**  
13       **A-WATT PROGRAM DO NOT EXCEED THE PREDETERMINED**  
14       **LEVELS SET OUT IN THE AGREEMENT.**

15   **A.   First, let me emphasize that the Agreement does not guarantee or ensure that the**  
16       **Company will realize or achieve the earnings levels set out in the Agreement.**  
17       **The Company assumes the risk that projected savings will not materialize and that**  
18       **revenues received from customers based on the percentage of avoided cost**  
19       **savings retained by the Company will not result in any management incentive or**  
20       **cover the costs of energy efficiency and demand-side management programs.**  
21       **Having said that, the process used to determine compliance with the earnings cap**  
22       **provision will be as follows. The Company will calculate the level of after-tax**  
23       **earnings, on a net present value basis, that would be produced by deducting actual**

1 program costs incurred during the four-year settlement period from the  
2 cumulative revenue level to which the Company is entitled based on the  
3 provisions of the Agreement. The cumulative revenue level, which will exclude  
4 the recovery of lost revenues, will be calculated by applying the various  
5 provisions set out in the discussion of the true-up process above. The Company  
6 will then apply the appropriate tax factors in order to determine the after-tax  
7 earnings level produced by these values. The after-tax earnings level will be  
8 divided by actual program costs incurred in order to determine the percentage  
9 return (*i.e.*, rate of return) on actual program costs. The Company will compare  
10 the rate of return on actual program costs produced by this calculation to the rate  
11 of return cap (*i.e.*, management incentive) that is provided for in Section F of the  
12 Agreement taking into consideration the percentage of avoided cost savings  
13 actually realized relative to the \$754 million of targeted system avoided costs  
14 savings (see chart below). If the rate of return on actual program costs is less than  
15 the capped level provided for in the Agreement, in other words, if the Company is  
16 not able to realize the level of earnings that are provided for in the Agreement,  
17 then no further adjustment will be made. If, on the other hand, the rate of return  
18 on actual program costs incurred exceeds the level provided for in the Agreement,  
19 then the excess earnings level (grossed-up for applicable taxes) will be refunded  
20 to customers. The performance targets and earnings caps levels set out in Section  
21 F-1 of the Agreement are as follows:

1

% of Target Achievement	Earnings Cap
≥90%	15%
80% to 89%	12%
60% to 79%	9%
<60%	5%

2

3 **Q. PLEASE EXPLAIN FARMER SETTLEMENT EXHIBIT NO. 4.**

4 **A. Farmer Settlement Exhibit No. 4 is a revision of the Rider EE (NC) tariff that was**  
5 **previously filed with the Commission that incorporates the provisions of the**  
6 **Agreement. Duke Energy Carolinas is requesting Commission approval of the**  
7 **tariff provisions and rates included on Farmer Settlement Exhibit No. 4.**

8

**V. CONCLUSION**

9 **Q. WERE FARMER SETTLEMENT EXHIBIT NOS. 1-4 PREPARED BY**  
10 **YOU OR AT YOUR DIRECTION?**

11 **A. Yes.**

12 **Q. DOES THIS COMPLETE YOUR TESTIMONY IN SUPPORT OF THE**  
13 **AGREEMENT AND JOINT STIPULATION OF SETTLEMENT?**

14 **A. Yes, it does.**



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1 Q. (By Ms. Nichols) Mr. Farmer, do you have a summary  
2 of your testimony?

3 A. I do.

4 Q. Can you please provide that at this time?

5 A. Yes.

6 (THE SUMMARY OF THE PREFILED TESTIMONY OF STEPHEN  
7 M. FARMER WILL BE COPIED INTO THE RECORD AS GIVEN  
8 ORALLY FROM THE WITNESS STAND.)

**DUKE ENERGY CAROLINAS, LLC**  
**Docket No. E-7, Sub 831**  
**SUMMARY OF SETTLEMENT TESTIMONY OF**  
**STEPHEN M. FARMER**

1           The purpose of my testimony is to explain and support certain provisions of the  
2   Agreement and Joint Stipulation of Settlement among the Stipulating Parties and, more  
3   specifically, to describe differences in customer rate impacts and jurisdictional revenue  
4   requirement between the original save-a-watt filing and the Settlement Agreement.

5           My testimony explains that the cumulative jurisdictional revenue that will be  
6   billed North Carolina retail customers over the initial four-year cost recovery period,  
7   based on the negotiated provisions and terms of the Agreement, is less than the revenue  
8   requirement that would have been billed customers under the Company's original save-a-  
9   watt plan. My testimony explains that the Agreement provides for the limited recovery of  
10   net lost revenues and that such recovery will end two after the end of the initial four-year  
11   cost recovery period. My testimony includes an explanation of the various factors that  
12   affect the level of revenue that will be collected by the Company..

13          My testimony explains that the Stipulating Parties have agreed to mitigate any  
14   potential overbilling of costs to customers by initially billing customers at a rate that  
15   assumes the Company will achieve 85% of its targeted avoided cost savings goals (as  
16   opposed to the Company's original assumption of 100%). I explain that the Agreement  
17   provides for an annual true-up process in order to adjust jurisdictional revenue  
18   requirement to reflect historical customer participation levels in addition to any changes  
19   or updates to forecasted customer participation levels. In addition, the Agreement  
20   provides for a final true-up after the end of the initial four-year cost recovery period that  
21   will capture differences not only due to actual versus projected customer participation

1 levels but also projected versus independently verified program impacts. The end-of-  
2 period true-up also will capture any adjustment that may result from the cap on Company  
3 earnings provided for in the Agreement that is more fully explained in my testimony.  
4 Differences between amounts due the Company based on actual avoided cost savings  
5 realized by customers and amounts billed customers at 85% of target achievement will be  
6 collected from or refunded to customers as part of the annual and/or end of period true-  
7 up.

8 Because the Company's energy efficiency and demand-side management  
9 programs included in the portfolio of programs approved in this proceeding are programs  
10 directed specifically to Duke Energy Carolinas' retail customers, the Company believes it  
11 is appropriate to recover the costs of such programs only from these customers. The  
12 Public Staff did not agree to this proposal. The Public Staff believes that a portion of the  
13 save-a-watt revenue requirement should be allocated to the Company's wholesale  
14 customers. The Agreement provides that inputs applicable to demand-side management  
15 programs be allocated between the North Carolina and South Carolina retail jurisdictions  
16 based on contributions to system retail peak demand by all system retail customers based  
17 on the Company's 2008 cost of service study. Inputs for energy efficiency programs and  
18 net lost revenues have been assigned to the North Carolina and South Carolina retail  
19 jurisdictions based on kilowatt-hour sales to system retail customers also from the cost of  
20 service study. Program costs applicable to energy efficiency and demand-side  
21 management programs will be allocated between North Carolina and South Carolina  
22 jurisdictions on the same basis as the revenue requirement. Under the provisions of the

1 Agreement, the recovery of program costs applicable to a particular vintage of energy  
2 efficiency programs will occur during the program vintage year.

3 Although there was no explicit recognition or recovery of net lost revenues in the  
4 Company's original save-a-watt proposal, the Settlement terms provide for the limited  
5 recovery of net lost revenues. The reduced percentages of avoided costs used to  
6 determine revenue requirement set forth in the Agreement were calculated recognizing  
7 that net lost revenues would be recovered separately. The recovery of net lost revenues  
8 will be subject to adjustment (either up or down) based on the level of independently  
9 verified kW and kWh reductions actually realized. The recovery of net lost revenues will  
10 be limited to the level of estimated net lost revenues that are expected to occur during the  
11 36-month period that begins as of each initial vintage year of customer participation in  
12 Company sponsored programs.

13 The Agreement includes a number of other changes and modifications that will  
14 impact the recovery of jurisdictional revenue requirement, which my pre-filed testimony  
15 describes in detail. The changes in concepts and terms discussed in my testimony are  
16 implicitly included in the Agreement through the calculation of the projected system  
17 avoided cost savings of \$754 million.

18 This concludes the summary of my settlement testimony.

1 MS. NICHOLS: Mr. Farmer is now available  
2 for cross examination.

3 CHAIRMAN FINLEY: Cross examination? Mr.  
4 Green.

5 MR. GREEN: Thank you, Mr. Chairman.

6 CROSS EXAMINATION BY MR. GREEN:

7 Q. Good morning, Mr. Farmer.

8 A. Good morning, Mr. Green.

9 Q. On page 14 of your testimony lines, 11 through 16,  
10 you reference the Settlement Agreement Section G  
11 regarding net lost revenues. Would you look at the  
12 Settlement Agreement that's Mr. Schultz's Exhibit  
13 1? On page 22, that section G, net lost revenues?

14 A. Would you give me the page reference again?

15 Q. It's page 22.

16 A. Okay. I have it.

17 Q. All right. The table in section G sets forth the  
18 net lost revenues that are estimated to be received  
19 by Duke under the settlement with energy efficiency  
20 savings at 85 percent. Is that correct?

21 A. That's correct.

22 Q. And looking at Table G -- in the table in G, it  
23 sets the net lost revenues to be received by Duke  
24 in year one at \$7.7 million. Correct?

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1 A. That's correct.

2 Q. And in year two it would be 16.5 million?

3 A. Correct.

4 Q. In year three the net lost revenues would be 29.9  
5 million?

6 A. Yes.

7 Q. In year four the net lost revenues would be 42.3  
8 million?

9 A. That's also correct.

10 Q. In year five they would be 33.9 million?

11 A. That's right.

12 Q. And in year 6 they would be 20.5 million?

13 A. Yes.

14 Q. So the total net lost revenues over the six-year  
15 revenue stream would be \$151 million?

16 A. That's correct.

17 Q. Looking at section F of the Settlement Agreement,  
18 which is on page 21 of Schultz Exhibit B, the table  
19 there states the save-a-watt earnings cap at  
20 different levels of energy efficiency savings. Is  
21 that correct?

22 A. Yes.

23 Q. At the 85 percent energy efficiency savings level,  
24 the earnings cap is 12 percent. Correct?

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1 A. Yes.

2 Q. The second sentence below the table there showing  
3 the earnings cap states, "Earnings shall be  
4 calculated as an after tax rate of return on the  
5 actual program costs incurred by the Company over  
6 the four-year plan period on a net present value  
7 basis." Does that mean that the 12 percent  
8 earnings cap will not be calculated on an annual  
9 basis?

10 A. That's true. After -- actually, the earnings  
11 calculation will be done, first of all, at the end  
12 of the -- after the end of the four-year period so  
13 that the earnings of the company are assessed over  
14 the entire four-year period rather than on an  
15 annual period -- on an annual basis. So the  
16 sentence provides that the net present value of the  
17 revenues and the expenses that are incurred during  
18 that four-year period will be used to calculate the  
19 percentage rate of return on the actual program  
20 cost.

21 Q. So the 12 percent earnings cap reflected there will  
22 be calculated using four years of revenue received  
23 by the Company divided by four years of the program  
24 cost?

1 A. There are other parts of the calculation; for  
2 example, income taxes and other related taxes,  
3 other costs. But if you include that in the  
4 definition of cost, then that's the case. The  
5 earnings -- the cap -- and to look at earnings, the  
6 restriction -- cap on earnings basically is a cap  
7 on the earnings over the entire four-year period.

8 Q. And the four years of revenues used to calculate  
9 the earnings cap will not include any net lost  
10 revenues. Is that correct?

11 A. That's correct.

12 MR. GREEN: Mr. Chairman, may I approach  
13 the witness?

14 CHAIRMAN FINLEY: Yes, sir.

15 MR. GREEN: Mr. Chairman, I have handed  
16 the witness a document that I have marked Attorney  
17 General's Farmer Cross Examine Exhibit No. 1.

18 CHAIRMAN FINLEY: This paper writing will  
19 be marked for identification as Attorney General's  
20 Farmer Cross Examination Exhibit No. 1.

21 (ATTORNEY GENERAL FARMER CROSS EXAMINATION  
22 EXHIBIT NO. 1 WAS MARKED FOR IDENTIFICATION.)

23 Q. (By Mr. Green) Mr. Farmer, have you seen this  
24 Exhibit 1 before?



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1 A. I have.

2 Q. I believe this is a data request provided by my  
3 office that you responded to?

4 A. Yes. It was prepared by individuals within the  
5 Company. I've reviewed the schedule.

6 MR. GREEN: And just for the record, I --  
7 I had a discussion with Duke counsel about whether  
8 or not there's any confidential information in this  
9 docket -- in this document. And my understanding  
10 is that it's not.

11 MS. HEIGEL: That's correct.

12 Q. On Table 1, the first column labeled NPV is the net  
13 present value of the amounts listed below that  
14 heading. Is that correct?

15 A. That's correct.

16 Q. The last entry in the first column, which is line  
17 13 labeled ROI, is your calculation of the return  
18 on investment that Duke will receive if net lost  
19 revenues are included in the after tax earnings  
20 calculation. Is that correct?

21 A. That's correct.

22 Q. And that calculation is 58.8 percent. Right?

23 A. Yes. That assumes that -- first of all, that the  
24 revenue recovered through the -- through the

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1           Company's tracker representing the recovery of net  
2           lost revenues is not offset or, in effect, it's --  
3           in effect it's assuming that there is no negative  
4           effect of reducing sales and reducing the revenue  
5           stream from the Company and that there is -- there  
6           is no effect of that on -- on Company earnings  
7           because it's -- it basically is -- the economic  
8           effect of that is zero.

9   Q.       You calculated the ROI of 58.8 percent by dividing  
10           the after tax margin on line 12, which is 92.1  
11           million, by the program cost on line 8 which is  
12           156.6 million. Is that correct?

13   A.       Yes.

14   Q.       Looking at the second page on Table 2, the first  
15           column on that table labeled NPV is the net present  
16           value of the amounts listed below that heading. Is  
17           that correct?

18   A.       Yes.

19   Q.       Comparing Table 1 and Table 2, the main difference  
20           between those is on line 6, where on Table 2 you  
21           have included net lost revenues as a cost. Is that  
22           correct?

23   A.       Yes.

24   Q.       In Table 2 the inclusion of net lost revenues as

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1 revenue on line 2 and as a cost on line 6 means  
2 that those two items cancel each other out, and net  
3 lost revenues are not included in the ROI  
4 calculation. Is that correct?

5 A. That's correct.

6 Q. The last entry in the first column on Table 2, line  
7 number 13, labeled ROI is your calculation of the  
8 return on investment that Duke will receive if net  
9 lost revenues are not included in the after tax  
10 earnings calculation. Is that correct?

11 A. That is correct.

12 Q. Net return on investment is 11.1 percent. Correct?

13 A. Yes, all these numbers obviously based on the  
14 estimates of revenues and expenses that are -- that  
15 are included in the Company's plan. The -- yes,  
16 the return on investment or return on program cost  
17 is 11.1 percent which, you know, it's less than the  
18 cap, the authorized percentage return of 12  
19 percent.

20 Q. You calculated the ROI on that Table 2 of 11.1  
21 percent by dividing the after tax margin on line 2  
22 -- excuse me, line 12, which is 17.3 million by the  
23 program cost on line 8, which is 156.6 million. Is  
24 that correct?

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1 A. That's correct.

2 Q. And based on the information in Tables 1 and 2,  
3 inclusion of net lost revenues in the save-a-watt  
4 return on investment shows that Duke's save-a-watt  
5 return on investment to be a little over five times  
6 the Company's ROI when net revenues are not  
7 included in the calculation. Is that correct?

8 A. Could you restate that again, please?

9 Q. Based on the information in Tables 1 and 2, the  
10 inclusion of net lost revenues in the save-a-watt  
11 ROI shows Duke's save-a-watt ROI to be a little  
12 over five times the Company's ROI when net lost  
13 revenues are included -- or not included in the  
14 calculation?

15 A. Yes, that's correct. And it gives you a sense of  
16 how important the recovery of net lost revenues are  
17 to the Company.

18 Q. And Duke's present authorized overall rate of  
19 return on its generation business is 8.57 percent.  
20 Is that correct?

21 A. I believe that's correct taking into consideration  
22 both the debt and equity components of the return,  
23 the -- the combined rate of return I believe is in  
24 that -- in that range. I think that's a return on

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1 rate base, jurisdictional rate base.

2 MR. GREEN: Thank you, Mr. Farmer. I  
3 have no additional questions.

4 CHAIRMAN FINLEY: Mr. Runkle.

5 CROSS EXAMINATION BY MR. RUNKLE:

6 Q. Good morning, Mr. Farmer.

7 A. Good morning.

8 Q. I'd also like to look at the net lost revenues.

9 And as I understand it, there are -- the Company is  
10 not seeking net lost revenues on the DSM program.

11 Is that correct?

12 A. That's correct.

13 Q. Now, is -- what's the rationale for that?

14 A. That -- that basically, the demand response  
15 recovers the cost of the program. There is --  
16 there would be no net lost revenues at the -- at  
17 recovering capacity.

18 Q. In fact, if you -- looking at a peak time, if you  
19 spend a dollar on a DSM program, you don't have to  
20 provide that -- the amount of electricity needed at  
21 the peak period. Is that correct?

22 A. When you say the amount of electricity, are you  
23 defining that as kW or kWh? Yes, the statement is  
24 true.

1 Q. So for -- for a demand-side management program, the  
2 Company actually benefits, does it not? You don't  
3 have to spend as much money on a DSM program that  
4 you do as providing a new power plant or purchasing  
5 from somebody else?

6 A. Yes, and that's embedded in the -- the calculation  
7 of revenue requirement. Revenue requirement in  
8 this proceeding, which is based on the percentage  
9 of avoided cost, that's all taken into  
10 consideration.

11 Q. Okay. All right.

12 A. And on your question, your earlier question on net  
13 lost revenue and whether the Company is -- why it  
14 has not included any calculations of revenues that  
15 might be lost due to demand-side management  
16 programs, you know, I'd add on that that there is a  
17 net lost revenues -- there is a reduction in  
18 revenues that occurs as -- as peaks are reduced by  
19 demand-side management programs. If you think  
20 about a -- for example, an industrial customer  
21 that's on a demand energy rate, and if you lower  
22 the demands then you're going to lower the -- the  
23 revenue from that -- that customer. The bottom  
24 line, even though there is net lost revenue on

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1 demand-side management programs, the Company has  
2 chosen to not ask for recovery of those.

3 Q. And then -- so on the energy efficiency side,  
4 describe what you mean by lost revenues? What does  
5 that encompass?

6 A. The energy efficiency side has customers reduce  
7 their load, their usage of energy, then obviously  
8 they will -- the revenue received from that  
9 customer will also be reduced. That reduction in  
10 revenue received from the customer will include not  
11 only a reduced variable cost but also it will  
12 represent a reduction in revenues to the Company to  
13 recover -- to cover its fixed costs.

14 Q. And now on the net, what is -- what is netted out  
15 of the lost revenues?

16 A. It's net of the variable costs so that the  
17 calculation of net lost revenues represents that  
18 portion of the reduction in revenues that  
19 represents the contribution to the recovery of  
20 fixed costs.

21 Q. Now, are you familiar with Mr. Colton's testimony?

22 A. Generally, not really that familiar. I believe I  
23 may have skimmed that one time, but no.

24 Q. He -- he presents a case that in looking at the net

1           lost revenues that you need to consider some  
2           utility nonenergy benefits. Are you familiar with  
3           that concept?

4   A.       I do recall that he was -- had some testimony that  
5           maybe talked about societal benefits.

6   Q.       And are there -- are there actual benefits to the  
7           Company for having energy efficiency programs as  
8           opposed to building new coal or nuclear plants?

9   A.       Well, certainly there is the direct benefit that's  
10           those costs that would be avoided due to reduction  
11           in peak loads and reduction in load throughout the  
12           off-peak and both on-peak. There is that direct  
13           relationship. But --

14   Q.       Well, let me suggest goodwill. Would a -- would a  
15           Company that has an ambitious energy efficiency  
16           program have more goodwill than one that is  
17           building coal and nuclear plants?

18   A.       Well, yes, certainly they would. And the Company  
19           has made its position pretty clear on this, that  
20           they aggressively want to pursue energy efficiency  
21           and demand response, and there's certainly a  
22           feeling in the community that that's a good thing,  
23           and the Company is supportive of it. In fact, has  
24           been a leader in it. So there's an amount of



1 goodwill there, although for purposes of what I do,  
2 and that's calculating the nuts and bolts of what  
3 the costs of the business are and who pays, then  
4 goodwill is not a factor I would take into  
5 consideration.

6 Q. Can you monetize goodwill for a company?

7 A. No. I don't know how I would do that. I think it  
8 would be pretty difficult.

9 Q. Now, the Company spends money for goodwill  
10 advertising, does it not?

11 A. It does. You know, any company, I believe, wants  
12 to be a good corporate citizen. Certainly Duke  
13 does and I believe that it has been an excellent  
14 corporate citizen in the state of North and South  
15 Carolina. And quite frankly, it's just the way  
16 business should be done. That's -- that's the  
17 standard that we ought to be held to as companies,  
18 I believe.

19 Q. Would a Company that has an ambitious energy  
20 efficiency program have a better bond rating than  
21 one that was looking to build new coal plants and  
22 new nuclear plants?

23 A. Well, I -- I think it -- we had testimony by a  
24 witness earlier in this proceeding on that. I

1 think it depends on -- number one, it depends on  
2 what the cost recovery mechanism is because we're  
3 talking about several millions of dollars of cost  
4 to be incurred to put these programs in place that  
5 allow customers another tool to -- to -- to control  
6 the amount of usage. So if, for example, the  
7 Commission were to not allow the Company to recover  
8 its costs so that its return was less than what's a  
9 fair and reasonable return, then its bond ratings,  
10 I believe, would be affected and affected  
11 negatively.

12 Q. And so who would -- who would determine the fair  
13 and reasonable? Is that your -- your decision or  
14 your analysis?

15 A. Oh, obviously, we all as parties have an opinion as  
16 to what that is. Ultimately, it's the Commission  
17 who will decide. And the bond community and the  
18 investment community will make their decision also  
19 whether they -- they believe that is fair and  
20 reasonable.

21 Q. And so if -- if the -- if Duke Energy's bond  
22 ratings are improved because the Company has an  
23 ambitious energy efficiency program is that an  
24 economic benefit to the Company?

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1 A. Yes.

2 Q. Is -- under the Settlement Agreement is that  
3 economic benefit a part of the net lost revenues?

4 A. No, because the -- basically, the Company is -- no,  
5 it is not.

6 Q. Now, in Mr. Colton's testimony he also talked of  
7 some other benefits to the Company such as lower  
8 bad debt write-off. Would that be a benefit to a  
9 Company if they didn't have to write off as many  
10 bad debts?

11 A. Yes, it would if -- if there is such a thing and if  
12 one is -- yes, it would be.

13 Q. Reduced carrying costs on arrearages?

14 A. If arrearages should happen to change because of  
15 the energy efficiency demand-side management  
16 programs. If that were to occur, then that would  
17 be a benefit. I believe it would probably be  
18 fairly minuscule, but I don't know that.

19 Q. Now, are those things that you would suggest to --  
20 to Duke that they -- that they look at as part of  
21 the -- the cost of their energy efficiency  
22 programs?

23 A. I believe that's probably getting out of the bounds  
24 of those items to be looked at as part of this

1 proceeding. Now, obviously, I'll say that -- that  
2 to the extent that those costs are reduced, then  
3 customers will ultimately benefit by that reduction  
4 through -- in a rate case that might -- might occur  
5 in the future. That could happen. Not could  
6 happen; it will happen.

7 MR. RUNKLE: I have no further questions.

8 CHAIRMAN FINLEY: Other questions on  
9 cross?

10 MR. HOLTZMAN: No questions. No, sir.

11 MS. THOMPSON: Nothing.

12 MR. OLSON: No questions.

13 MR. MCDONALD: No.

14 CHAIRMAN FINLEY: Redirect?

15 MS. HEIGEL: I have just a few questions.

16 REDIRECT EXAMINATION BY MS. HEIGEL:

17 Q. Mr. Farmer, are the earnings caps that Mr. Green  
18 was referring to earlier, are those guarantees of  
19 certain levels of earnings for the Company?

20 A. No. The Company has made it pretty clear  
21 throughout in its testimony that these are caps  
22 only -- these cap the Company's earnings. To the  
23 extent that the Company earns less than that, then  
24 that's the Company's issue, basically. And in

1 fact, the example that we went through with Mr.  
2 Green which showed that -- his lost revenue example  
3 as we were going through that, that example showed  
4 that the -- based on the numbers -- the Company's  
5 estimate of cost and revenues, the actual return  
6 earned would be 11.1 percent and not the 12 percent  
7 that's provided for in the agreement. So that's  
8 the long answer.

9 The short answer is if we exceed the cap,  
10 we'll give monies back to customers. If we are  
11 under the cap, that will be our problem. There is  
12 no provision that we could recover additional costs  
13 from customers.

14 Q. And Mr. Farmer, do customers pay for advertising to  
15 build goodwill?

16 A. I don't believe they do in North Carolina. That's  
17 my impression. That's generally the rule  
18 throughout most all utilities. I know, for  
19 example, Indiana has that same rule, that that is  
20 not a cost that's recoverable from customers.

21 Q. Now, are the magnitude of investments in energy  
22 efficiency equivalent to the investments in new  
23 base load generation?

24 A. Pardon me? Say that again, please?

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1 Q. Are the magnitude of investments by the Company in  
2 energy efficiency equivalent to investments in new  
3 base load generation?

4 A. No, significantly less.

5 Q. And can you elaborate on how nonutility benefits  
6 are captured in rate cases?

7 A. Nonutility -- you might need to help me with that.

8 Q. Some of the things that Mr. Runkle was --

9 A. Oh, okay.

10 Q. Lower cost of --

11 A. Yes.

12 Q. -- debt and things of that nature?

13 A. Yeah. I think of nonutility as being something not  
14 part of the utility operations.

15 Q. Yeah, I should have been a little more explicit.

16 A. No, it's -- now, I think I -- hopefully, I made it  
17 clear that to the extent that some of these other  
18 costs might change and might go down, that -- that  
19 to the extent that that does happen, then that  
20 would be reflected in determination of the revenue  
21 requirement in a future rate case and that those --  
22 the benefits of those would be passed on directly  
23 to the customers.

24 MS. HEIGEL: Thank you. I have nothing

1 further.

2 CHAIRMAN FINLEY: All right. We're going  
3 to take a morning recess, and we'll be back at five  
4 minutes until 11.

5 (RECESS TAKEN FROM 10:40 A.M. UNTIL 10:55 A.M.)

6 CHAIRMAN FINLEY: I believe we had  
7 finished the redirect examination of Mr. Farmer,  
8 and the next item would be questions by the  
9 Commission. Mr. Culpepper.

10 COMMISSIONER CULPEPPER: Have you got a  
11 copy of the August 10, 2009 filing entitled Duke  
12 Energy Carolinas Responses to the Commission's Pre-  
13 hearing Order Requiring Verified Information? Do  
14 you have a copy of that?

15 THE WITNESS: I do.

16 COMMISSIONER CULPEPPER: Okay. Could you  
17 flip over to -- there's an exhibit toward the back  
18 of that called Attachment 8-1. It says it's two  
19 pages, but I don't know. I want to take a look at  
20 page 2 of 2, if you can get over there to that.  
21 Tell me when you get there.

22 THE WITNESS: I have it.

23 COMMISSIONER CULPEPPER: All right. Do  
24 you see the category -- the category there called

1           Total Avoided Costs and then there's residential  
2           programs and then you get down to about five or six  
3           or three or four or four or five. It says Total  
4           Residential Energy Efficiency Avoided Costs. Fifty  
5           -- I'm talking about year one now. It looks like  
6           \$50,501,201. Do you see that?

7                       THE WITNESS: Yes.

8                       COMMISSIONER CULPEPPER: You see that  
9           figure?

10                      THE WITNESS: Yes, I do.

11                      COMMISSIONER CULPEPPER: And then  
12           underneath that is Power Manager. Now, I  
13           understand that's the one residential DSM program.  
14           Is that correct?

15                      THE WITNESS: That's correct.

16                      COMMISSIONER CULPEPPER: All right. And  
17           then you've got a figure right there something over  
18           \$17 million. And then you've got Total Residential  
19           Avoided Costs and there's a 67.9 figure there. You  
20           see all that?

21                      THE WITNESS: Yes.

22                      COMMISSIONER CULPEPPER: Okay. Now,  
23           setting that aside, can you turn over to your  
24           Exhibit No. 3 that's attached to your testimony,



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1 Farmer Exhibit Number 3? It's entitled Estimated  
2 Annual Riders Applicable to the Company's Energy  
3 Efficiency Plan. Do you have that in front of you?

4 THE WITNESS: I do.

5 COMMISSIONER CULPEPPER: Okay. I just  
6 want to zero in on year one, not the whole -- all  
7 of it, just talking about year one. I'm trying to  
8 get a handle on something. You've got a figure  
9 there that says Residential Avoided Cost Revenue  
10 Requirement, and it's \$17,780,486. Do you see that  
11 figure?

12 THE WITNESS: Yes.

13 COMMISSIONER CULPEPPER: Now, am I  
14 understanding correctly that that figure might not  
15 be the correct figure that everybody agrees upon at  
16 this point in time?

17 THE WITNESS: Are you assuming the  
18 Commission will make adjustments to -- that might  
19 affect this figure or --

20 COMMISSIONER CULPEPPER: No, sir. I was  
21 just wondering if the Public Staff agrees with that  
22 -- with that particular figure.

23 THE WITNESS: They do not.

24 COMMISSIONER CULPEPPER: They do not?

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1           Okay. So there's some disagreement about that  
2           figure?

3                   THE WITNESS: Yes.

4                   COMMISSIONER CULPEPPER: All right. But  
5           there is some figure that's eventually going to be  
6           decided in this case for year one residential  
7           avoided cost revenue requirement. Let me ask you  
8           this. On this particular exhibit, does this  
9           include both energy efficiency and the one DSM  
10          program or is this strictly energy efficiency?

11                   THE WITNESS: This is the combination of  
12          both of the energy efficiency and the DSM.

13                   COMMISSIONER CULPEPPER: All right.  
14          Okay, good. All right. So here's what I want to  
15          ask you. Looking at this figure over here, these  
16          three figures in the attachment 8-1, page 2, we  
17          talked about total residential energy efficiency  
18          avoided cost, and there's a figure of a little over  
19          \$50 million. And then there's the one DSM program,  
20          and it's about 17.5 million. And the total is  
21          67.9. Tell me how you get from those figures to  
22          this 17.78 figure on your exhibit. What do you  
23          multiply those figures by in order to get this  
24          figure on your exhibit?

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1 THE WITNESS: I'll give you my best -- on  
2 this. There may be -- you may have a need to  
3 clarify this with Dr. Stevie, but I think I can  
4 answer your question.

5 COMMISSIONER CULPEPPER: Okay.

6 THE WITNESS: First of all, the avoided  
7 cost that you are looking at on the Attachment 8-1,  
8 which actually is a Dr. Stevie exhibit, I believe  
9 that those are -- are just that. They are the  
10 avoided costs by year. They have not been -- the  
11 percentages, the 75 percent and 50 percent, I don't  
12 believe have been multiplied times these numbers,  
13 that being 75 percent of the demand-side management  
14 avoided cost and 50 percent of the net present  
15 value of the energy efficiency. So I don't believe  
16 that that's taken place at this point.

17 And then also, obviously, the -- that --  
18 what would -- that resultant, then, has not been  
19 allocated to -- between the North Carolina and the  
20 South Carolina jurisdictions, so that would cause  
21 this number on my exhibit to be lower than on  
22 Exhibit 8-1. And then the allocation to  
23 residential and nonresidential customers has really  
24 not been factored into those numbers that are on

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1 Exhibit 8-1 although --

2 COMMISSIONER CULPEPPER: Well, let me  
3 stop you.

4 THE WITNESS: Although, you do have --  
5 the number as I -- yeah, we're looking at  
6 residential numbers on 8-1 so that there is -- that  
7 distinction is there. I misspoke on that.

8 COMMISSIONER CULPEPPER: All right.  
9 Well, let me ask you this. Are you saying, then,  
10 that these figures on Attachment 8-1 that we've  
11 been talking about, that those are not just North  
12 Carolina figures, that that's North Carolina and  
13 South Carolina.

14 THE WITNESS: I believe that's the case,  
15 yes.

16 COMMISSIONER CULPEPPER: All right. So -  
17 - well, let me -- let me just ask you this for  
18 purposes of getting straight in my mind about how  
19 you would get to your -- your figure on your  
20 exhibit, your 17.7. If -- if these figures on  
21 Attachment 8-1, if they were strictly North  
22 Carolina figures, do I understand it that you would  
23 take that figure for the total residential energy  
24 efficiency cost and multiply that time 50 percent,

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1           that is 0.5, and then multiply that by 0.85 and  
2           then take the power manager North Carolina figure  
3           and multiply that time 0.75 and then multiply the  
4           resultant figure by 0.85, add the two resulting  
5           figures together, and that should be your figure  
6           here, residential avoided cost revenue requirement  
7           for year one? Is that right?

8                   THE WITNESS: The only thing that I'm  
9           wondering about -- and I need Dr. Stevie to confirm  
10          what these numbers are. The values in years one,  
11          two, three, and four for the avoided cost for --  
12          for example, for energy efficiency, the \$50 million  
13          number that we saw in this table. I'm assuming  
14          that that is what it says it is, the avoided cost  
15          for that year. Now, of course, the revenue  
16          requirement for energy efficiency based on the  
17          Company's model is based on the net present value  
18          of the avoided costs that occur over the life of  
19          the measure.

20                   COMMISSIONER CULPEPPER: Well, there's  
21          testimony that that -- the NPV factor isn't there  
22          for year one. Isn't that correct? That's a factor  
23          for year two, three, and four? You reduce --

24                   THE WITNESS: Well --

1 COMMISSIONER CULPEPPER: You reduce year  
2 two's calculations by some discount factor.

3 THE WITNESS: Yeah, I think --

4 COMMISSIONER CULPEPPER: It's beyond me,  
5 but it's there.

6 THE WITNESS: I think theoretically I  
7 believe that's correct. And again, that's -- you  
8 might want to confirm that with Dr. Stevie or Mr.  
9 Smith could probably confirm that for you. But  
10 yes, in theory -- theoretically and conceptually, I  
11 agree with what you're saying.

12 COMMISSIONER CULPEPPER: All right.  
13 Thank you. Thank you.

14 CHAIRMAN FINLEY: Mr. Farmer, I want to  
15 call your attention to some of the answers to the  
16 supplemental information provided by the Company on  
17 August 10, 2009, in particular Attachment 1 --  
18 excuse me, Attachment 3-1. Total costs.

19 THE WITNESS: Okay, I have it.

20 CHAIRMAN FINLEY: Do you see that's  
21 broken down into implementation and assessment  
22 costs, administration costs, and in the lower  
23 category there is incentives? Do you see the  
24 headings on the top of the columns there?

1 THE WITNESS: Yes.

2 CHAIRMAN FINLEY: I guess my question is  
3 when we talk about incentives on that exhibit, are  
4 those incentives paid by Duke to consumers or is  
5 that incentives that Duke earns on the program?

6 THE WITNESS: No, it -- it's not the  
7 latter. I believe it is the -- the former. It's  
8 the incentives paid to the customer; not the, for  
9 example, the 1512 or percent return. I believe  
10 that to be the case. I'm pretty certain of that.  
11 You might want to confirm that with Mr. Smith.

12 CHAIRMAN FINLEY: All right. If you then  
13 would turn back to the settlement exhibit itself on  
14 page 23? Are you with me?

15 THE WITNESS: Yes, I have it.

16 CHAIRMAN FINLEY: There in paragraph 3  
17 you have a table that's labeled Total Revenue  
18 Requirements. Is that correct?

19 THE WITNESS: Yes.

20 CHAIRMAN FINLEY: I want to ask you about  
21 the last set of lines and columns. Total revenue  
22 requirement at 85 percent achievement. And the sum  
23 total of that is \$369.2 million. Correct?

24 THE WITNESS: Yes.

1                   CHAIRMAN FINLEY: And that is to be the  
2                   Company's determination of the full revenue  
3                   requirements during the four-year term of the plan  
4                   with the exception of any outstanding balance of  
5                   net lost revenues to be collected by the Company or  
6                   revenue credit to be refunded to customers, is it  
7                   not?

8                   THE WITNESS: That's correct.

9                   CHAIRMAN FINLEY: So the total revenue  
10                  requirement at 85 percent achievement of the \$369.2  
11                  million shown there is to -- is to recover the  
12                  program costs, net lost revenues, and the earnings  
13                  to the Company that result from the incentive  
14                  compensation. Right?

15                  THE WITNESS: That is correct. These --  
16                  the -- the numbers here are all inclusive of those  
17                  three components that would be recovered through  
18                  the revenue requirement.

19                  CHAIRMAN FINLEY: And if you turn to  
20                  revised Farmer Exhibit 1 which was, again, provided  
21                  in response to question 15 to the Commission's  
22                  requests -- are you there?

23                  THE WITNESS: Yes.

24                  CHAIRMAN FINLEY: And column G, Revised



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1 Farmer Exhibit No. 1, you show a total revenue  
2 requirement there on line 5 --

3 THE WITNESS: I'm sorry. I need to -- I  
4 was not there. I misspoke, I guess. I didn't --  
5 didn't have the exhibit and the question.  
6 Actually, I'm not sure if my data book has that  
7 exhibit.

8 CHAIRMAN FINLEY: It's the last page on a  
9 submission.

10 (COUNSEL HANDS DOCUMENT TO WITNESS)

11 THE WITNESS: Okay. I have it.

12 CHAIRMAN FINLEY: If you will, look at  
13 column G, line 5.

14 THE WITNESS: Okay, I have that.

15 CHAIRMAN FINLEY: The \$218.2 million?

16 THE WITNESS: Yes.

17 CHAIRMAN FINLEY: That shows a total  
18 revenue requirement of \$218.2 million for the  
19 four-year pilot program excluding the revenue  
20 recovery related to net lost revenues. Correct?

21 THE WITNESS: That's correct.

22 CHAIRMAN FINLEY: And by our calculation  
23 that agrees to the estimated revenues at 85 percent  
24 achievement shown on Exhibit B, paragraph H.3 on

1           page 23. And this revenue requirement is designed  
2           to recover the program costs and the earnings to  
3           the Company that result from the incentive  
4           compensation. Right?

5                   THE WITNESS: That's correct.

6                   CHAIRMAN FINLEY: Okay. And if we look  
7           back at the Smith exhibit, Exhibit 3-1 -- have you  
8           made it back to attachment to 3-1?

9                   THE WITNESS: These are exhibits to Mr.  
10          Smith's testimony?

11                   CHAIRMAN FINLEY: This is attachment 3-1  
12          to the -- your answers to the Commission's  
13          questions. We looked at this moment ago when I  
14          asked you about the incentives.

15                   THE WITNESS: Okay.

16                   CHAIRMAN FINLEY: At the bottom there,  
17          the last line, you have the totals for years one,  
18          two, three, and four. Right?

19                   THE WITNESS: Yes.

20                   CHAIRMAN FINLEY: And if you add those  
21          up, the 35.4 million, the 45.8, the 79.0, the 114.7  
22          -- that adds up to be 275 million. Right? Would  
23          you accept that?

24                   THE WITNESS: I'll accept that, yes.

1                   CHAIRMAN FINLEY: If you would please  
2                   explain how the \$218.2 million that we were looking  
3                   at over on attachment 15-1 is designed to recover  
4                   the Company's projected program costs of 275  
5                   million as provided on attachment 3-1. In other  
6                   words, does that total revenue requirement indeed  
7                   recover all of those costs?

8                   THE WITNESS: It --

9                   CHAIRMAN FINLEY: -- and the incentives  
10                  and the net lost revenues?

11                  THE WITNESS: Yeah, I think this is a  
12                  question for Mr. Smith. Now, I will say I think  
13                  what may be happening here is that the -- the  
14                  numbers on attachment 3-1 are -- I believe are both  
15                  North Carolina and South Carolina numbers. They  
16                  are the cost to administer the program in both  
17                  jurisdictions, where the revenue requirement on --  
18                  on my exhibit is after the allocation to the  
19                  jurisdictions and the allocation to residential and  
20                  nonresidential. I -- I believe that's certainly  
21                  one item that might contribute to these  
22                  differences. And again, I -- I suggest you ask Mr.  
23                  Smith.

24                  CHAIRMAN FINLEY: Very well. Mr. Smith

1 is back there I hope and --

2 MS. NICHOLS: He'll be next.

3 CHAIRMAN FINLEY: He'll be next. All  
4 right. If you would look on page 4, lines 15 and  
5 18 of your June 19, 2009 testimony, please?

6 THE WITNESS: Was that line 4, page 19?

7 CHAIRMAN FINLEY: No, no. Page 4, lines  
8 15 and 18.

9 THE WITNESS: Okay. I wasn't even close.  
10 Page 4, lines -- I have it.

11 CHAIRMAN FINLEY: You state there that  
12 Farmer Supplemental Exhibit No. 1 shows that the  
13 sum of the jurisdictional revenue requirement based  
14 on the terms and provisions of the agreement is  
15 \$27.4 million, 8 percent less than the Company's  
16 original filing over the four-year recovery period.  
17 Right?

18 THE WITNESS: Yes.

19 CHAIRMAN FINLEY: And if you turn back to  
20 that page Ms. Nichol gave you a moment ago, there  
21 is a footnote 2 in very small print down at the  
22 bottom of the page. You see that?

23 THE WITNESS: Yes.

24 CHAIRMAN FINLEY: This states in part

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1           that the Company estimates that the combined sum of  
2           net lost revenues subject to recovery by North  
3           Carolina customers in year five and six will total  
4           approximately \$54 million at 85 percent of targeted  
5           achievement results. And the question is if you  
6           were to include the 54 million of projected net  
7           lost revenue recovery referenced in footnote 2 and  
8           your comparison on exhibit 15-1, is it not true  
9           that the sum of the jurisdictional revenue  
10          requirement based on the terms and provisions of  
11          the Settlement Agreement are greater than the  
12          Company's original filed save-a-watt proposal by  
13          approximately \$27 million? And if not, could you  
14          explain why?

15                 THE WITNESS: That is a true statement.  
16           And, you know, as I -- as this testimony was put  
17           together I -- I certainly did not want to mislead  
18           anyone on -- on this issue. In fact, my testimony  
19           a couple of times points out, hopefully clearly,  
20           that beyond the initial four-year period that there  
21           would be an additional recovery of net lost  
22           revenues for years five and six so that -- so that  
23           the total revenue, like -- like you say, is the  
24           same or is greater than under the Company's

1 original proposal during the six -- that six-year  
2 period. Well, no. Actually, that's not the case.

3 This became kind of a difficult thing to  
4 -- to show. And that's because under the original  
5 -- the Company's original proposal the revenue  
6 requirement extended out a number of years. For  
7 example, up to 18 years or so. And now we have --  
8 under the Settlement Agreement we have a -- a plan  
9 that recovers revenues over a relatively short  
10 period of time, a four-year period with an  
11 additional two years for net lost revenue recovery.

12 So, you know, to -- to make a really  
13 valid comparison of the settlement -- revenue under  
14 Settlement Agreement versus the original SAW  
15 proposal you would have to take all of that into  
16 consideration, the revenue over the entire length  
17 of the period. So it becomes very confusing,  
18 especially to put that in written word in  
19 testimony. So I want to be very clear that -- that  
20 what this comparison is is over the initial four-  
21 year period the revenue that would be collected is  
22 less when compared to those numbers that was in the  
23 Company's original proposal.

24 However, yes, there are additional

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1 revenues in the fifth and sixth years. And if you  
2 take those into consideration then the numbers that  
3 you have are correct. And if you wanted to really  
4 get to -- I'm going on further than I need to, but  
5 if you really want to compare the revenues on these  
6 -- the requirement of these two plans you'd also  
7 have to take into consideration the revenues beyond  
8 years four and beyond year six. And so, you know,  
9 you slice and dice it a number of different ways so  
10 --

11 CHAIRMAN FINLEY: Thank you. That's --  
12 anybody else -- any other Commissioner have  
13 questions?

14 (No response.)

15 CHAIRMAN FINLEY: Okay. Any questions on  
16 the Commission's questions?

17 MS. HEIGEL: No, Mr. Chairman. At this  
18 time I would move Mr. Farmer's Exhibits 1 through 4  
19 into the record.

20 CHAIRMAN FINLEY: Farmers Exhibits 1  
21 through 4 are admitted into evidence.

22 MR. GREEN: Mr. Chairman, I will move the  
23 Attorney General's Farmer Exhibit Number 1 into  
24 evidence.

1 CHAIRMAN FINLEY: Attorney General's  
2 Farmer Cross Examination Exhibit No. 1 is entered  
3 into evidence.

4 (FARMER DIRECT EXHIBITS 1 THROUGH 4 AND  
5 AND ATTORNEY GENERAL'S FARMER CROSS EXAMINATION  
6 EXHIBIT NO. 1 WERE ADMITTED INTO EVIDENCE.)

7 CHAIRMAN FINLEY: All right. Duke?

8 THE WITNESS: Thank you, Mr. Chairman and  
9 members of the Commission.

10 CHAIRMAN FINLEY: Thank you, Mr. Farmer.

11 MS. NICHOLS: At this time we call Mr.  
12 Raiford Smith.

13 CHAIRMAN FINLEY: Mr. Smith, come around.

14 MS. NICHOLS: We are going to put up Mr.  
15 Smith for purposes of his MIRR testimony that was  
16 requested -- the calculation that was requested by  
17 the Commission, and then we will call him back up  
18 after Mr. Colton testifies for his rebuttal  
19 testimony.

20 CHAIRMAN FINLEY: Very well.

21 (WHEREUPON, RAIFORD L. SMITH WAS CALLED AS A  
22 WITNESS, DULY SWORN, AND TESTIFIED AS FOLLOWS:)

23 DIRECT EXAMINATION BY MS. NICHOLS:

24 Q. Mr. Smith, please state your full name and business



1 address.

2 A. My name is Raiford Lawrence Smith, and my address  
3 is 526 South Church Street, Charlotte, North  
4 Carolina 28202.

5 Q. By whom are you employed and in what capacity?

6 A. I'm employed by Duke Energy, and I am director of  
7 strategy and collaboration for the marketing and  
8 energy efficiency group.

9 Q. Did you cause to be prefiled in this docket  
10 testimony consisting of 12 -- settlement supporting  
11 testimony consisting of six pages plus Smith  
12 Exhibit No. 1 consisting of six pages?

13 A. I did.

14 Q. Do you have any changes or corrections to your  
15 settlement testimony or its exhibit?

16 A. I do not.

17 MS. NICHOLS: At this time we move that  
18 the prefiled settlement testimony of Mr. Smith be  
19 copied into the record as if given orally from the  
20 stand and that his exhibit be marked as prefiled.

21 CHAIRMAN FINLEY: Mr. Smith's direct  
22 prefiled testimony shall be copied into the record  
23 as though given orally from the stand, and his  
24 exhibit shall be marked as premarked in the file.

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(THE PREFILED SETTLEMENT TESTIMONY OF  
RAIFORD L. SMITH WILL BE COPIED INTO THE  
RECORD AS IF GIVEN ORALLY FROM THE  
WITNESS STAND, AND SMITH EXHIBIT NO. 1  
WAS MARKED FOR IDENTIFICATION.)

**I. INTRODUCTION AND PURPOSE**

1 **Q. PLEASE STATE YOUR NAME, ADDRESS, AND POSITION WITH DUKE**  
2 **ENERGY BUSINESS SERVICES, LLC.**

3 **A. My name is Raiford L. Smith, and my business address is 526 South Church Street,**  
4 **Charlotte, North Carolina. I am Director, Strategy and Collaboration for Duke**  
5 **Energy Business Services, LLC, a service company affiliate of Duke Energy**  
6 **Carolinas, LLC ("Duke Energy Carolinas" or the "Company") and am responsible for**  
7 **leading collaborative efforts on new product development and energy efficiency**  
8 **across all retail markets served by Duke Energy Corporation ("Duke Energy"),**  
9 **including Duke Energy Carolinas' service territory.**

10 **Q. PLEASE STATE BRIEFLY YOUR EDUCATION AND BUSINESS**  
11 **BACKGROUND AND EXPERIENCE.**

12 **A. I earned a Bachelor of Science degree in Computer Science from the University of**  
13 **Georgia in Athens, Georgia in 1995. I also have earned a Masters of Business**  
14 **Administration from the University of Virginia's Darden Graduate School of Business**  
15 **Administration in Charlottesville, Virginia in 2002. I am currently pursuing a Juris**  
16 **Doctor degree from the Charlotte School of Law in Charlotte, North Carolina.**

17 **In addition to my current role with Duke Energy, I am also currently the vice**  
18 **chairman of the Southeastern Energy Efficiency Alliance and a member of the board**  
19 **for the Midwestern Energy Efficiency Alliance. I am a recipient of the 2006**  
20 **Southeastern Electric Exchange Industry Excellence Award in the category of rates**  
21 **and regulation and earned my Six Sigma Green Belt certification in 2006.**

1 I also have seventeen years of experience in the energy industry. During that  
2 time, I have served in various roles in both the regulated retail and unregulated  
3 wholesale electric and natural gas businesses with The Southern Company, Mirant,  
4 and Duke Energy. My experience includes energy efficiency, pricing and rates,  
5 product development, customer management, wholesale deal structuring, mergers and  
6 acquisitions, and technology. Prior to my current position, I held several other  
7 positions at Duke Energy, including Director of Marketing Operations, Director of  
8 Product Development, and Manager of Energy Efficiency Products for the Marketing  
9 and Energy Efficiency organization.

10 **Q. WHAT IS THE PURPOSE OF YOUR SETTLEMENT TESTIMONY?**

11 **A.** The purpose of my testimony is to sponsor the modified internal rate of return  
12 ("MIRR") analysis on the Joint Agreement and Stipulation filed by the Public Staff,  
13 the Environmental Intervenors, and Duke Energy Carolinas on June 12, 2009 (the  
14 "Settlement Agreement"). This analysis was requested by the Commission in its  
15 Order Scheduling Hearing to Consider "Agreement and Joint Stipulation of  
16 Settlement," dated June 18, 2009.

**II. MODIFIED INTERNAL RATE OF RETURN**

17 **Q. HAVE YOU PREPARED ANY EXHIBITS?**

18 **A.** Yes, I have. Attached to my testimony as Smith Exhibit No. 1 is an MIRR analysis of  
19 the Company's energy efficiency and demand-side management portfolio at 100%  
20 achievement. This exhibit (1) details revenues and costs to the program level, and (2)  
21 shows nominal revenues and expenses on both a system level and North Carolina-

1           only basis. The revenues allocated to North Carolina use the same allocation  
2           methodology the Company proposed in the Settlement Agreement.

3   **Q.   PLEASE SUMMARIZE THE MIRR ANALYSIS SET FORTH IN SMITH**  
4           **EXHIBIT NO. 1.**

5   **A.   The MIRR analysis compares cash inflows to the Company versus costs the Company**  
6           **would incur. Revenues (cash inflows) are comprised of both avoided cost-based**  
7           **revenues and net lost revenue recovery. Expenses include both program costs and**  
8           **net lost revenues. Based on this analysis, the Company's overall MIRR is calculated**  
9           **to be 6.1%.**

10           All revenues and expenses included in the MIRR analysis assume the  
11           Company will achieve 100% of its avoided cost targets. However, if the Company  
12           fails to attain 100% of its avoided cost targets, the Company's revenues would be  
13           reduced in accordance with the Settlement Agreement. This revenue reduction would  
14           limit the Company's earnings opportunity, reduce the portfolio's after-tax return on  
15           investment below 15%, and lower the MIRR of the portfolio.

16   **Q.   HOW DOES THE MIRR ANALYSIS OF THE SETTLEMENT COMPARE TO**  
17           **THE MIRR ANALYSIS FILED BY THE COMPANY ON MARCH 31, 2009?**

18   **A.   The Company has used the same format and methodology for calculating expenses in**  
19           **this analysis as it did in the March 31<sup>st</sup> filing. In that filing, the Company included**  
20           **several MIRR calculations using a variety of revenue requirement calculations,**  
21           **including save-a-watt as originally filed, a modified version of save-a-watt, and the**  
22           **Progress Energy Carolinas methodology. Those methods yielded overall MIRR's of**  
23           **7.1%, 6.4%, and 6.0%, respectively, compared to the 6.1% return produced by the**

1 settlement methodology at 100% achievement. The settlement proposes the same  
2 compensation mechanism as the modified save-a-watt proposal shown in Scenario I  
3 of the March 31<sup>st</sup> filing, with two major changes: (1) energy efficiency revenues were  
4 lowered from 55% to 50% of avoided costs, and (2) the energy efficiency portfolio  
5 was scaled up to achieve higher impacts. These changes led to an MIRR reduction of  
6 roughly 30 basis points.

7 **Q. IS THE MIRR A USEFUL METRIC IN DETERMINING THE**  
8 **PROFITABILITY OF THE COMPANY'S PROPOSED ENERGY**  
9 **EFFICIENCY PLAN?**

10 **A.** The MIRR is a well-recognized financial metric for capital budgeting that is used to  
11 compare a company's cost of capital to the return from an investment in an asset.  
12 However, for determining the profitability of the Company's modified save-a-watt  
13 incentive mechanism proposed in the Settlement Agreement, MIRR has a notable  
14 limitation based on how cash flows are recognized. In order for the MIRR  
15 calculation to provide a meaningful result, it requires that the project begin with an  
16 investment (recognized as a cash outflow) followed by positive cash inflows for the  
17 remaining life of the project. Traditional capital-based investments follow this  
18 structure because they incur costs while the asset is under construction. Once the  
19 asset has been constructed, the Company then receives positive cash inflows for the  
20 remainder of the life of the asset to recover the asset's capital costs.

21 However, revenues and expenses for energy efficiency and demand-side  
22 management investments do not fit the paradigm of a traditional capital investment.  
23 Instead, revenues and certain program expenses for energy efficiency and demand-

1 side management occur within the same year. Additionally, energy efficiency creates  
2 ongoing expenses in the form of net lost revenues. Thus, in order to calculate an  
3 MIRR with the appropriate cash inflows and outflows, net lost revenues and program  
4 expenses from energy efficiency were recognized on a net present value basis in the  
5 first year even though they actually occur over the life of the programs. As a result,  
6 the MIRR calculation is less meaningful for financial comparisons because the cash  
7 flows from the energy efficiency investment have been re-structured to fit the MIRR  
8 calculation. Instead, the Company believes a return on investment calculation is more  
9 appropriate because it does not require cash flows to be restructured. Accordingly,  
10 the Settlement Agreement proposes to set the Company's earnings cap on a return on  
11 investment basis.

12 **III. CONCLUSION**

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

14 **A. Yes, it does.**

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1 Q. Do you have a summary of your settlement testimony,  
2 Mr. Smith?

3 A. I do.

4 Q. Please give that settle -- please give that summary  
5 to the Commission.

6 (THE SUMMARY OF THE PREFILED SETTLEMENT TESTIMONY  
7 OF RAIFORD L. SMITH WILL BE COPIED INTO THE RECORD  
8 AS GIVEN ORALLY FROM THE WITNESS STAND.)



**DUKE ENERGY CAROLINAS, LLC**  
**Docket No. E-7, Sub 831**  
**SUMMARY OF MIRR TESTIMONY OF**  
**RAIFORD L. SMITH**

1       The purpose of my testimony is to sponsor the modified internal rate of return, or  
2       MIRR, analysis, on the Joint Agreement and Stipulation filed by the Public Staff, the  
3       Environmental Intervenors, and Duke Energy Carolinas on June 12, 2009.

4       The MIRR analysis in the exhibit attached to my pre-filed testimony compares cash  
5       inflows to the Company versus costs the Company would incur. The exhibit uses the same  
6       format and methodology for calculating expenses in this analysis as it did in the March 31<sup>st</sup>  
7       filing. Based on this analysis, the Company's overall MIRR is calculated to be 6.1%.

8       The settlement proposes the same compensation mechanism as the modified save-a-  
9       watt proposal shown in Scenario I of the March 31<sup>st</sup> filing, with two major changes: First,  
10      energy efficiency revenues were lowered from 55% to 50% of avoided costs. Second, the  
11      energy efficiency portfolio was scaled up to achieve higher impacts. These changes led to an  
12      MIRR reduction of roughly 30 basis points.

13      All revenues and expenses included in the MIRR analysis assume the Company will  
14      achieve 100% of its avoided cost targets. However, if the Company fails to attain 100% of  
15      its avoided cost targets, the Company's revenues would be reduced in accordance with the  
16      Settlement Agreement. This revenue reduction would limit the Company's earnings  
17      opportunity, reduce the portfolio's after-tax return on investment below 15%, and lower the  
18      MIRR of the portfolio.

19      The MIRR is a well-recognized financial metric for capital budgeting. For  
20      determining the profitability of the Company's modified save-a-watt incentive mechanism

1 proposed in the Settlement Agreement, however, MIRR has a notable limitation based on  
2 how cash flows are recognized. Revenues and expenses for energy efficiency and demand-  
3 side management investments do not fit the paradigm of a traditional capital investment.  
4 Instead, revenues and certain program expenses for energy efficiency and demand-side  
5 management occur within the same year. Additionally, energy efficiency creates ongoing  
6 expenses in the form of net lost revenues. Thus, in order to calculate an MIRR with the  
7 appropriate cash inflows and outflows, net lost revenues and program expenses from energy  
8 efficiency were recognized on a net present value basis in the first year even though they  
9 actually occur over the life of the programs. As a result, the MIRR calculation is less  
10 meaningful for financial comparisons because the cash flows from the energy efficiency  
11 investment have been re-structured to fit the MIRR calculation. Instead, the Company  
12 believes a return on investment calculation is more appropriate because it does not require  
13 cash flows to be restructured. Accordingly, the Settlement Agreement proposes to set the  
14 Company's earnings cap on a return on investment basis.

15 This concludes the summary of my MIRR Testimony.

1 MS. NICHOLS: Mr. Smith is available for  
2 cross examination.

3 MR. GREEN: No questions for me.

4 MR. RUNKLE: No, sir.

5 MR. HOLTZMAN: No, sir.

6 MS. THOMPSON: No questions.

7 MR. OLSON: I have no questions.

8 CHAIRMAN FINLEY: Congratulations, Mr.  
9 Smith. You get a pass at least for now.

10 THE WITNESS: Thank you, sir.

11 MS. NICHOLS: Chairman, would you like to  
12 ask Mr. Smith the questions that you were talking  
13 to Mr. Farmer about in terms of the differences?

14 CHAIRMAN FINLEY: Right. And I failed to  
15 allow other commissioners to ask questions.  
16 Anybody else have a question of Mr. Smith?

17 (No response.)

18 CHAIRMAN FINLEY: Good assumption on my  
19 part. Mr. Smith, did you hear the questions that  
20 we asked of Mr. Farmer? I'll be happy to try to  
21 repeat them.

22 THE WITNESS: I would appreciate it if  
23 you could repeat them so I could look at the exact  
24 exhibits.

1 CHAIRMAN FINLEY: If I'm able. Let me  
2 see here. If you will turn to page 23 of the  
3 settlement -- the settlement exhibit, Schultz  
4 Settlement Exhibit No. 1?

5 THE WITNESS: Yes, sir. I'm there.

6 CHAIRMAN FINLEY: All right. Do you see  
7 the number on the far right-hand corner at the  
8 bottom of -- sum total of \$369.2 million?

9 THE WITNESS: Yes, I do.

10 CHAIRMAN FINLEY: All right. That's the  
11 full revenue requirements during the four-year plan  
12 with the exception of an outstanding balance of net  
13 lost revenues to be collected by the Company or  
14 revenue credit to be refunded to customers. Is it  
15 not?

16 THE WITNESS: That is correct.

17 CHAIRMAN FINLEY: All right. And if we  
18 turn to the last page of the supplemental  
19 information provided by the Company that is  
20 encaptioned Attachment 15-1? That's the response  
21 to question 15?

22 THE WITNESS: Yes, I'm there.

23 CHAIRMAN FINLEY: Do you see the number  
24 on column G, line 5, of \$218.2 million?

1 THE WITNESS: Yes, I do.

2 CHAIRMAN FINLEY: That is the total  
3 revenue requirement for the four-year pilot program  
4 excluding revenue recovery related to net lost  
5 revenues, correct?

6 THE WITNESS: Yes, that is correct.

7 CHAIRMAN FINLEY: And if you look at  
8 attachment 3-1 of the supplemental information  
9 having to do with the program costs?

10 THE WITNESS: Yes.

11 CHAIRMAN FINLEY: At the bottom there,  
12 the total is 35.4 million, 45.8 million, 79  
13 million, \$114.7 million. Those add up to be \$275  
14 million in total program costs. Correct?

15 THE WITNESS: They do add to that sum,  
16 yes.

17 CHAIRMAN FINLEY: And the question is can  
18 you please explain how the \$218.2 million of  
19 revenue requirement as shown on column G of  
20 attachment 15-A is designed to recover the  
21 Company's projected program costs of \$275 million  
22 as provided on attachment 3-1?

23 THE WITNESS: Yes, sir. There are two  
24 notable differences to talk about here that are

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1 shown in attachment 3-1. The first is the expenses  
2 shown in 3.1 represent the Company's projections  
3 for both North and South Carolina. The second  
4 difference is the revenue requirements shown both  
5 in attachment 15-1 and in the Company's exhibit in  
6 the settlement document represent recovery at 85  
7 percent of achievement. If you look at those  
8 differences, the revenue requirements are meant to  
9 recover those expenses over that time period, but  
10 you would need to change what's shown in exhibit 3-  
11 1 to reflect just North Carolina's expenses.

12 CHAIRMAN FINLEY: Very well. Thank you  
13 very much. That clarifies that. Appreciate it.  
14 Are there questions on the commission's questions?

15 MS. NICHOLS: There was also an earlier  
16 question by Commissioner Culpepper of Mr. Farmer  
17 related to how the avoided costs set forth in  
18 attachment 8-1 are translated into the revenue  
19 requirements on Farmer Exhibit 3. And I thought  
20 perhaps Mr. Smith could also verify that response  
21 as well.

22 THE WITNESS: Would you mind repeating  
23 the question to make sure I'm looking at the right  
24 things?

1 MS. NICHOLS: Well, I didn't want to make  
2 more work for the Commissioner.

3 THE WITNESS: Sorry. Yeah, so I guess --

4 MS. NICHOLS: Let me -- let me try to do  
5 that for you.

6 COMMISSIONER CULPEPPER: No, that's all  
7 right. It's okay. Well, I was talking about this  
8 document that's labeled attachment 8-1. You got --

9 THE WITNESS: Yes, sir.

10 COMMISSIONER CULPEPPER: -- your hands on  
11 that?

12 THE WITNESS: Yes, sir.

13 COMMISSIONER CULPEPPER: And on page 2 of  
14 this document -- and I was kind of trying to relate  
15 that to Farmer Exhibit No. 3. I don't know if  
16 you've got that in front of you or not. Do you?

17 THE WITNESS: One moment. Yes, sir. I  
18 do.

19 COMMISSIONER CULPEPPER: Okay. And I  
20 guess the question is with respect to attachment 8-  
21 1, page 2 of 2, the figures there toward the middle  
22 of the page under -- the caption is Total  
23 Residential Energy Efficiency Avoided Costs. Year  
24 one, \$50.5 million. Then Power Manager year one,

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1           the figure is 17.4 for a total residential avoided  
2           costs of \$67.9 million. Are those North Carolina  
3           and South Carolina figures or just North Carolina  
4           figures?

5           THE WITNESS: They represent the nominal  
6           sum of that vintage -- each vintage's total avoided  
7           costs for both North and South Carolina.

8           COMMISSIONER CULPEPPER: Well, let me ask  
9           you this. This is a proceeding here in North  
10          Carolina. Why -- why would you all file an exhibit  
11          here that's got both North Carolina and South  
12          Carolina figures on it? I mean, what -- how is  
13          that going to make any sense to us deciding this  
14          case?

15          THE WITNESS: Yeah, that's a fair  
16          criticism. I think in the future we should just  
17          file the North Carolina only specific information  
18          so that it's more clear.

19          COMMISSIONER CULPEPPER: All right.  
20          Well, let me ask you this. You heard my line of  
21          questioning when I was talking with Mr. Farmer  
22          about it, and I want to ask you the same thing.  
23          Let's just say for purposes of you and me talking,  
24          that these figures here on page 2, attachment 8-1,



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1           were just North Carolina figures.

2           THE WITNESS: Yes, sir.

3           COMMISSIONER CULPEPPER: What would I do  
4           to those figures that I just talked to you about to  
5           get to this figure under year one on Farmer Exhibit  
6           No. 1?

7           THE WITNESS: Yes, sir. You -- you  
8           couldn't exactly get there from here because they  
9           represent the nominal sum of the vintage of avoided  
10          costs. Stevie Exhibit 2 actually might be more  
11          appropriate for that. What you would do for  
12          conservation programs is you would take the net  
13          present value of the avoided costs over their life  
14          for that particular vintage, multiply it by 55 or,  
15          excuse me, 50 percent, and that should get you to  
16          the 100 percent revenue requirement number shown.

17          COMMISSIONER CULPEPPER: Then you  
18          multiply that times 0.85 and you should have a  
19          figure shown up there?

20          THE WITNESS: Yes, sir.

21          COMMISSIONER CULPEPPER: All right. So  
22          basically, it's multiplying the 0.5 and then the  
23          0.85 and reducing something down to a net present  
24          value. Is that it?

1 THE WITNESS: Yes, sir.

2 COMMISSIONER CULPEPPER: All right.

3 Thank you.

4 CHAIRMAN FINLEY: Are there questions on  
5 the Commission's questions?

6 MS. NICHOLS: Nothing for Duke.

7 CHAIRMAN FINLEY: Very well. Thank you,  
8 Mr. Smith. We will see you later.

9 MS. NICHOLS: That concludes Duke's  
10 direct case.

11 CHAIRMAN FINLEY: All right. Who's next?

12 MS. FENTRESS: The Public Staff will call  
13 James McLawhorn.

14 CHAIRMAN FINLEY: Very well.

15 (WHEREUPON, JAMES S. MCLAWHORN WAS CALLED AS A  
16 WITNESS, DULY SWORN, AND TESTIFIED AS FOLLOWS:)

17 DIRECT EXAMINATION BY MS. FENTRESS:

18 Q. Good morning, Mr. McLawhorn. If it's all right with  
19 the Commission, I'll proceed.

20 A. Good morning.

21 Q. Could you please state your name, address, and  
22 present position for the record?

23 A. Yes, my name is James S. McLawhorn. My business  
24 address is 430 North Salisbury Street, Raleigh,

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1 North Carolina. And I am the director of the  
2 Electric Division of the Public Staff.

3 Q. And Mr. McLawhorn, did you prepare and cause to be  
4 filed in this docket prefiled testimony on June 19,  
5 2009 consisting of 14 pages and one appendix?

6 A. Yes, I did.

7 Q. Do you have any corrections to your testimony?

8 A. No, I do not.

9 Q. If you were asked those same questions today would  
10 your answers be the same?

11 A. Yes, they would.

12 MS. FENTRESS: I would request that the  
13 prefiled testimony be copied into the record as  
14 filed.

15 CHAIRMAN FINLEY: Mr. McLawhorn's  
16 prefiled testimony shall be copied into the record  
17 as though given orally from the stand.

18 (THE PREFILED TESTIMONY OF JAMES S. MCLAWHORN WILL  
19 BE COPIED INTO THE RECORD AS IF GIVEN ORALLY FROM  
20 THE WITNESS STAND.)

**JUN 19 2009**Clerk's Office  
N.C. Utilities Commission**DUKE ENERGY CAROLINAS, LLC, DOCKET NO. E-7, SUB 831****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**

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

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

**16**  
**17 TRANSPARENCY**  
**18**

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

**21 A. The initial save-a-watt model based Duke's recovery on simply a percentage of**  
**22 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**

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

8  
9 **OTHER BENEFITS TO THE SETTLEMENT AGREEMENT**

10  
11 **Q. ARE THERE OTHER PROVISIONS OF THE SETTLEMENT AGREEMENT**  
12 **THAT THE PUBLIC STAFF BELIEVES ARE IMPROVEMENTS TO THE SAVE-**  
13 **A-WATT APPROACH AS INITIALLY FILED?**

14 **A. Yes. The Settlement Agreement provides that no more than 35% of the target**  
15 **may be met by DSM programs, providing an emphasis on energy efficiency**  
16 **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.

1  
2  
3  
4  
5  
6  
7  
8

MS. FENTRESS: Thank you.

Q. Mr. McLawhorn, do you have a summary of your  
testimony?

A. Yes, I do.

Q. Please give it.

(THE SUMMARY OF THE PREFILED TESTIMONY OF JAMES S.  
MCLAWHORN WILL BE COPIED INTO THE RECORD AS GIVEN  
ORALLY FROM THE WITNESS STAND.)

DUKE ENERGY CAROLINAS, LLC  
DOCKET NO. E-7, SUB 831

SUMMARY OF TESTIMONY OF JAMES S. MCLAWHORN

The purpose of my testimony is to address key components of the Settlement Agreement entered into by the Southern Environmental Law Center, Environmental Defense Fund, the Natural Resources Defense Council, and Southern Alliance for Clean Energy (collectively, the Environmental Intervenors), Duke Energy Carolinas, LLC (Duke or the Company), and the Public Staff in this proceeding. With these key components, the Settlement Agreement addresses certain concerns that the Public Staff had with the initial save-a-watt methodology as proposed by Duke. The key components are: (1) the provision for a pilot program of limited duration; (2) the provisions for the more limited recovery of incentive amounts, including net lost revenues, by the Company; (3) the provision for more transparent cost and incentive recovery; and (4) the protection of ratepayers from the risks of tying revenue recovery for energy efficiency and demand-side management (DSM) programs to future avoided supply-side costs.

First, the initial save-a-watt model did not have a finite term. The Public Staff was concerned that it potentially would have resulted in the Company earning an excessive incentive to implement DSM and energy efficiency programs for an indefinite period with limited opportunity for review and modification by the Commission. The Settlement Agreement, however, provides for a limited term of four years. This term limits the exposure of the parties to unintended consequences that can result from a novel regulatory approach and is similar to the Public Staff's recommendation earlier in this proceeding that the Commission review incentive amounts after a period of three years. The Public Staff had also previously recommended that Duke's net lost revenue recovery be limited to a period of 36 months. The Settlement Agreement now reflects that recommendation and provides that Duke may recover net lost revenues for a period of 36 months for each vintage year.

Second, the Public Staff believed that the Company's initial proposal to recover 90% of the avoided costs achieved by its proposed energy efficiency and DSM programs would have resulted in excessive earnings by Duke on insufficient savings on energy by the ratepayers. Under the Settlement Agreement, however, the Company's revenues are now to be recovered on the basis of separate percentages of avoided costs for DSM and energy efficiency programs. These percentages include 75% of avoided capacity costs for DSM and 50% of the net present value (NPV) of avoided energy costs plus 50% of the NPV of avoided capacity costs for energy efficiency programs. Also, unlike the initial save-a-watt approach, Duke's revenues to be recovered are subject to earnings caps, depending on Duke's success in reaching a targeted aggregate energy efficiency and DSM avoided cost savings level. With respect to the energy savings, the Public Staff notes that the Settlement Agreement provides for

an approximate 50% increase in projected energy savings when compared to the initial save-a-watt model.

With regard to net lost revenues, the Settlement Agreement further limits the recovery of net lost revenues by recognizing that they are net of any increases in revenues resulting from any activity by the Company's public utility operations that causes customers to increase demand or energy consumption. The Settlement Agreement also shields ratepayers from the risk of Duke collecting revenues in excess of what is allowed under the Settlement Agreement by providing for the true-up and return, with interest, of any over-collections.

In addition, net lost revenues are recovered separately from the program costs and incentives and are subject to separate measurement and verification, which provides for greater transparency than the initial save-a-watt approach.

Also with respect to the initial save-a-watt method, the Public Staff had voiced concerns that the Company proposed to tie its recovery for implementing energy efficiency and DSM programs to its avoided supply-side costs. Specifically, the Public Staff was concerned that if avoided supply-side costs increased from one year to the next, ratepayers would pay for that increase, even in the absence of additional energy efficiency or demand reduction from Duke-sponsored programs. The Settlement Agreement addresses this concern by "locking in" for the term of the agreement the per MWh and per MW-year avoided costs, except in certain limited circumstances.

The Settlement Agreement does not resolve all of the issues among the parties. The issue of the allocation of costs between the wholesale and retail jurisdictions and the determination of the interest rate to be applied to customer refunds remain unresolved. Public Staff witness Maness will address the cost allocation issues in his testimony. However, the terms and conditions of the Settlement Agreement adequately address the concerns that the Public Staff identified in its previous analysis of the Duke's proposed save-a-watt model as filed; therefore, the Public Staff recommends that the Commission approve it in its entirety.

This concludes my summary.

1 MS. FENTRESS: Mr. Maness is -- I mean,  
2 Mr. McLawhorn is available for cross examination.

3 CHAIRMAN FINLEY: Are there any questions  
4 of Mr. McLawhorn by the intervenors?

5 MR. GREEN: I have no questions, Mr.  
6 Chairman.

7 CHAIRMAN FINLEY: Mr. Runkle.

8 CROSS EXAMINATION BY MR. RUNKLE:

9 Q. Good morning, Mr. McLawhorn.

10 A. Good morning.

11 Q. Now, I had asked one of the Duke witnesses earlier  
12 about how strong a commitment this is in terms of  
13 is Duke really required to do anything under the  
14 stipulation agreement or does it just set up goals  
15 and targets. Were you here for that -- for those  
16 questions?

17 A. Yes.

18 Q. In your opinion, and as in charge of the  
19 Electricity Division and with the Public Staff, is  
20 -- what's going to happen with this -- the save-a-  
21 watt proposal? Is Duke going to meet these goals?  
22 Are they going to surpass the goals? Or are they  
23 just going to come back in three or four years and  
24 see what happens?

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1 A. Well, it's -- it's very difficult to say if they,  
2 in fact, will meet the goals. But it is certainly  
3 our belief that Duke entered into the Settlement  
4 Agreement with -- with the good faith intentions of  
5 the other parties. And we believe that Duke is  
6 planning to put forth every effort to achieve these  
7 goals.

8 Q. Is there any -- is there anything that the  
9 Commission should do to make those targets  
10 mandatory?

11 A. Well, I -- you know, that would be up to the  
12 Commission as to how strongly they feel about that  
13 and how sincere that they believe Duke is in  
14 meeting these targets. I am satisfied that Duke is  
15 committed to doing this.

16 MR. RUNKLE: I have no further questions.

17 CHAIRMAN FINLEY: Other intervenors?

18 MR. HOLTZMAN: No, sir.

19 CHAIRMAN FINLEY: Duke?

20 MS. HEIGEL: No, Mr. Chairman.

21 CHAIRMAN FINLEY: Cross? I mean,  
22 redirect?

23 MS. FENTRESS: Just very briefly.

24 REDIRECT EXAMINATION BY MS. FENTRESS:

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1 Q. Mr. McLawhorn, Mr. Runkle asked you about Duke's  
2 ability to meet the targets. There is a tiered  
3 target system, is there not?

4 A. That is correct.

5 Q. And would you say that the recovery is tied to what  
6 proportion of the target they -- they hit?

7 A. Yes. That was the design of the -- the agreement.

8 Q. And was that present in the initial save-a-watt  
9 proposal?

10 A. No, it was not.

11 MS. FENTRESS: Thank you. That's all I  
12 have.

13 CHAIRMAN FINLEY: Questions by the  
14 Commission? Commissioner Joyner.

15 COMMISSIONER JOYNER: I have just a  
16 couple. In your prefiled testimony, Mr. McLawhorn,  
17 one of the things that you discuss is how the  
18 Settlement Agreement that the staff supports  
19 addresses the Public Staff's concerns about the  
20 lack of transparency that -- that you assert  
21 existed in the original petition. Do you  
22 understand -- do you recall that discussion?

23 THE WITNESS: Yes.

24 COMMISSIONER JOYNER: Let me confess that

1 I had meant to ask this question of Mr. Schultz and  
2 forgot. Fortunately, you mentioned the regional  
3 efficiency advisory group in your testimony so --  
4 so I catch you on that. Mr. Schultz's testimony  
5 refers to the creation of a regional efficiency  
6 advisory committee. And -- and you've mentioned  
7 that too. Is it your understanding that this is  
8 going to be a -- a new organization or a new  
9 entity? And the reason I ask is that in prior  
10 dockets, the numbers of which escape me now, we  
11 have had discussions from Duke witnesses about  
12 using stakeholder groups to -- to develop programs.

13 And my sense was that that was an ongoing  
14 initiative, that that was a very useful initiative  
15 in figuring out what programs, efficiency programs  
16 or DSM I guess, would work. And I'm trying to  
17 figure out if this is a new entity if the existing  
18 advisory or stakeholder group is -- is continuing  
19 in this iteration or whether that has been  
20 discontinued. Do you -- do you have any insight on  
21 that?

22 THE WITNESS: I -- I do not. I am  
23 familiar with the collaborative group that Duke had  
24 prior to the original save-a-watt filing because



1 the Public Staff was a participant in that. But  
2 what the exact plans are for this one and how  
3 closely it will or will not resemble that -- that  
4 group, I don't know.

5 CHAIRMAN FINLEY: The Settlement  
6 Agreement, though, does provide that the Public  
7 Staff will be able to -- to monitor the work of  
8 that advisory group, doesn't it?

9 THE WITNESS: Yes, I would anticipate  
10 that our role will be -- that our role, the Public  
11 Staff's role, will be similar to the role we played  
12 in the original collaborative effort.

13 COMMISSIONER JOYNER: The -- the other  
14 thing I'm interested in is whether or not you have  
15 reviewed the testimony of Mr. Colton that's been  
16 filed in this case.

17 THE WITNESS: I did review it. I'm not  
18 intimately familiar with it, but I did review his  
19 testimony.

20 COMMISSIONER JOYNER: As the -- a part of  
21 an agency charged with representing the interest of  
22 the using and consuming public, have you evaluated  
23 and formed an opinion as to the sufficiency of this  
24 proposal in terms of its meeting the needs of low-

1 income consumers in North Carolina?

2 THE WITNESS: Well, I don't know that we  
3 have determined that this proposal meets all of the  
4 needs for low-income customers from now on. We  
5 certainly think that there were some positive steps  
6 made to address the needs of low-income customers  
7 in this proposal. I think I noted in my testimony  
8 that there were, you know -- the availability of  
9 the programs to customers who are renters as well  
10 as owners of their home, which was not there  
11 before, is certainly an extension of the benefits  
12 to low-income customers.

13 Duke has also, I believe, made  
14 commitments to work with other third-party  
15 organizations to try to enhance the -- the low  
16 income energy efficiency efforts. So there  
17 certainly is a greater commitment than there was  
18 before. But I, you know, couldn't say that this is  
19 it; this is all we need to be doing.

20 COMMISSIONER JOYNER: And -- and what  
21 we're looking at here is a pilot of a -- of a  
22 finite duration?

23 THE WITNESS: That is correct.

24 COMMISSIONER JOYNER: And is my

1           assumption accurate that either through the  
2           regional advisory group or some other mechanism,  
3           the Company and other interested stakeholders will  
4           continue to evaluate and develop programs,  
5           hopefully that will extend the benefits of -- of  
6           efficiency to all of its customers without regard  
7           to -- to income?

8                       THE WITNESS: I certainly -- I believe  
9           so. I know the Public Staff believes that that is  
10          what will take place, and other parties as well.

11                      COMMISSIONER JOYNER: And -- and my -- my  
12          final question is whether or not to the extent that  
13          -- that you are participating and monitoring this  
14          process, whether or not this is an issue that the  
15          Public Staff will -- will attend to and monitor.

16                      THE WITNESS: Certainly we will.

17                      COMMISSIONER JOYNER: Thank you.

18                      CHAIRMAN FINLEY: Mr. Culpepper.

19                      COMMISSIONER CULPEPPER: Mr. McLawhorn,  
20          have you got this attachment 8-1 in front of you?

21                      THE WITNESS: No, sir. I do not.

22                      COMMISSIONER CULPEPPER: Let's see if  
23          your lawyer can get it in front of you. Well, let  
24          me ask you this while she's getting that. Have you

1 got the -- have you got the Settlement Agreement in  
2 front of you?

3 THE WITNESS: I do have that.

4 COMMISSIONER CULPEPPER: How about  
5 flipping over to page 20 on that.

6 THE WITNESS: Okay.

7 COMMISSIONER CULPEPPER: All right.  
8 You've got attachment 8-1 now. If you'd go to page  
9 2 of 2 of that, and tell me when you're there.

10 THE WITNESS: Two of two, okay.

11 COMMISSIONER CULPEPPER: Yeah, it's  
12 supposed to be 2 of 2. Looks like it's three  
13 pages, but anyhow.

14 THE WITNESS: All right.

15 COMMISSIONER CULPEPPER: See down there  
16 toward the bottom, three lines up, it says total  
17 avoided cost \$753,611,563?

18 THE WITNESS: Yes, I see that number.

19 COMMISSIONER CULPEPPER: All right. Take  
20 a look at page 20, item 6, it says the Company's  
21 avoided cost target is \$754 million?

22 THE WITNESS: Yes, sir.

23 COMMISSIONER CULPEPPER: Is that the same  
24 figures? Are we talking about the same figures

1           there?

2                   THE WITNESS: I believe so, yes.

3                   COMMISSIONER CULPEPPER: Well, based on  
4           Mr. -- witness Smith's testimony these figures on  
5           attachment 8-1 are North Carolina and South  
6           Carolina. Is that what you understood his  
7           testimony to be?

8                   THE WITNESS: That's what I understood.

9                   COMMISSIONER CULPEPPER: So are you  
10          saying this \$754 million figure that is in item 6  
11          on Exhibit B attached to the Settlement Agreement  
12          in this North Carolina case involves a figure that  
13          involves both North Carolina and South Carolina?

14                  THE WITNESS: Yes. If you look right  
15          after that I believe it says that it's system  
16          dollars. So whenever I see the word system, that --  
17          -- to me that says North Carolina and South  
18          Carolina.

19                  COMMISSIONER CULPEPPER: Okay. So -- so  
20          the system portfolio impacts, that's a system --  
21          and that's in the same item there, number 6.  
22          That's North Carolina and South Carolina too?

23                  THE WITNESS: That's correct.

24                  COMMISSIONER CULPEPPER: Is there

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1 anywhere that -- that the Commission can take a  
2 look and see what's going to happen if we approve  
3 this settlement -- happen here in North Carolina as  
4 opposed to just systemwide? Because we can only  
5 decide a case based on, you know, decide here in  
6 North Carolina. South Carolina is going to do what  
7 they're going to do in another case.

8 THE WITNESS: I am sure that there is a  
9 way to estimate what the -- the programs will  
10 produce in -- in North Carolina, although I believe  
11 it's Duke's intent to implement the programs on a  
12 systemwide basis. But you're right; South Carolina  
13 could do -- they could do something entirely  
14 different from what we do that could impact the  
15 ability to achieve those targets on a -- from their  
16 -- in the state of South Carolina.

17 COMMISSIONER CULPEPPER: All right.  
18 Thank you.

19 CHAIRMAN FINLEY: All right. A couple of  
20 questions, Mr. McLawhorn. We have this issue of  
21 incentives versus mandates. Am I not correct in my  
22 understanding that with respect to both energy  
23 efficiency measures and demand-side management  
24 measures, part of the success of the programs

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1 depends on what the consumer of the services of  
2 Duke does?

3 THE WITNESS: Yes, sir. It does.

4 CHAIRMAN FINLEY: And are you aware of  
5 something that Duke could do or that this  
6 Commission could do to mandate that the customers  
7 sign up for the programs and use the programs as  
8 they are intended?

9 THE WITNESS: That would mandate that  
10 customers do that? Well, I -- I guess you could  
11 make -- well, I think it would be difficult on  
12 energy efficiency. I mean, you know, the  
13 Commission could certainly change its rules on  
14 demand response. It -- well, I can't speak for the  
15 entire Public Staff. It wouldn't be my  
16 recommendation that you do that, but you could --  
17 you could, I guess, change your rules that said  
18 that if a new customer comes onto the Duke system  
19 they would have to agree to implement DSM. But  
20 that would not be my recommendation. Mr. Gruber  
21 might see it differently. I don't think so.

22 CHAIRMAN FINLEY: Part of the Senate Bill  
23 3, it has a reps requirement, right?

24 THE WITNESS: Yes.

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1 CHAIRMAN FINLEY: And that's a mandate?

2 CHAIRMAN FINLEY: That is.

3 CHAIRMAN FINLEY: And part of the ability  
4 of Duke and Progress and Dominion to meet the  
5 mandate can be to take use of energy efficiency,  
6 right?

7 THE WITNESS: 25 percent, I believe,  
8 initially.

9 CHAIRMAN FINLEY: So Senate Bill 3 has  
10 both carrots and sticks? It has mandates and it  
11 has incentives?

12 THE WITNESS: Yes.

13 CHAIRMAN FINLEY: All right. Thanks.  
14 Any questions on the Commission's questions?

15 MS. NICHOLS: I do have just one or two.

16 CROSS EXAMINATION BY MS. NICHOLS:

17 Q. Mr. McLawhorn, you're familiar with Duke's IRP,  
18 correct?

19 A. Yes, generally.

20 Q. And that -- and Duke plans its system on a system  
21 basis for both North Carolina and South Carolina,  
22 correct?

23 A. That is correct.

24 Q. So when it's looking at a resource such as the



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1           Cliffside Unit 6 that's under construction, it  
2           looks at that -- it looks at its need on a system  
3           basis and it looks at resources on a system basis,  
4           correct?

5   A.       That's correct. That should be the more economical  
6           and efficient way to plan.

7   Q.       And energy efficiency and DSM are just another  
8           resource to meet its customers' needs, correct?

9   A.       Yes.

10   Q.       So when you look at the -- the energy efficiency  
11           plan being presented here, that's a resource that  
12           is input into the overall IRP, correct?

13   A.       Yes, it is.

14                   MS. NICHOLS: Thank you.

15                   CHAIRMAN FINLEY: Other questions on the  
16           Commission's questions?

17                   (NO RESPONSE.)

18                   CHAIRMAN FINLEY: All right. Thank you,  
19           Mr. McLawhorn.

20                   THE WITNESS: Thank you.

21                   (WITNESS EXCUSED.)

22                   MS. FENTRESS: We would move -- well, I  
23           don't think there were any exhibits.

24                   CHAIRMAN FINLEY: All he had was an

1           appendix, and we'll take that as part of his  
2           testimony.

3                   MS. FENTRESS: That's -- yes, please do.  
4           And we would call Mike Maness.

5                   CHAIRMAN FINLEY: Did we get all the Duke  
6           exhibits in?

7                   MS. NICHOLS: We did not. I was going to  
8           do that when we brought Mr. Smith back, but we  
9           would move both Smith Exhibit 1 as well as the Duke  
10          Hearing Exhibit 1 that we introduced at the  
11          beginning of the hearing, the Responses to the  
12          Commission's Order that were filed on August 10.

13                   CHAIRMAN FINLEY: All right. Without  
14          objection, those exhibits will be received into  
15          evidence.

16                               (SMITH DIRECT EXHIBIT NO. 1 AND  
17                               DUKE HEARING EXHIBIT NO. 1 WERE  
18                               ADMITTED INTO EVIDENCE.)

19                   (WHEREUPON, MICHAEL C. MANESS WAS CALLED AS A  
20          WITNESS, DULY SWORN, AND TESTIFIED AS FOLLOWS:)

21          DIRECT EXAMINATION BY MS. FENTRESS:

22                   MS. FENTRESS: Mr. Chairman, for the  
23          record Mr. Green is assisting me in passing out  
24          replacement pages for Mr. Maness' testimony that --

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1 his original testimony contained a formatting  
2 error, which I alerted the Commission to by letter.  
3 I'd like to replace the testimony with those pages,  
4 and I will walk Mr. Maness through those  
5 corrections as soon as everybody gets a copy of it.

6 CHAIRMAN FINLEY: And let's get your mic  
7 in front of you there, Ms. Fentress.

8 Q. (By Ms. Fentress) Good afternoon, Mr. Maness,  
9 almost afternoon.

10 A. Good afternoon.

11 Q. Can you please state your name, address, and  
12 present position for the record?

13 A. My name is Michael C. Maness. My business address  
14 is 430 North Salisbury Street, Raleigh, North  
15 Carolina. And my present position is assistant  
16 director of the Accounting Division of the Public  
17 Staff.

18 Q. And Mr. Maness, did you prepare and cause to be  
19 filed in this docket prefiled supplemental --  
20 supplementary testimony on July 2, 2009 consisting  
21 of 20 pages and three exhibits?

22 A. Yes.

23 Q. And Mr. Maness, do you have any corrections to make  
24 to your testimony and, if so, could you start with

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1 the formatting correction?

2 A. Yes, I do. On page 3 of my testimony as originally  
3 filed the last paragraph on the page, which began  
4 on line 25, should have been indented on the left  
5 and the right as a direct quotation. And that has  
6 been corrected on the replacement page that's just  
7 been distributed.

8 Then on page 6, beginning on line 1, in  
9 the testimony as originally filed the first seven  
10 lines are indented on the right and the left as if  
11 a direct quotation. Those are, in fact, not a  
12 quotation and should have been set out at the  
13 regular margins. And that has been also corrected  
14 in the replacement pages --

15 Q. And --

16 A. -- that have been distributed.

17 Q. And the replacement pages contain no changes to  
18 text. It's only those formatting changes. Is that  
19 correct?

20 A. Yes.

21 Q. Thank you. And do you have any other corrections?

22 A. I do. On page 1 of my testimony, line 15, the  
23 title of the Settlement Agreement in italics there,  
24 *Agreement and Joint Stipulation of Settlement*, the

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1 word stipulation should be italicized.

2 Then on page 5 of my testimony, on line 3  
3 I have an insertion. The sentence that begins  
4 "Commission Rule R8-69," at the beginning of that  
5 sentence should be the words "paragraph (b)(1) of"  
6 and then continue on "Commission Rule R8-69."

7 Then on page 18 of my testimony, line 20,  
8 the second to last word on that line "cost" should  
9 be deleted.

10 Then on Maness Exhibit 1 -- excuse me,  
11 Maness Exhibit 2, page 1 of 2, that's attached to  
12 my testimony -- on line 15 in the column denoted  
13 Item the word "energy" should be replaced with  
14 "demand." And on the very next page, page 2 of 2  
15 of that exhibit, on line 34 the same change should  
16 be made; the word "energy" should be replaced with  
17 "demand."

18 Q. And are those all your corrections?

19 A. Yes.

20 Q. Mr. Maness, if you were asked the same questions  
21 today would your answers be the same?

22 A. Yes, they would.

23 Q. Mr. Maness, did you also file two exhibits in  
24 response to the Commission's August 14, 2009 pre-

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1           hearing request for verified information?

2       A.       Yes, I did.

3       Q.       And do you have any corrections to those exhibits?

4       A.       No, I do not.

5                       MS. FENTRESS: I would request that the  
6       prefiled testimony and exhibits be copied into the  
7       record with the noted corrections.

8                       CHAIRMAN FINLEY: Well, we will copy the  
9       prefiled direct testimony into the record as though  
10      given orally from the stand, and we will -- as  
11      amended and corrected, and we will mark the  
12      exhibits, both the exhibits filed with the  
13      testimony on July 2 and the supplemental exhibits  
14      for identification purposes at this point.

15                      (THE PREFILED SUPPLEMENTAL TESTIMONY OF MICHAEL C.  
16      MANESS, AS AMENDED AND CORRECTED, WILL BE COPIED  
17      INTO THE RECORD AS IF GIVEN ORALLY FROM THE WITNESS  
18      STAND AND MANESS EXHIBITS AND SUPPLEMENTAL EXHIBITS  
19      WERE MARKED FOR IDENTIFICATION.)

**FILED**

**JUL 02 2009**

Clerk's Office  
N.C. Utilities Commission

**DUKE ENERGY CAROLINAS, LLC  
DOCKET NO. E-7, SUB 831**

**SUPPLEMENTAL TESTIMONY OF MICHAEL C. MANESS  
ON BEHALF OF THE PUBLIC STAFF  
NORTH CAROLINA UTILITIES COMMISSION**

**July 2, 2009**

1 Q. MR. MANESS, HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN THIS  
2 PROCEEDING?

3 A. Yes. On June 26, 2008, the Public Staff filed my initial direct testimony in this  
4 proceeding, which I presented at the hearing that began on July 28, 2008.  
5 Additionally, on August 25, 2008, the Public Staff filed my affidavit addressing a  
6 portion of the supplemental testimony and exhibits of Duke Energy Carolinas, LLC  
7 (Duke or the Company) witness Theodore E. Schultz.

8

9 Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

10 A. The purpose of my supplemental testimony is to satisfy the requirements of the  
11 Commission's *Order Scheduling Hearing to Consider "Agreement and Joint*  
12 *Stipulation of Settlement"* (Settlement Hearing Order), issued on June 18, 2009. In  
13 the Settlement Hearing Order, the Commission required both Duke and the Public  
14 Staff to file (a) Modified Internal Rate of Return (MIRR) analyses consistent with the  
15 terms of the *Agreement and Joint Stipulation of Settlement* (Agreement) filed on

1 June 12, 2009,<sup>1</sup> given their respective positions on the appropriate inputs to the  
 2 MIRR calculations, and (b) testimony regarding the outstanding issue between  
 3 Duke, the Public Staff, and the Environmental Intervenors (the Stipulating Parties)  
 4 of the appropriate jurisdictional allocation method to use in determining the North  
 5 Carolina retail Demand-Side Management / Energy Efficiency Rider (DSM/EE  
 6 Rider). My supplemental testimony addresses both of these requirements, and also  
 7 sets forth the Public Staff's recommended DSM/EE rider.

8  
 9 ALLOCATION OF SYSTEM AMOUNTS TO NORTH CAROLINA RETAIL OPERATIONS

10 Q. HOW DOES THE AGREEMENT PROVIDE FOR THE ISSUE OF  
 11 JURISDICTIONAL ALLOCATIONS TO BE RESOLVED?

12 A. Paragraph H.8 of Exhibit B (the Settlement Terms) of the Agreement reads as  
 13 follows:

14 The North Carolina retail revenue requirement applicable to demand-  
 15 side management, energy efficiency programs, and net lost revenues  
 16 will be determined by allocating the various inputs to the revenue  
 17 calculation (avoided costs, program costs, net lost revenues, etc.) to  
 18 the North Carolina retail jurisdiction and then applying the  
 19 percentages and other revenue requirement determinants set forth in  
 20 this agreement.

21  
 22 The Stipulating Parties will present the issue of the appropriate  
 23 jurisdictional allocation method to the Commission through testimony  
 24 in this matter. For purposes of determining the North Carolina retail  
 25 revenue requirement, Duke Energy Carolinas and the Environmental  
 26 Intervenors agree that (1) for demand-side management programs,  
 27 inputs will be allocated between the North Carolina and South  
 28 Carolina retail jurisdictions based on contributions to system retail  
 29 peak demand by all system retail customers based on the cost of  
 30 service study, and (2) for energy efficiency programs and net lost

<sup>1</sup> The Agreement was filed by the Public Staff and Duke, along with the Southern Alliance for Clean Energy, the Environmental Defense Fund, the Natural Resources Defense Council, and the Southern Environmental Law Center (collectively, the Environmental Intervenors).



1 revenues, inputs will be assigned to the North Carolina and South  
2 Carolina retail jurisdictions based on kWh sales to system retail  
3 customers from the cost of service study. The program costs  
4 allocated under this methodology will be used to calculate the  
5 earnings cap.  
6

7 The Public Staff does not agree with the allocation methodology  
8 proposed by Duke and the Environmental Intervenors and instead  
9 proposes that (1) for demand-side management programs, inputs will  
10 be allocated to the North Carolina retail jurisdiction based on  
11 contributions to total system peak demand by all system customers,  
12 retail and wholesale, and (2) for energy efficiency programs, inputs  
13 should be allocated to the North Carolina retail jurisdiction based on  
14 kWh sales to all system customers, retail and wholesale.  
15

16 Q. HAS THE COMPANY PRESENTED TESTIMONY ON THIS MATTER?

17 A. Yes. On June 19, 2009, the Company filed the *Settlement Testimony of Stephen M.*  
18 *Farmer* (Settlement Testimony), setting forth its discussion of this issue. Mr. Farmer  
19 indicates that the Company believes that because its proposed DSM and EE  
20 programs are directed specifically at its retail customers, it is appropriate to recover  
21 the costs of those programs only from those customers. Mr. Farmer testifies that  
22 this approach is more consistent than that of the Public Staff with G.S. 62-133.9(e),  
23 which reads as follows:

24 The Commission shall determine the appropriate assignment of costs of new  
25 demand-side management and energy efficiency measures for electric public  
26 utilities and shall assign the costs of the programs only to the class or classes of  
27 customers that directly benefit from the programs.  
28

1 However, Mr. Farmer does not dispute the fact that all customers likely will receive  
2 benefits (which he describes as "indirect") from the Company's programs.

3  
4 Q. WHY DOES THE PUBLIC STAFF DISAGREE WITH THE COMPANY'S  
5 POSITION?

6 A. The Company relies on the language of G.S. 62-133.9(e) to guide its position. In  
7 other words, the Company seems to indicate that because that subsection requires  
8 the assignment of new DSM and EE program costs only to customer *classes* that  
9 directly benefit from the programs (i.e., under the Company's position, participate in  
10 the programs), the statute would also logically require the allocation or assignment  
11 of those costs only to the *jurisdictions* that benefit (participate) in the same manner.  
12 However, there is no language anywhere in the statute that refers to the methods to  
13 be used to allocate costs between jurisdictions for North Carolina retail ratemaking  
14 purposes. Furthermore, it is a long-standing regulatory practice in this State that  
15 jurisdictional allocations and customer class allocations are separate (albeit related)  
16 ratemaking procedures for electric public utilities. In this process, jurisdictional  
17 allocation methods, formulas, and factors are first applied to system revenues and  
18 costs to determine the appropriate change to total North Carolina retail revenues  
19 necessary to attain the total North Carolina retail revenue requirement. Only then is  
20 the North Carolina retail revenue requirement assigned or allocated to specific  
21 customer classes. Therefore, it is not clear that G.S. 62-133.9(e) was intended to  
22 address jurisdictional cost allocations at all.

1 When adopting the rules required to implement Senate Bill 3, the Commission  
2 appeared to interpret G.S. 62-133.9(e) consistently with this long-standing  
3 regulatory practice. Commission Rule R8-69 - Cost Recovery for Demand-Side  
4 Management and Energy Efficiency Measures of Electric Public Utilities - reads as  
5 follows, in pertinent part:

6 Those expenses approved for recovery shall be allocated to the North  
7 Carolina retail jurisdiction consistent with the system benefits provided  
8 by the new demand-side management and energy efficiency  
9 measures and shall be assigned to customer classes in accordance  
10 with G.S. 62-133.9(e) and (f).  
11

12 In its *Order Adopting Final Rules*, (Rules Order) issued in Docket No. E-100, Sub  
13 113, on February 29, 2008, the Commission stated as follows regarding the issue of  
14 cost allocation and paragraph R8-69(b)(1) when addressing a Progress Energy  
15 Carolinas, Inc., proposal to in part allocate DSM and EE costs only to retail  
16 customers:

17 As explained elsewhere herein, issues involving cost allocation are  
18 complex. Additionally, the manner in which such issues are ultimately  
19 resolved has important consequences. The appropriate resolution of  
20 cost allocation issues almost always requires evidentiary proceedings.  
21 The present issue is no exception to that general rule. Indeed, the  
22 Commission is of the opinion that the record in this rulemaking  
23 proceeding is plainly inadequate to allow the Commission to make an  
24 informed decision.  
25

26 Therefore, based upon the foregoing logic and the entire record of  
27 this proceeding, the Commission finds and concludes that it should  
28 not include a requirement in the provisions of this Rule that would  
29 mandate the use of a particular cost allocation methodology and/or  
30 require that the costs at issue here be recovered solely from retail  
31 customers.  
32

33 (Rules Order, pp. 114-15).

1 If the Commission had believed that the language of G.S. 62-133.9(e)  
2 required DSM and EE costs to be allocated to only the retail  
3 jurisdictions, it could have simply said so and written its rule  
4 accordingly; however, it chose not to do so. Furthermore, the portion  
5 of Rule R8-69(b)(1) that both refers to jurisdictional allocation  
6 separately from class allocation and states that jurisdictional  
7 allocation shall be consistent with "system benefits" remained intact.  
8

9 Based on all of the factors cited above, therefore, the Public Staff believes that G.S.  
10 62-133.9(e) does not control the jurisdictional allocation of system DSM and EE  
11 costs and revenues to North Carolina retail operations. In reaching this conclusion,  
12 I note that if the General Assembly's purpose in creating this statutory provision  
13 within Senate Bill 3 was to protect certain customer classes from having DSM and  
14 EE costs unreasonably allocated to them, it is also evident that the allocation of  
15 costs to the wholesale jurisdiction does not advantage or disadvantage any North  
16 Carolina retail customer class relative to any other.

17  
18 Since the Public Staff does not believe that G.S. 62-133.9(e) controls jurisdictional  
19 cost allocation, the question is then what system benefits in particular are  
20 appropriate for determining jurisdictional cost allocation pursuant to Rule R8-  
21 69(b)(1). The Public Staff believes that allocating costs only to the retail  
22 jurisdictions, as the Company proposes, does not reflect the system benefits that  
23 will arise from implementation of DSM and EE programs. The benefit of a DSM or  
24 EE program to the utility system is the long-term reduction in cost of service  
25 achieved by the utility as a result of it acquiring DSM and EE resources to serve

1 load growth at a lower cost than would have been incurred had the utility instead  
2 been required to serve that load growth through acquisition of supply-side  
3 resources. This reduction in cost can typically be expected to accrue to the benefit  
4 of all system customers (although perhaps in varying amounts). This benefit should  
5 be the basis for determining the jurisdictional allocation of program costs and  
6 incentives.

7  
8 Q. PLEASE ELABORATE.

9 A. The primary benefits sought by a utility implementing DSM and EE programs are  
10 the utility cost reductions that will accrue in some amount to the entire system,  
11 including wholesale operations, through the freeing up of existing system capacity  
12 and energy resources to serve growth in system demand and energy requirements.  
13 The utility is thereby relieved of the burden of serving that growth through the  
14 construction or purchase of additional supply-side resources at marginal cost.  
15 These are the benefits measured in the Utility Cost Test (UCT) and the Total  
16 Resource Cost (TRC) Test – the marginal supply-side resource acquisition and  
17 operation costs avoided as a result of implementing a DSM or EE program. Since  
18 achieving those system benefits is the essential purpose of the DSM and EE  
19 programs, those benefits should be the basis for determining which DSM and EE  
20 program costs and incentives are assigned or allocated to the North Carolina retail  
21 jurisdiction. Those benefits include benefits accruing to the wholesale jurisdiction.

1 Q. WHY DO YOU SAY THAT THE COST REDUCTIONS RESULTING FROM UTILITY  
2 IMPLEMENTATION OF DSM AND EE PROGRAMS WILL ACCRUE IN SOME  
3 AMOUNT TO ALL SYSTEM CUSTOMERS?

4 A. The costs that are avoided through the operation of cost-effective DSM and EE  
5 programs are for the most part demand- and energy-driven generation and  
6 transmission costs (both capitalized and expensed). The Company operates its  
7 generation and transmission system on a total system basis. Accordingly, for  
8 ratemaking purposes, the Commission has traditionally not directly assigned  
9 system-level generation and transmission costs to particular jurisdictions, but  
10 instead has allocated those costs to jurisdictions on the basis of demand at the  
11 system peak and annual energy usage as percentages of total system peak  
12 demand and annual energy usage, respectively. Thus, the costs avoided by  
13 utilization of DSM and EE, if incurred instead, would likely have been handled for  
14 ratemaking purposes by aggregating them with other generation and production  
15 costs on a total system basis and then allocating the total to all jurisdictions. This  
16 treatment would allocate the costs incurred at the margin to all jurisdictions, not just  
17 the jurisdictions in which demand and energy growth had occurred. Therefore, if  
18 demand and energy growth at the North Carolina retail level is avoided through the  
19 use of DSM and EE programs, the benefits of thereby avoiding supply-side costs at  
20 the margin are also spread among all of the jurisdictions.

1 Q. BASED ON ALL OF THESE FACTORS, WHAT IS THE PUBLIC STAFF'S  
2 CONCLUSION REGARDING JURISDICTIONAL COST ALLOCATION?

3 A. The Public Staff believes that the appropriate and reasonable manner of allocating  
4 the costs and incentives reflected in the DSM/EE Rider is to treat those costs and  
5 incentives as total system costs, and allocate them across the total system,  
6 including the wholesale jurisdiction.

7

8 Q. HAS THE PUBLIC STAFF MAINTAINED THIS POSITION THROUGHOUT THIS  
9 PROCEEDING?

10 A. Yes. In my direct testimony filed on June 26, 2008, I stated that in the Public Staff's  
11 opinion, the DSM and EE programs proposed by the Company directly benefit both  
12 the retail and system wholesale customers and should be allocated accordingly for  
13 purposes of a DSM/EE Rider.<sup>2</sup>

14

15 Q. HOW DID THE COMPANY RESPOND TO YOUR TESTIMONY?

16 A. In his rebuttal testimony filed on July 21, 2008, Company witness Farmer stated that  
17 the Company did not "oppose or object to" the Public Staff's recommendation  
18 regarding jurisdictional cost allocation, and that it was based on "standard cost of  
19 service principles ... rooted in sound economic theory." However, Mr. Farmer also  
20 noted the language of G.S. 62-133.9(e), and stated that it made the Public Staff's  
21 recommendation "problematic."<sup>3</sup>

---

<sup>2</sup> Tr. Vol. 9, pp. 19-20.

<sup>3</sup> Tr. Vol. 5, p. 88.

1 Q. DO YOU HAVE ANY OTHER COMMENTS REGARDING COST ALLOCATION?

2 A. Yes. With regard to the allocation of North Carolina retail revenue requirements to  
3 customer groups, Paragraph H.9 of the Settlement Terms of the Agreement reads  
4 as follows:

5 Within the North Carolina retail jurisdiction, customer group revenue  
6 requirements applicable to demand-side management and energy  
7 efficiency programs will be determined by assigning or allocating the  
8 North Carolina retail revenue requirement to the various customer  
9 groups. The appropriate allocation or assignment method to be used  
10 for these purposes will be determined by the Commission in this  
11 proceeding.  
12

13 On page 11 of his Settlement Testimony, Company witness Farmer states that "[t]he  
14 only remaining item of contention [excepting jurisdictional allocation] is that the  
15 Public Staff believes it would be more appropriate to allocate revenue requirement  
16 on a class-by-class basis rather than on a 'residential' and 'non-residential' basis  
17 ...." With this language, Mr. Farmer appears to refer to the topic of whether Duke  
18 should be allowed to implement just one non-residential rate, rather than separate  
19 rates for each of the individual non-residential customer classes. As shown by  
20 Paragraph H.9, the Public Staff is not contesting that Company proposal; instead,  
21 the method of allocation to customer groups is the disputed issue. Pursuant to  
22 discussions with Duke personnel, the Public Staff understands that Duke plans to  
23 clarify this matter prior to the reconvened hearing.



1 Q. WHAT IS THE PUBLIC STAFF'S POSITION ON THE ISSUE OF ALLOCATION OF  
2 NORTH CAROLINA RETAIL REVENUE REQUIREMENTS TO CUSTOMER  
3 CLASSES?

4 A. The Public Staff believes that allocation of North Carolina retail DSM and EE  
5 revenue requirements to customer classes is, unlike jurisdictional allocation  
6 discussed above, controlled by G.S. 62-133.9(e). Based on the Public Staff's  
7 interpretation of that statute, allocation of North Carolina retail DSM and EE revenue  
8 requirements to customer classes should be based on the same contribution to  
9 system peak load and system energy requirements methodology that it believes is  
10 appropriate for jurisdictional cost allocations.

11  
12 The Public Staff acknowledges that the Commission has recently disagreed with it  
13 on this issue, in Docket No. E-2, Sub 931; however, the Public Staff still believes in  
14 the correctness of its position, and respectfully requests the Commission to reach a  
15 different conclusion in this proceeding.

16  
17 Q. HAVE YOU PREPARED ANY SCHEDULES SETTING FORTH THE NORTH  
18 CAROLINA RETAIL REVENUE REQUIREMENTS CALCULATED IN  
19 ACCORDANCE WITH THE PUBLIC STAFF'S POSITION ON COST  
20 ALLOCATION?

1 A. Yes. Maness Exhibit 2, attached to my supplemental testimony, sets forth the  
2 estimated North Carolina retail residential and non-residential revenue requirements  
3 and DSM/EE riders for each of the four years of the settlement term.  
4

5 MIRR CALCULATIONS

6 Q. PLEASE PROVIDE A BRIEF SUMMARY OF THE MIRR CALCULATIONS THAT  
7 HAVE PREVIOUSLY BEEN FILED IN THIS PROCEEDING.

8 A. During the initial hearing held in this proceeding, the Commission asked the  
9 Company to provide the internal rate of return it expected to achieve with respect to  
10 each DSM and EE program proposed in its application in this subdocket. In  
11 response, Company witness Schultz filed, as Confidential Schultz Supplemental  
12 Exhibit No. 1, MIRR calculations for each program, as well as for aggregate  
13 groupings of residential, non-residential, and total programs.  
14

15 On February 26, 2009, the Commission issued its *Order Resolving Certain Issues,*  
16 *Requesting Information on Unsettled Matters, and Allowing Proposed Rider to*  
17 *Become Effective Subject to Refund* (Initial Order). As part of the Initial Order, the  
18 Commission required Duke to file MIRR calculations for several scenarios.  
19 Accordingly, on March 31, 2009, Duke filed its *Response to Order Requesting*  
20 *Information on Unsettled Matters* (Response to Initial Order), in which it presented a  
21 modified MIRR calculation for the case set forth in Confidential Schultz  
22 Supplemental Exhibit No. 1, as well as MIRR calculations for nine separate

1 scenarios. These MIRR calculations reflected three significant departures from  
2 those presented on Confidential Schultz Supplemental Exhibit No. 1: first, existing  
3 Interruptible Service (IS) and Standby Generation (SG) customers were excluded  
4 from the analysis, consistent with the provisions of the Initial Order; second, a single  
5 time period of 18 years was used as the investment period for each program and  
6 grouping of programs presented for each scenario; and third, the benefit and cost  
7 impacts of the Company's two DSM programs, Power Manager and Power Share,  
8 were truncated to four years.

9  
10 Finally, as noted previously, in the Settlement Hearing Order the Commission has  
11 required both Duke and the Public Staff to file MIRR calculations to reflect the terms  
12 of the Agreement and their respective positions on how the MIRR calculations  
13 should be performed. On June 26, 2009, the Company filed the *MIRR Supporting*  
14 *Testimony of Raiford L. Smith*, along with Smith Exhibit No. 1, which sets forth the  
15 Company's calculation of MIRRs consistent with the terms of the Agreement.  
16 These calculations continued to reflect the above-described modifications to the  
17 calculations introduced in the Company's Response to Initial Order.

18  
19 Q. HAVE YOU REVIEWED COMPANY WITNESS SMITH'S TESTIMONY AND  
20 EXHIBIT?

21 A. Yes.

1 Q. DO YOU HAVE ANY COMMENTS REGARDING YOUR REVIEW OF HIS  
2 TESTIMONY AND EXHIBIT?

3 A. Yes. Before I specifically discuss his testimony and exhibit, I would reiterate the  
4 comments I made in my affidavit, filed on August 25, 2008. During the Public Staff's  
5 investigation of this case, I made a significant effort to generate a rate-of-return-type  
6 measurement by which the cost recovery and incentive mechanisms proposed by  
7 the Company and the Public Staff could be evaluated from a financial basis. For  
8 various reasons, this did not prove possible. A portion of this effort included  
9 consideration of the MIRR approach. However, I found that the MIRR calculations  
10 for the programs proposed by Duke were too heavily influenced by the overall rate  
11 of return used in the formula (7.46%) to provide accurate and reasonably  
12 differentiating results. Therefore, because of the difficulty of isolating and  
13 quantifying specific internal rates of return for each program, and because of heavy  
14 bias toward the overall cost of capital implicit in the MIRR calculation, the Public  
15 Staff concluded, and still believes, that a net present value (NPV) margin approach  
16 is the most appropriate method by which to estimate the potential profitability of  
17 Duke's proposal. I note that Company witness Smith expresses similar concerns  
18 regarding the MIRR in his testimony.

19  
20 Q. WHAT OTHER CONCLUSIONS HAVE YOU DRAWN FROM YOUR REVIEW OF  
21 MR. SMITH'S TESTIMONY AND CALCULATIONS?

1 A. First, Mr. Smith has filed MIRR calculations for the Company's DSM and EE  
2 programs at both a system level and a North Carolina retail level of operations.  
3 Because of the consistency of the North Carolina retail allocation factors applied to  
4 each program's MIRR calculation inputs, the MIRRs calculated on a North Carolina  
5 retail basis are virtually equal to those calculated on a system basis.

6  
7 Second, the system level revenues, program costs, and net lost revenues used by  
8 Mr. Smith in his calculations are consistent with the system amounts the Public Staff  
9 believes are appropriate under the terms of the Agreement, subject to certain  
10 adjustments that I will discuss later in this testimony and some immaterial  
11 mathematical differences. However, the North Carolina retail amounts that Mr.  
12 Smith has used differ from those the Public Staff believes are appropriate, due to  
13 our disagreement regarding the appropriate North Carolina retail allocation factors.

14  
15 Third, the Public Staff disagrees with some of the inputs and methods that Mr.  
16 Smith has used in the calculations of the MIRRs. The inputs and methods were  
17 also used by the Company in its scenario MIRR calculations filed in the Response  
18 to Initial Order, and have been previously addressed by the Public Staff in its  
19 Comments filed on June 12, 2009. Because of the disagreement with the Company  
20 on these inputs and methods, the Public Staff's MIRR calculations differ from those  
21 of the Company.

1 Q. WOULD YOU ELABORATE ON THIS THIRD POINT?

2 A. Yes. I specifically disagree with the following two characteristics of the Company's  
3 June 26 MIRR calculations:

4 (1) The inclusion of net lost revenues as a reduction in cash flows after the end  
5 of the 36-month limitation set forth in the Agreement on recovery of such net  
6 lost revenues.

7 (2) The use of an 18-year investment period for every individual program and  
8 grouping of programs for purposes of calculating the MIRR.  
9

10 I am also concerned about the Company's classification of net lost revenues as a  
11 cash outflow, rather than a reduction in cash inflows. I will discuss each of these  
12 disagreements and concerns below.  
13

14 First, with regard to the Company's inclusion of net lost revenues in the MIRR  
15 calculations, although per the Agreement net lost revenue recovery for measures  
16 installed in each vintage year is limited to the first 36 months of net lost revenues  
17 experienced, Duke has assumed that net lost revenues are incurred throughout the  
18 life of each program. For the reasons set forth in my direct testimony<sup>4</sup> and further  
19 explained its June 12, 2009 comments, the Public Staff believes that this  
20 assumption is inconsistent with the premise underlying the limitation of net lost  
21 revenue recovery to 36 months, namely that net revenues lost as a result of EE or  
22 DSM programs or, to be more specific, the impacts on the Company's earnings due  
23 to such net lost revenues, do not continue in perpetuity. Thus, the Public Staff  
24 believes that for the purpose of the MIRR calculations, net lost revenues reflected

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<sup>4</sup> Tr. Vol. 9, pp. 14-17.

1 as a reduction in cash flows should be limited to the 36-month limitation on net lost  
2 revenue recovery agreed to by the Stipulating Parties.

3  
4 Second, with regard to the Company's use of an 18-year investment period for each  
5 program for purposes of the MIRR calculations, the Public Staff agrees that an 18-  
6 year period is appropriate for calculating the MIRR for the aggregate of all of the  
7 programs set forth by the Company, because such a period reasonably represents  
8 the overall length of the life of the first bundle of the Company's aggregate portfolio.

9 In measuring the MIRR for any individual program or group of programs with a  
10 shorter life, however, the Public Staff believes that the life of the first bundle for that  
11 particular program or group of programs should be used as the investment period,  
12 to more accurately set forth the MIRR for that particular program or grouping of  
13 programs. By life, I mean the period over which that first bundle is estimated to  
14 produce avoided cost benefits, subject to the four-year limitation placed on DSM  
15 avoided cost benefits under the terms of the Agreement.

16  
17 Finally, with regard to whether net lost revenues should be treated as a cash  
18 outflow, as the Company has done, or as a reduction in cash inflows, I believe that  
19 credible arguments can be made for either perspective, depending on specific  
20 circumstances. However, one particular factor, in this proceeding at least, favors  
21 the reduction-in-cash-inflow treatment: the Agreement provides for dollar-for-dollar  
22 recovery of net lost revenues. This dollar-for-dollar recovery is consistent with using

1 the UCT and the TRC Test as the primary tests to determine whether DSM or EE  
2 programs should be implemented. Neither of those tests recognizes net lost  
3 revenues as a cost; they are, instead, essentially a "side effect" of implementing  
4 certain programs that must be addressed to ensure that the utility is not unduly  
5 harmed by the implementation of a particular program. Since the "cure" for the  
6 "side effect", the dollar-for-dollar recovery of reasonable net lost revenues,  
7 essentially eliminates net lost revenues from the measurement of cash flows, the  
8 Public Staff believes that treating net lost revenues as a reduction in cash inflows is  
9 more reasonable, thus essentially eliminating them from the MIRR calculation.

10  
11 Q. THE COMMENTS FILED BY THE PUBLIC STAFF ON JUNE 12 ALSO STATE  
12 THAT TRUNCATING THE MIRR CALCULATION FOR DSM PROGRAMS TO  
13 FOUR YEARS, AS DONE BY THE COMPANY, ARTIFICIALLY LOWERS THE  
14 MIRR PERCENTAGES FOR THOSE PROGRAMS. WHY HAVE YOU NOT  
15 RAISED THIS ISSUE WITH REGARD TO THE CALCULATIONS PERFORMED BY  
16 MR. SMITH?

17 A. The Public Staff's June 12, 2009 Comments specifically address the MIRR  
18 calculations presented by the Company in its March 31, 2009 Response to Initial  
19 Order. As of March 31, the Public Staff considered the Company's position to be  
20 the same as it had initially filed in this proceeding: a Save-a-Watt cost revenue  
21 calculation mechanism that would be put into place for an indefinite period.  
22 However, the Agreement subsequently reached by the Stipulating Parties is for a



1 pilot program with a definite term of only four years; at the end of that term, the  
2 parties will essentially be back to square one with regard to the appropriate cost  
3 recovery and incentive mechanism. Therefore, the Public Staff does not consider  
4 limiting the MIRR calculation for the Company's proposed DSM programs to the  
5 term of the Agreement to be unreasonable.<sup>5</sup>

6  
7 Q. HAVE YOU PERFORMED MIRR CALCULATIONS THAT REFLECT THE PUBLIC  
8 STAFF'S POSITIONS?

9 A. Yes. Maness Exhibit 3 sets forth the MIRRs calculated in accordance with the  
10 Public Staff position regarding the amount of net lost revenues to be included and  
11 the appropriate investment periods for each program, but with net lost revenues still  
12 treated as a cash outflow. Maness Exhibit 4 sets forth MIRRs calculated in the  
13 same manner, but with net lost revenues treated as a reduction in cash inflows, as  
14 preferred by the Public Staff.

15  
16 Q. WHAT ARE THE RESULTS OF YOUR CALCULATIONS, AS COMPARED TO  
17 THOSE OF THE COMPANY?

18 A. The table below sets forth the MIRRs calculated by both the Company and the  
19 Public Staff:

---

<sup>5</sup> If the term of the Agreement were longer, the Public Staff would likely recommend that the investment period for DSM programs be longer as well.

1

<b>PROGRAM/GROUP</b>	<b>SMITH EXHIBIT 1</b>	<b>MANESS EXHIBIT 3</b>	<b>MANESS EXHIBIT 4</b>
Residential Energy Assessments	5.6%	7.8%	8.3%
Residential Smart Saver – AC	2.5%	5.4%	4.7%
Residential Smart Saver – Energy Star	6.6%	10.6%	17.7%
LIEE / Weatherization Assistance	4.8%	6.6%	5.7%
EE Education Program for Schools	5.8%	8.6%	10.2%
Power Manager	12.1%	29.8%	29.8%
Total Residential	6.2%	8.2%	9.0%
Non-Residential Smart Saver - Lighting	6.0%	9.5%	11.1%
Non-Residential Smart Saver - Motors	6.0%	11.5%	14.3%
Non-Residential Smart Saver – Other Prescriptive	6.2%	9.6%	10.6%
Non-Residential Smart Saver – Food Service	5.7%	9.8%	11.3%
Non-Residential Smart Saver – HVAC	3.1%	5.7%	5.2%
Non-Residential Smart Saver – Custom Rebate	3.3%	5.3%	4.6%
Power Share	8.5%	12.2%	12.2%
Total Non-Residential	6.0%	8.3%	8.5%
Total Residential and Non-Residential	6.1%	8.2%	8.7%
Total EE	5.4%	7.9%	8.3%
Total DSM	10.0%	19.5%	19.5%

2

3 Q. DOES THIS COMPLETE YOUR SUPPLEMENTAL TESTIMONY?

4 A. Yes.

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1 Q. Mr. Maness, do you have a summary of your  
2 testimony?

3 A. I do.

4 Q. Will you please read it?

5 (THE SUMMARY OF THE PREFILED SUPPLEMENTAL TESTIMONY  
6 OF MICHAEL C. MANESS WILL BE COPIED INTO THE RECORD  
7 AS GIVEN ORALLY FROM THE WITNESS STAND.)

DUKE ENERGY CAROLINAS, LLC  
DOCKET NO. E-7, SUB 831

SUMMARY OF SUPPLEMENTAL TESTIMONY OF MICHAEL C. MANESS

The purpose of my supplemental testimony is to respond to the Commission's Settlement Hearing Order issued on June 18, 2009. In that Order, the Commission required both Duke and the Public Staff to file (a) Modified Internal Rate of Return (MIRR) analyses consistent with the terms of the Settlement Agreement filed on June 12, 2009, given their respective positions on the appropriate inputs to the MIRR calculations, and (b) testimony regarding the outstanding issue between the Stipulating Parties of the appropriate jurisdictional allocation method to use in determining the North Carolina retail demand-side management (DSM)/energy efficiency (EE) Rider. Duke Energy Carolinas and the Environmental Intervenors propose that the system revenue requirements for DSM and EE programs be allocated only to retail customers. The Public Staff instead proposes that system revenue requirements be allocated to the wholesale jurisdiction as well.

In his Settlement Testimony, Duke witness Stephen M. Farmer asserts that because Duke's proposed DSM and EE programs are directed specifically at its retail customers, it is appropriate to recover the costs of those programs only from those customers. Mr. Farmer testifies that this approach is more consistent with G.S. 62-133.9(e) than that of the Public Staff. However, G.S. 62-133.9(e) refers specifically to assignments of costs to customer classes; there is no language in the statute that refers to the methods to be used to allocate costs between jurisdictions for North Carolina retail ratemaking purposes. Furthermore, in paragraph (b)(1) of Commission Rule R8-69, the Commission refers to jurisdictional allocation and class assignment as separate processes, and associates G.S. 62-133.9(e) only with class assignment. In the rulemaking proceeding that resulted in Rule R8-69, the Commission declined to indicate that the statute applied to jurisdictional allocation, and explicitly declined to require that the DSM and EE costs be recovered solely from retail customers.

The Public Staff believes that allocating costs only to the retail jurisdictions, as the Company proposes, does not reflect the system benefits that will arise from implementation of DSM and EE programs. The benefit of a DSM or EE program to the utility system is the long-term reduction in cost of service achieved by the utility as a result of it acquiring DSM and EE resources to serve load growth at a lower cost than would have been incurred had the utility instead been required to serve that load growth through acquisition of supply-side resources. This reduction in cost can typically be expected to accrue to the benefit of all system customers (although perhaps in varying amounts), because the costs themselves, if incurred, would be allocated to the entire system, including the wholesale jurisdiction. Since achieving those system benefits is the essential purpose of the DSM and EE programs, those benefits should also be the basis for determining which DSM and EE program costs and incentives are assigned or allocated to the North Carolina retail jurisdiction. The Public Staff believes that the appropriate and reasonable manner of allocating the costs and incentives reflected in the DSM/EE Rider is

to treat them as total system costs, and allocate them across the total system, including the wholesale jurisdiction.

With regard to the allocation of North Carolina retail revenue requirements to customer groups (residential and non-residential), the Settlement Agreement provides that the appropriate allocation or assignment method to be used will be determined by the Commission in this proceeding. Company witness Farmer appears to assert that the issue in contention between the Company and the Public Staff relates to the topic of whether Duke should be allowed to implement just one non-residential rate, rather than separate rates for each of the individual non-residential customer classes. However, the Public Staff is not contesting that Company proposal; instead, the method of allocation to customer groups is the disputed issue. In that regard, the Public Staff believes that allocation of North Carolina retail DSM and EE revenue requirements to customer classes is, unlike jurisdictional allocation discussed above, controlled by G.S. 62-133.9(e). Based on the Public Staff's interpretation of that statute section, allocation of North Carolina retail DSM and EE revenue requirements to customer classes should be based on the same contribution to system peak load and system energy requirements methodology that it believes is appropriate for jurisdictional cost allocations.

Maness Exhibit 2, attached to my supplemental testimony, sets forth the estimated North Carolina retail residential and non-residential revenue requirements and DSM/EE riders for each of the four years of the settlement term, consistent with the Public Staff's recommendations regarding cost and incentive allocation.

With regard to MIRR calculations, during the initial hearing held in this proceeding, the Commission asked the Company to provide the internal rate of return it expected to achieve with respect to each DSM and EE program proposed in its application in this subdocket. In response, Company witness Schultz filed, as Confidential Schultz Supplemental Exhibit No. 1, MIRR calculations for each program, as well as for aggregate groupings of residential, non-residential, and total programs. Subsequently, on March 31, 2009, Duke filed a modified MIRR calculation for the case set forth in Confidential Schultz Supplemental Exhibit No. 1, as well as MIRR calculations for nine separate scenarios. These MIRR calculations reflected three significant departures from those presented previously: first, existing Interruptible Service (IS) and Standby Generation (SG) customers were excluded from the analysis, consistent with the provisions of the Commission's February 26, 2009 Order in this docket; (Initial Order); second, a single time period of 18 years was used as the investment period for each program and grouping of programs presented for each scenario; and third, the benefit and cost impacts of the Company's two DSM programs, Power Manager and Power Share, were truncated to four years.

In the Settlement Hearing Order, the Commission required both Duke and the Public Staff to file MIRR calculations to reflect the terms of the Agreement and their respective positions on how the MIRR calculations should be performed. Company witness Raiford L. Smith filed the Company's calculation of MIRRs consistent with the terms of the Agreement. These calculations continue to reflect the above-described modifications to

the calculations introduced in the Company's Response to Initial Order, and also include net lost revenues as a reduction in cash flows after the end of the 36-month limitation on recovery of such net lost revenues set forth in the Agreement. The Public Staff disagrees with some of the inputs and methods that Mr. Smith has used in the calculations of the MIRR, specifically the inclusion of net lost revenues after the end of the 36-month limitation and the use of an 18-year investment period for every individual program and grouping of programs. I am also concerned about the Company's classification of net lost revenues as a cash outflow, rather than a reduction in cash inflows.

First, with regard to the Company's inclusion of net lost revenues in the MIRR calculations, Duke has assumed that net lost revenues are incurred throughout the life of each program. The Public Staff believes that this assumption is inconsistent with the premise underlying the limitation of net lost revenue recovery to 36 months, namely that net revenues lost as a result of EE or DSM programs do not continue in perpetuity. Second, with regard to the Company's use of an 18-year investment period for each program, the Public Staff agrees that an 18-year period is appropriate for calculating the MIRR for the aggregate of all of the programs set forth by the Company, because such a period reasonably represents the overall length of the life of the first bundle of the Company's aggregate portfolio. In measuring the MIRR for any individual program or group of programs with a shorter life, however, the Public Staff believes that the life of the first bundle for that particular program or group of programs should be used as the investment period. Finally, with regard to whether net lost revenues should be treated as a cash outflow or as a reduction in cash inflows, I believe that although credible arguments can be made for either perspective, the dollar-for-dollar recovery of net lost revenues provided for in the Settlement Agreement, because it essentially eliminates net lost revenues from the measurement of overall cash flows, makes it more reasonable to treat net lost revenues as a reduction in cash inflows for purposes of calculating an MIRR.

Maness Exhibit 3 sets forth the MIRRs calculated in accordance with the Public Staff position regarding the amount of net lost revenues to be included and the appropriate investment periods for each program, but with net lost revenues treated as a cash outflow. Maness Exhibit 4 sets forth MIRRs calculated in the same manner, but with net lost revenues treated as a reduction in cash inflows, as preferred by the Public Staff.

This completes my summary.

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1 MS. FENTRESS: Mr. Maness is available  
2 for cross examination.

3 CHAIRMAN FINLEY: Cross examination of  
4 Mr. Maness by interveners? Mr. Green.

5 MR. GREEN: Yes. Thank you, Mr.  
6 Chairman.

7 CROSS EXAMINATION BY MR. GREEN:

8 Q. Good afternoon, Mr. Maness.

9 A. Good afternoon.

10 Q. Looking at Section F of the Settlement Agreement,  
11 which is on page 21 of Schultz Exhibit B.

12 A. Yes.

13 Q. There's a table there under Section F that shows  
14 the earnings caps at different performance levels.

15 Is that correct?

16 A. Yes, that's correct.

17 Q. And at the 85 percent energy efficiency savings  
18 level the earnings cap is 12 percent, correct?

19 A. Yes, that's correct.

20 Q. The earnings cap is going to be calculated on a  
21 four-year basis, not an annual basis. Is that  
22 correct?

23 A. Yes.

24 Q. So rather than the earnings cap being calculated

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1           every year, it will be basically four years of  
2           revenues received by the company divided by the  
3           four years of the program costs?

4   A.       Yes. There will be some net present value  
5           calculations involved to make sure that the dollars  
6           in each year are considered on an appropriately  
7           equivalent basis. But in general, that's the  
8           concept.

9   Q.       That's the basic calculation? All right. And the  
10          four years of revenues used to calculate the  
11          earnings cap, 12 percent or whatever level it's  
12          going to be at, will not include any net lost  
13          revenues. Is that correct?

14   A.       The net lost revenues are considered to be  
15          recovered on a dollar-for-dollar basis, so they --  
16          essentially, the recovery of those dollars and the  
17          net lost revenues themselves eliminate each other.  
18          And so you're left with the revenue recovery  
19          exclusive of net lost revenues to make the  
20          calculation.

21   Q.       You're -- in other words, you're describing the  
22          Settlement Agreement as being net lost revenues are  
23          considered both a cost and a revenue so they cancel  
24          each other out?



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1 A. Well, there is a -- we do consider net lost  
2 revenues as actually being incurred, and then there  
3 is revenue that is recovered to compensate the  
4 Company for those losses. So they cancel each  
5 other out, yes.

6 Q. So the first part of your answer, net lost revenues  
7 being incurred, treats them as a program cost. Is  
8 that fair to say?

9 A. Well, I don't think -- going back to my  
10 recollection of the Commission rule making, I think  
11 the Commission has indicated that the recovery of  
12 those is to be considered an incentive rather than  
13 a cost. But we do, in fact, accept that certain of  
14 the Company's programs will result in those lost  
15 revenues. And that is a -- unless compensated,  
16 would result in a reduction in the Company's  
17 return.

18 MR. GREEN: May I approach the witness?

19 CHAIRMAN FINLEY: Yes, sir.

20 MR. GREEN: We'll mark this piece of  
21 paper as Attorney General's Maness Cross  
22 Examination Exhibit No. 1.

23 (ATTORNEY GENERAL'S MANESS CROSS EXAMINATION  
24 EXHIBIT NO. 1 WAS MARKED FOR IDENTIFICATION.)

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1 Q. Mr. Maness, this Cross Exam Exhibit No. 1 is a  
2 response to a data request that was presented to  
3 the Public Staff by the Attorney General's office.  
4 Is that correct?

5 A. Yes.

6 Q. And you made -- you provided this response to the  
7 data request. Is that correct?

8 A. I prepared it. I don't recall whether I sent it  
9 directly or had our attorney send that. But I did  
10 prepare this, yes.

11 Q. And the exhibit shows two columns of figures, one  
12 labeled Per the Settlement and the other labeled  
13 Per Attorney General's Requested Calculation. The  
14 amounts used in both columns are at present value  
15 for the six years that Duke will receive these  
16 amounts? Or was it four year?

17 A. Well, yes, six years has -- has previously been  
18 discussed, although the term of the Settlement  
19 Agreement and the mechanism that's been set up by  
20 it is four years. There will be -- when you have  
21 vintage year three and four, installations of  
22 measures that caused net lost revenues, the 36  
23 months for those installations will extend beyond  
24 year four and, therefore, there are net lost

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1 revenues to be recovered in years five and six.  
2 Additionally, there will be a true-up, and  
3 application of the cap is appropriate as finalized,  
4 measured, and verified results become available.  
5 And some of that may also occur after the end of  
6 year four.

7 Q. Looking at the second column in your prepared  
8 response, the one entitled Per Attorney General's  
9 Requested Calculation, line number 12, labeled Net  
10 Income as a Percentage of Program Costs -- is your  
11 calculation of the Company's net income if net lost  
12 revenues are included in the after tax earnings  
13 calculation. Is that correct?

14 A. The 63.01 percent calculation reflects the recovery  
15 by the Company of dollars to compensate for net  
16 lost revenues, but excludes the net lost revenues  
17 themselves from reducing the Company's returns.

18 Q. So another way of saying that is that it calculates  
19 the Company's net income including net lost  
20 revenues?

21 A. Well, that could be another way to say it. I think  
22 the Public Staff's concern with that calculation is  
23 that the -- the entire premise for including the  
24 amount of compensation on line 2 is, in fact, that

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- 1           that amount of net lost revenue is actually  
2           experienced. And so if you look at the Per  
3           Settlement column, that is consistent with the  
4           premise. But we don't think that the Attorney  
5           General's requested calculation is consistent. If  
6           we did not believe that the net lost revenues were  
7           going to be experienced, we would not include the  
8           amounts on line two as compensation for those.  
9           Because, in the end, it's supposed to be a dollar-  
10          for-dollar compensation.
- 11   Q.       Then looking at the first column, the Per  
12           Settlement column, line 12 is your calculation of  
13           the net income that Duke will receive if net lost  
14           revenues are not included in the after tax earnings  
15           calculation. Is that correct?
- 16   A.       Could you repeat that? I'm sorry.
- 17   Q.       Looking at the first column, labeled Per Settlement  
18           --
- 19   A.       Yes.
- 20   Q.       -- your line 12 is your calculation of the net  
21           income that Duke will receive if net lost revenues  
22           are not included in the after tax earnings  
23           calculation?
- 24   A.       Again, I would say that a little bit differently.

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1           It -- they include net lost revenues -- it includes  
2           net lost revenues in the calculation, but it also  
3           includes the compensation for net lost revenues and  
4           the two eliminate each other. So the mathematical  
5           result is the same as what you're describing, but  
6           the way you get there, the logic behind getting  
7           there is a little bit different.

8   Q.       Well, essentially, the only two differences in the  
9           tables in the calculations you're made is -- you  
10          made is under the Per Settlement column you've  
11          included under line two revenue required based on  
12          net lost revenues at 164. -- almost 6 million in  
13          both calculations, I mean both columns. Correct?

14   A.       Yes.

15   Q.       All right. And then on line 5, net lost revenues  
16          assumed to be experienced are included as a  
17          deduction in the first column, but not under the  
18          second column. Is that correct?

19   A.       Yes, that's correct. And that goes to what I'm  
20          saying, is that if in the end there was measurement  
21          and verification and it somehow miraculously showed  
22          that there were no net lost revenues, then the  
23          Company would not recover the amount on line two.

24                   MR. GREEN: All right. Thank you, Mr.

1 Maness. No further questions.

2 CHAIRMAN FINLEY: Do any other  
3 intervenors have questions for Mr. Maness?

4 (NO RESPONSE.)

5 CHAIRMAN FINLEY: Duke?

6 MS. HEIGEL: No questions, Mr. Chairman.

7 CHAIRMAN FINLEY: Redirect?

8 MS. FENTRESS: Just very briefly.

9 REDIRECT EXAMINATION BY MS. FENTRESS:

10 Q. Mr. Green and you had a conversation about net lost  
11 revenues being an incentive per the Commission's  
12 rules. But you agree, I think you've said, net  
13 lost revenues -- they act to make a company whole;  
14 they act to replace revenues they've lost from  
15 enacting an energy efficiency program. Would you  
16 agree with that?

17 A. The recovery of net lost revenues, yes.

18 Q. And so that is the incentive in the viewpoint of  
19 the Public Staff. Would you agree?

20 A. Yes.

21 Q. It is not, in our viewpoint, an incentive on top of  
22 another incentive that the Commission might award  
23 for implementing energy efficiency programs. Is  
24 that correct?

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1 A. That's correct. I think another way of saying that  
2 is that without that net lost revenue compensation,  
3 there would be a disincentive to proceed with those  
4 types of programs.

5 MS. FENTRESS: Thank you. That's all I  
6 have.

7 CHAIRMAN FINLEY: Are there questions by  
8 the Commission of Mr. Maness?

9 (NO RESPONSE.)

10 CHAIRMAN FINLEY: Very well. Thank you,  
11 Mr. Maness.

12 (WITNESS EXCUSED.)

13 MS. FENTRESS: I'd like to move Mr.  
14 Maness' exhibits attached to his supplementary  
15 testimony and the verified responses into the  
16 record.

17 CHAIRMAN FINLEY: They shall be received  
18 as evidence.

19 (MANESS SUPPLEMENTARY EXHIBITS AND VERIFIED  
20 RESPONSES WERE ADMITTED INTO EVIDENCE.)

21 CHAIRMAN FINLEY: Let me see counsel up  
22 here just a moment.

23 MR. GREEN: Mr. Chairman, I'd like to  
24 move the Attorney General's cross exam exhibits

1           into evidence.

2                       CHAIRMAN FINLEY: Attorney General's  
3           Maness Cross Examination Exhibit No. 1 will be  
4           entered into evidence.

5           (ATTORNEY GENERAL'S MANESS CROSS EXAMINATION  
6           EXHIBIT NO. 1 WAS ADMITTED INTO EVIDENCE.)

7                       (OFF-THE-RECORD DISCUSSION)

8                       CHAIRMAN FINLEY: We will now take our  
9           luncheon recess, and we will reconvene at two  
10          o'clock.

11                       \_\_\_\_\_  
12          (THE HEARING WAS ADJOURNED TO BE RECONVENED AT 2:00 P.M.)  
13                       \_\_\_\_\_



STATE OF NORTH CAROLINA

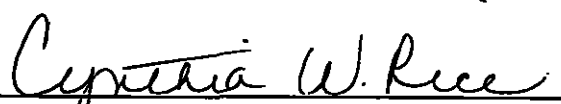
COUNTY OF WAKE

C E R T I F I C A T E

I, Cynthia W. Rice, Notary Public/Court Reporter, do hereby certify that the foregoing hearing before the North Carolina Utilities Commission in Docket No. E-7, Sub 831 was taken and transcribed under my supervision; and that the foregoing pages numbered 1 through 224 constitute a true and accurate transcript of said Hearing.

I do further certify that I am not of counsel for, or in the employment of either of the parties to this action, nor am I interested in the results of this action.

IN WITNESS WHEREOF, I have hereunto subscribed my name this 31st day of August, 2009.

  
Cynthia W. Rice  
Notary Public No. 200602400090

**FILED**

**SEP 01 2009**

**Clerk's Office  
N.C. Utilities Commission**