

STATE OF NORTH CAROLINA  
UTILITIES COMMISSION  
RALEIGH  
Docket No. E-7, Sub 831

**FILED**

OCT 07 2009

Clerk's Office  
N.C. Utilities Commission

In the Matter of

**OFFICIAL COPY**

Application of Duke Energy Carolinas, LLC )  
For Approval of Save-A-Watt Approach, )  
Energy Efficiency Rider, and Portfolio of )  
Energy Efficiency Programs )

**ATTORNEY GENERAL'S  
BRIEF**

On February 26, 2009, the Commission entered an *Order Resolving Certain Issues, Requesting Information on Unsettled Matters, and Allowing Proposed Rider to Become Effective Subject to Refund* (Order) in this docket. The Order decided several issues concerning Duke Energy Carolinas, LLC's (Duke's) application for approval of its Save-A-Watt (SAW) proposal.

On June 12, 2009, Duke, the Public Staff, Environmental Defense Fund, Natural Resources Defense Council, Southern Alliance for Clean Energy and Southern Environmental Law Center (collectively the "settling parties") filed an "Agreement and Joint Stipulation of Settlement" (Settlement Agreement) with the Commission. The Settlement Agreement sets forth details of a four year SAW program, including authorized earnings levels. The Settlement Agreement also specifies cost allocation and interest rate determination issues that the settling parties were unable to agree upon and, therefore, request that the Commission decide. Although the AGO sought to participate in the settlement negotiations, Duke rejected the AGO's request to participate.

On August 19, 2009, the Commission held an evidentiary hearing concerning the terms of the Settlement Agreement. The Commission requested that the parties file briefs and proposed orders by October 7, 2009.

Full Dis. May  
- AG

**SUMMARY OF ATTORNEY GENERAL'S POSITION**

The Attorney General's Office (AGO) agrees that Duke should earn a reasonable profit on its demand-side management (DSM) and energy efficiency (EE) programs. However, the Commission must ensure that Duke's profit is not unreasonable. Consumers will not participate in DSM and EE programs if they are required to pay rates that are higher than needed to appropriately balance energy conservation and energy generation.

The AGO believes that the earnings levels established by the Settlement Agreement will allow Duke to earn appropriate incentives and a reasonable profit on SAW, with one exception. In addition to the profits allowed under the Settlement Agreement, which range from 5% to 15%, depending on the amount of DSM/EE savings achieved by SAW, the Settlement Agreement provides that Duke will receive net lost sales revenues. For example, if Duke achieves 85% of targeted DSM/EE savings, then Duke will receive a profit of 12%, plus \$151 million in lost sales revenues. However, if that \$151 million is included in the calculation of Duke's SAW profit,

then the profit is actually 58%, rather than 12%. That level of profit is excessive and will not produce reasonable consumer rates. Therefore, the Commission should modify the Settlement Agreement to require that net lost revenues be included in the calculation of Duke's profit level.

### **THE COMMISSION'S PRIOR ORDER**

The Commission's Order of February 26, 2009 included three main components. First, the Commission approved most of Duke's proposed DSM and EE programs as new DSM and EE programs under N.C. Gen. Stat. § 62-133.9(a) (2008), thus making those programs eligible for recovery of costs and incentives under N.C. Gen. Stat. § 62-133.9(d). *Order*, Findings of Fact Nos. 5-42, at 5-10. Second, the Commission rejected Duke's position that SAW's costs and incentives be recorded and reported separately from Duke's regulated jurisdictional earnings. Duke asserted that separate recording and reporting of SAW's costs and incentives was appropriate because SAW's costs and incentives should not be subject to a regulated rate of return. The Commission ruled otherwise, stating that:

[N]o party appears to dispute that the level of jurisdictional earnings that a utility is currently achieving is a key indicator of the reasonableness of its jurisdictional rates or that it is inappropriate or unnecessary for the Commission to monitor those earnings on an ongoing quarterly basis.

...

Indeed, the Commission is of the opinion that the aforesaid information is central to the Commission's effective fulfillment of its present statutory duties and responsibilities. The Commission is also of the opinion that it is critical that the jurisdictional information provided by the utility (including income statements and statements of rate base and return) be developed and presented utilizing established regulatory accounting principles, practices, and procedures and that such information, including key financial ratios, be provided, presented, and expressed in unambiguous conventional terms of art, including overall rate of return and return on common equity.

*Order*, Finding of Fact No. 55, at 12; Commission Conclusions, at 55-60.

Thus, the Commission held that Duke's costs and earnings from SAW must be recorded in the same manner as Duke's generation-side costs and earnings, and that the Commission will regulate Duke's SAW earnings similar to the manner in which it regulates Duke's generation-side earnings, i.e. set a maximum rate of return and give Duke a reasonable opportunity to earn that rate of return.

Third, the Commission requested that Duke file supplemental information in the form of modified internal rate of return (MIRR) calculations to be used in estimating the expected rate of return on SAW program costs. Although Duke and other parties filed MIRR calculations and comments, the Settlement Agreement employs a more traditional earnings approach utilizing a percentage of revenues over program costs to express the profit level. *See Schultz Settlement*

*Exhibit B*, at 21 (“‘Earnings’ shall be calculated as an after-tax rate of return on actual program costs incurred by the Company over the four-year plan period on a net present value basis.”). Indeed, the testimony of Duke and the Public Staff at the August 19, 2009 evidentiary hearing essentially stated that the MIRR methodology is not useful in measuring Duke’s SAW profits. *See Pre-Filed Supplemental Testimony of Raiford L. Smith*, at 5-6; *Pre-Filed Supplemental Testimony of Michael C. Maness*, at 12-20.

## **QUESTION PRESENTED**

WHETHER THE REVENUES DUKE WOULD RECEIVE ABOVE SAW PROGRAM COSTS WOULD BE APPROPRIATE INCENTIVES UNDER N. C. GEN. STAT. § 62-133.9?

## **ARGUMENT**

THE REVENUES DUKE WOULD RECEIVE ABOVE SAW PROGRAM COSTS WOULD BE APPROPRIATE INCENTIVES UNDER N. C. GEN. STAT. § 62-133.9 IF THE COMMISSION ORDERS THAT ALL SAW REVENUES, INCLUDING NET LOST SALES REVENUES, WILL BE INCLUDED UNDER THE SAW PROFIT CAPS.

Under the proposed Settlement Agreement, “Net lost revenues mean revenue losses, net of marginal costs avoided at the time of the lost kilowatt-hour sale(s) incurred by the Company’s public utility sales operations as the result of a new demand-side management or energy efficiency measure.” *Schultz Settlement Exhibit B*, at 22.

There are four important facts concerning the inclusion of net lost sales revenues in the calculation of SAW’s profit caps.

- The estimated amount of net lost revenues to be received by Duke is \$151 million, assuming that SAW achieves 85% of the targeted DSM/EE savings.
- At 85% of targeted DSM/EE savings, if net lost revenues are not included under the earnings cap, Duke’s North Carolina ratepayers would pay Duke a 12% profit on SAW, plus \$151 million.
- If net lost revenues are included in the profit calculation, Duke’s actual profit is 58%.
- Duke’s present authorized overall earnings level on its generation business is 8.57%.

Under the Settlement Agreement, SAW earnings would be capped at a percentage return on program costs, with the percentage varying based on Duke’s achievement of DSM/EE savings targets, as follows.

<u>% Target Achieved</u>	<u>Maximum Return on Program Costs</u>
≥ 90%	15%
80% to 89%	12%
60% to 79%	9%
≤60%	5%

*Schultz Settlement Exhibit B*, at 21.

However, there would be no cap on net lost sales revenues. *Schultz Settlement Exhibit B*, at 22; *Testimony of Stephen M. Farmer*, T Vol. 1, at 102-103. Further, if net lost revenues are included in calculating SAW earnings, the result is a profit level of 58% - 60%. *See Testimony of Stephen M. Farmer*, T Vol. 1, at 103-108; *Attorney General's Farmer Cross-Exam Exhibit No. 1*; *Testimony of Michael C. Maness*, T Vol. 1, at 217-220; *Attorney General's Maness Cross-Exam Exhibit No. 1*. The table below compares the SAW residential rates under the Settlement Agreement with the SAW residential rates if net lost revenues are included under the profit cap.

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
SAW Residential Charge Under Settlement Agreement <sup>1</sup>	0.1206¢	0.1749¢	0.2787¢	0.4027¢
Charge with Lost Revenues Included Under Profit Cap	0.0886¢	0.1070¢	0.1597¢	0.2363¢
Percentage Decrease in SAW Residential Charge	26.5%	38.8%	42.6%	41.3%

A. Rates must be just and reasonable.

In the Public Utilities Act (hereinafter the "Act"), the General Assembly established three primary requirements for public utility services. First, the services must be adequate and reliable. Second, the utility must use the entire spectrum of resource options, including generation, demand-side management and energy efficiency. N.C. Gen. Stat. § 62-2(a)(3a) (2008). Third, the utility's service and its rates must be based on the least cost mix of generation resources, energy efficiency and demand-side management. *Id. See also*, § 62-133.9(b)(2008) (requiring least-cost mix of generation and demand reduction resources).

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<sup>1</sup> This is the per kilowatt charge, including Gross Receipts Tax and regulatory fee. *See Farmer Exhibit No. 3*.

Section 62-2(b) of the Act empowers the Commission to effectuate the policies established by the Act. *State ex rel. Utils. Comm'n v. Edmisten*, 294 N.C. 598, 606, 242 S.E.2d 862, 870 (1978). The above provisions of the Act, as well as the Commission's general ratemaking authority, N. C. Gen. Stat. § 62-130 (2008), require the Commission to set just and reasonable rates. Just and reasonable rates are those that provide the utility an opportunity to earn a fair return on its property and are fair to the utility's customers. *State ex rel. Utils. Comm'n v. Duke Power Co.*, 285 N.C. 377, 206 S.E.2d 269 (1974); *State ex rel. Utils. Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 119 S.E.2d 469 (1961). The proposed Settlement Agreement would not meet this standard.

- B. Duke's recovery of net lost revenues would not be an appropriate reward under G.S. § 62-133.9 if net lost revenues are in addition to the earnings allowed under the earnings cap.

Pursuant to G.S. § 62-2(a)(3a), the Commission can consider "appropriate rewards to utilities for efficiency and conservation which decrease utility bills." Similarly, under G.S. § 62-133.9(d)(2), the Commission may approve "[A]ppropriate rewards based on capitalization of a percentage of avoided costs achieved by demand-side management and energy efficiency measures."

Senate Bill 3 created a new annual rate rider for the recovery of the costs of energy efficiency programs. N.C. Gen. Stat. § 62-133.9. However, this statute did not modify the Act's traditional least cost and cost of service/rate of return principles. Rather, the substantive provisions of § 62-133.9 refer to and are built around the fundamental concept that a utility's reasonable cost is the basis on which the Commission shall set the level of demand-side management and energy efficiency cost recovery and incentives. For example, as previously stated, § 62-133.9(b) requires energy efficiency measures to be implemented at least cost. Subsection (c) requires cost-effective energy efficiency options to be included in the company's annual resource plans. Subsection (d) authorizes the Commission to "approve an annual rider to the electric public utility's rates to recover all reasonable and prudent costs incurred for the adoption and implementation" of new energy efficiency programs, and to allow utilities "to capitalize all or a portion of those costs to the extent that those costs are intended to produce future benefits." In particular, subsection (d) evinces the traditional cost of service/rate of return methodology, allowing the recovery of reasonable and prudent operating costs plus a rate base return on capitalized costs. In short, the Act's fundamental principles of cost-based rates and a reasonable profit are present throughout § 62-133.9.

In Duke's last general rate case in 2007, the Commission approved an 8.57% overall rate of return and 11% return on common equity, as agreed on by the parties. *Order Approving Stipulation and Deciding Non-Settled Issues*, NCUC Docket No. E-7, Sub 828 (Dec. 20, 2007). It would not be just or reasonable to require ratepayers to pay Duke a significantly higher return for saving electricity than what the Commission has authorized as just and reasonable for generating electricity. Indeed, the Commission adopted that position in its February 26, 2009 Order in this case.

[N]o party appears to dispute that the level of jurisdictional earnings that a utility is currently achieving is a key indicator of the reasonableness of its jurisdictional rates or that it is inappropriate or unnecessary for the Commission to monitor those earnings on an ongoing quarterly basis.

*Order*, at 58.

Further, the Commission adopted that approach with regard to net lost revenues in the Commission's decision on Progress Energy Carolinas' (PEC's) DSM/EE cost and incentive recovery. In PEC's case, the Commission held that

PEC should include all actual program revenues, including Net Lost Revenues and the PPI incentives, and costs for purposes of calculating and presenting its regulated earnings to the Commission in the Company's quarterly NCUC ES-1 Reports. Such information, including certain supplementary schedules, is necessary to allow the Commission to effectively and efficiently assess the financial implications of the Company's EE and DSM programs, including the reasonableness and efficacy of the Commission-approved Mechanism.

The Commission has a continuing statutory obligation to ensure, among other things, that the rates and charges of jurisdictional investor-owned electric utilities are just and reasonable, from the standpoint of both investor and ratepayer interests. The Commission is of the opinion that jurisdictional earnings presented in ES-1 Reports should be based on and reflect actual earnings.

*Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Commission-Required Modifications*, NCUC Docket No. E-2, Sub 931, Finding of Fact No. 15, at 10; Evidence and Conclusions for Finding of Fact No. 15, at 34 (June 15, 2009).

Consistent with the above Commission rulings, all net lost revenues received by Duke as SAW incentives should be included in calculating the maximum profit levels allowed under the Settlement Agreement. If all revenues, including net lost revenues, are included in the calculation of the maximum profit levels, then the profits allowed under the Settlement Agreement appear to be appropriately balanced to produce reasonable rates and adequate incentives. Therefore, the AGO does not oppose the Settlement Agreement if the Commission requires that all SAW revenues, including net lost sales revenues, are included in calculating SAW's maximum profit levels.

## CONCLUSION

The Commission should approve the Settlement Agreement, with the modification that all net lost sales revenues shall be included in calculating SAW's maximum profit levels.

This the 7th day of October, 2009.

ROY COOPER  
Attorney General



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**CERTIFICATE OF SERVICE**

The undersigned certifies that he has served a copy of the foregoing ATTORNEY GENERAL'S BRIEF upon the parties of record in this proceeding or their attorneys by depositing a copy of the same in the United States Mail, postage prepaid and properly addressed.

This the 7th day of October, 2009.



Leonard G. Green  
Assistant Attorney General