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October 7, 2009

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

RE: Docket No. E-7, Sub 831

Dear Ms. Vance:

Enclosed for filing are the original and thirty (30) copies of the Stipulating Parties' Proposed Order in the above referenced docket.

Also enclosed is the Proposed Order on CD in Microsoft Word format.

Sincerely,

Robert W. Kaylor

Robert W. Kaylor

Enclosures

cc: Parties of Record

(9l) Full Dist.

Disk to Kim Campbell

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

FILED
OCT 07 2009
Clerk's Office
N.C. Utilities Commission

DOCKET NO. E-7, SUB 831

In the Matter of:

Application of Duke Energy Carolinas, LLC for Approval of Save-a-Watt Approach, Energy Efficiency Rider and Portfolio of Energy Efficiency Programs	)	***STIPULATING PARTIES'*** **PROPOSED ORDER**

HEARD: Hearing Room, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina on August 19, 2009.

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

APPEARANCES:

For Duke Energy Carolinas, LLC:

Lara Simmons Nichols, Associate General Counsel
Catherine E. Heigel, Associate General Counsel
Duke Energy Corporation
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For the Using and Consuming Public:

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Public Staff – North Carolina Utilities Commission
4326 Mail Service Center, Raleigh, North Carolina 27699

Leonard G. Green, Assistant Attorney General
North Carolina Department of Justice
P.O. Box 629, Raleigh, North Carolina 27602

For N.C. Waste Awareness & Reduction Network (NC WARN):

John Runkle
P.O. Box 3793, Chapel Hill, North Carolina 27515

For North Carolina Justice Center, AARP, North Carolina Council of Churches and Legal Aid of North Carolina:

Jack Holtzman, North Carolina Justice Center
224 South Dawson Street, Raleigh, North Carolina 27601

For the Carolina Industrial Group for Fair Utility Rates (CIGFUR III) and Air Products and Chemicals, Inc.:

Ralph McDonald, Bailey & Dixon, LLP
P.O. Box 1351, Raleigh, North Carolina 27602

For the Carolina Utility Customers Association, Inc. (CUCA):

Robert F. Page, Crisp, Page, & Currin, LLP
Suite 205, 4010 Barrett Drive
Raleigh, North Carolina 27603

For Environmental Defense Fund, Natural Resources Defense Council, Southern Alliance for Clean Energy and Southern Environmental Law Center:

Gudrun Thompson, Southern Environmental Law Center
200 West Franklin Street, Suite 330, Chapel Hill, North Carolina 27516

For North Carolina Sustainable Energy Association:

Kurt J. Olson, North Carolina Sustainable Energy Association
111 Haynes Street, Suite 109, Raleigh, North Carolina 27628

BY THE COMMISSION: On May 7, 2007, Duke Energy Carolinas, LLC ("Duke Energy Carolinas" or "Company") filed an application for approval of its save-a-watt approach, energy efficiency rider and portfolio of energy efficiency programs ("Application") in Docket No. E-7, Sub 831 pursuant to the Commission's March 21, 2007 *Order Granting Certificate of Public Convenience and Necessity with Conditions* in Docket No. E-7, Sub 790 ("Cliffside CPCN Order") and N.C. Gen. Stat. §§ 62-2(3a), 62-30 and 62-130(a).

The intervention of the Attorney General has been recognized pursuant to N.C. Gen. Stat. §62-20, and the intervention of the Public Staff has been recognized pursuant to N.C. Gen. Stat. §62-15(d) and Commission Rule R1-19(e). On May 15, 2007, a petition to intervene was filed by the Carolina Utility Customers Association, Inc. ("CUCA"). The Carolina Industrial Groups for Fair Utility Rates ("CIGFUR III") filed a petition to intervene on May 17, 2007. The Commission entered an order allowing the intervention of CUCA and CIGFUR III on May 22, 2007. On May 24, 2007, Piedmont Natural Gas Company, Inc. ("Piedmont") filed a petition to intervene which the Commission granted on May 31, 2007. The Southern Alliance for Clean Energy ("SACE") filed a petition to intervene on May 31, 2007 which the Commission granted on June 7, 2007. On June 11, 2007, North Carolina Waste Awareness & Reduction Network, Inc. ("NC WARN") filed a motion to intervene which the Commission granted on June 14, 2007. Virginia Electric and Power Company d/b/a Dominion North Carolina Power ("Dominion") and Progress Energy Carolinas, Inc. ("PEC") filed petitions to intervene on June 20, 2007. The Commission entered an order allowing the intervention of Dominion and PEC on June 22, 2007. On June 22, 2007, North Carolina Sustainable Energy Association ("NCSEA") and Public Service Company of North Carolina, Inc. ("PSNC") filed petitions to intervene which the Commission granted on June 27, 2007. The City of Durham filed a petition to intervene on July 3, 2007 which the Commission granted on July 10, 2007. On August 13, 2007, Wal-Mart Stores East, LP ("Wal-Mart") filed a petition to intervene which the Commission granted on August 17, 2007. Environmental Defense ("ED") and Southern Environmental Law Center ("SELC") filed petitions to intervene on December 28, 2007. The Commission entered an order allowing the intervention of ED and SELC on January 11, 2008. On March 20, 2008, Air Products and Chemicals, Inc. ("Air Products") filed a petition to intervene which was granted by the Commission on March 24, 2008. On June 24, 2008, North Carolina Justice Center ("NCJC"), AARP, North Carolina Council of Churches ("NCCC") and Legal Aid of North Carolina ("LANC") (collectively, the "Public Interest Intervenors") filed a joint petition to intervene which the Commission granted July 3, 2008. Natural Resources Defense Council ("NRDC") filed a petition to intervene on June 26, 2008, which the Commission also granted on July 3, 2008.

On May 24, 2007, Piedmont filed a motion for establishment of a generic proceeding. On May 31, 2007, the Commission entered an order requesting comments regarding the statutory authority for the relief requested by Duke Energy Carolinas and the appropriateness of converting this docket into a generic investigation as requested by Piedmont. PEC and Dominion filed comments on June 20, 2007; Duke Energy Carolinas, the Attorney General, the Public Staff, CUCA, CIGFUR III, SACE, NCSEA and PSNC filed comments on June 22, 2007; NC WARN filed comments on June 25, 2007; Dominion filed further comments on June 29, 2007; and the City of Durham filed initial comments July 3, 2007. Reply comments were filed by Duke Energy Carolinas, PEC, PSNC, SACE, the Public Staff, NCSEA, CIGFUR III and Piedmont on July 13, 2007; the City of Durham filed reply comments on July 16, 2007. The Henderson County Chamber of Commerce filed notice of its intent to support Duke Energy Carolinas' proposed energy efficiency plan on July 12, 2007 and August 3, 2007.

On August 2, 2007, the Commission issued an order denying Piedmont's motion for establishment of a generic proceeding and consolidating Duke Energy Carolinas' petition in this docket with Docket Nos. E-7, Subs 828 and 829 and E-100, Sub 112, dockets which the Commission had consolidated earlier for purposes of hearing. Docket No. E-7, Sub 828 is Duke Energy Carolinas' current general rate case proceeding. At that time, the Commission acknowledged that pending legislation, Session Law 2007-397 ("Senate Bill 3"), would address the Commission's authority to examine energy efficiency programs and cost recovery for such programs outside of general rate cases. However, because Senate Bill 3 had not yet been enacted and the Commission was concerned with losing its opportunity to consolidate the energy efficiency docket with the general rate case, the Commission consolidated the dockets, reserving the right for reconsideration.

On August 14, 2007, Duke Energy Carolinas moved for reconsideration and requested to deconsolidate the energy efficiency docket on the grounds that Senate Bill 3, ratified by the General Assembly on August 2, 2007, includes N.C. Gen. Stat. §62-133.8[1] which provides the Commission with express authority to consider and grant the relief requested by Duke Energy Carolinas' energy efficiency Application, obviating the need to combine the energy efficiency docket with the Company's general rate case proceeding. In this motion, Duke Energy Carolinas also proposed a procedural schedule. On August 15, 2007, the Commission entered an order requesting comments on Duke Energy Carolinas' motion. Comments were filed on August 21, 2007 by CIGFUR III, CUCA, PSNC, Wal-Mart, the Public Staff and the Attorney General. On August 29, 2007, Duke Energy Carolinas, the Public Staff and the Attorney General filed reply comments.

On August 31, 2007, the Commission issued an order bifurcating this docket from the Company's pending general rate case investigation. The Commission concluded that Senate Bill 3, passed August 20, 2007, authorized the Commission to hear the energy efficiency docket separate from general rate proceedings, and that Duke Energy Carolinas' save-a-watt Application should not be heard and decided until after the Commission completed its rulemaking to implement Senate Bill 3. On February 29, 2008, the Commission issued its *Order Adopting Final Rules* in Docket No. E-100, Sub 113 adopting new rules and amendments to implement

[1] Renumbered §62-133.9 at the direction of the Revisor of Statutes.

Senate Bill 3; that same day the Commission also issued its *Order Scheduling Hearing* in this docket.

On March 11, 2008, Alliance to Save Energy, the American Council for an Energy-Efficient Economy, and the Energy Future Coalition filed notice of their agreement with Duke Energy Carolinas to support the Company's save-a-watt plan. These groups asked the Commission to include the first four elements of this agreement[2] in its ruling on this docket.

On April 4, 2008, Duke Energy Carolinas filed the direct testimony and exhibits of James E. Rogers, Chairman, President and Chief Executive Officer of Duke Energy Corporation ("Duke Energy"); Ellen T. Ruff, President of Duke Energy Carolinas; Judah Rose, Managing Director of ICF International; Jane Sadowsky, Senior Managing Director of Evercore Partners; Charles J. Cicchetti, co-founder and member in Pacific Economic Group, L.L.C.; Theodore E. Schultz, Vice President – Energy Efficiency, Duke Energy; Janice D. Hager, Managing Director of Integrated Resource Planning and Environmental Strategy, Duke Energy; Richard G. Stevie, Managing Director of Customer Market Analytics for Duke Energy Shared Services, Inc.; Nick Hall, President and owner of TecMarket Works; Stephen M. Farmer, an independent contractor who provides rate and regulatory consulting services; and J. Danny Wiles, Vice President – Franchised Electric & Gas Accounting, Duke Energy Carolinas.

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[2] (1) Identify and pursue every cost-effective energy efficiency program. Duke Energy Carolinas will not impose any predetermined cap on the Company's total energy efficiency investment.
(2) An overall energy efficiency target for save-a-watt to achieve on-going annual electricity savings of at least 1% of its 2009 retail sales by 2015, with savings each year over the 2009-2014 period ramping up to this 1% per year target.
(3) The use of accepted best practices in evaluation, measurement and verification ("EM&V"). Duke Energy Carolinas is committed to allocate 5% of energy efficiency expenditures to EM&V.
(4) Make evaluation results available to all interested parties, to establish a broad-based peer review and advisory process, and to use evaluation results as feedback to continuously improve the Company's programs.

Duke Energy Carolinas filed an Agreement and Stipulation of Settlement with PSNC ("PSNC Settlement Agreement") on June 24, 2008. An Agreement and Stipulation of Settlement between Duke Energy Carolinas and Piedmont ("Piedmont Settlement Agreement") was filed on June 26, 2008.

The Public Interest Intervenors filed the direct testimony and exhibits of Roger D. Colton on June 24, 2008. On or about June 26, 2008, ED, NRDC, SACE and SELC (collectively, the "Environmental Intervenors") filed the direct testimony and exhibits of Donald Gilligan, Brian M. Henderson and J. Richard Hornby; Air Products filed the direct testimony of James Butz; CIGFUR III filed the direct testimony and exhibits of Nicholas Phillips, Jr.; Wal-Mart filed the direct testimony and exhibits of James T. Selecky; CUCA filed the direct testimony of Kevin W. O'Donnell; and the Public Staff filed the direct testimony and exhibits of Jack Floyd, Michael C. Maness and Richard F. Spellman. NC WARN filed the direct testimony and exhibit of John O. Blackburn on June 27, 2008.

On July 21, 2008, Duke Energy Carolinas filed the rebuttal testimony and exhibits of Richard A. Morgan, President of the consulting firm Morgan Marketing Partners, and Witnesses Cicchetti, Stevie, Rose, Hager, Wiles, Farmer and Schultz. The case came on for hearing as ordered on July 28, 2008. On August 1, 2008, the Public Staff filed two late-filed exhibits requested by the Commission regarding data on the top twenty electric energy efficiency utilities in the United States for the years 2004 and 2006. On August 7, 2008, the Attorney General filed "Attorney General's Office Stevie Cross-Exam Exhibit No. 3," a reproduction of the information placed on the blackboard by the Attorney General's counsel and used during the cross-examination of Company Witness Stevie, which was requested by the Commission. On August 15, 2008, Duke Energy Carolinas filed the supplemental testimony and exhibits of Witness

Schultz in response to questions by the Commission during the hearing; the Public Staff filed the affidavit of Witness Maness in response to this supplemental testimony on August 25, 2008. Duke Energy Carolinas filed one late-filed exhibit on August 18, 2008 and two more August 27, 2008.

The parties submitted proposed orders and/or briefs on October 7, 2008. Proposed Orders were submitted by Duke Energy Carolinas, the Public Staff, and the Public Interest Intervenors. Briefs were filed by Duke Energy Carolinas, the Public Interest Intervenors, the Environmental Intervenors, CUCA, jointly by CIGFUR III and Air Products, NC WARN, and the Attorney General.

On February 26, 2009, the Commission issued its *Order Resolving Certain Issues, Requesting Information on Unsettled Matters, and Allowing Proposed Rider to Become Effective Subject to Refund* in this Docket ("Order"). Also on February 26, 2009, an errata order was issued replacing the supplemental information section of the Order beginning on page 60 and ending on page 63. On March 20, 2009, Air Products petitioned the Commission to reconsider the Order. On March 31, 2009, Duke Energy Carolinas filed the supplemental information requested in the Order and errata order.

The Order required Duke Energy Carolinas to work with the Public Staff to prepare a Notice to Customers giving notice of its proposed Rider EE. The Company and the Public Staff developed a Notice to Customers, which the Company filed on May 1, 2009. Duke Energy Carolinas filed Revised Tariffs and Riders on May 7, 2009. On May 8, 2009, the Commission approved the Revised Tariffs and Riders and Notice to Customers and ordered the Company to publish the Notice.

On May 22, 2009, the Public Interest Intervenors filed comments regarding the supplemental information the Company filed in response to the Order. NC WARN filed comments on May 26, 2009. On June 12, 2009, the Public Staff and CUCA filed comments.

Also on June 12, 2009, Duke Energy Carolinas, the Environmental Intervenors and the Public Staff (collectively, the "Stipulating Parties") filed an Agreement and Joint Stipulation of Settlement ("Settlement Agreement" or the "Agreement"). On June 9, 2009, the Public Staff filed the settlement testimony of James S. McLawhorn; the Environmental Intervenors filed the settlement testimony and exhibits of John D. Wilson; and Duke Energy Carolinas filed the settlement testimony and exhibits of Witnesses Wiles, Schultz, and Farmer.

On June 18, 2009, the Commission issued an order requiring both Duke Energy Carolinas and the Public Staff to file (a) Modified Internal Rate of Return ("MIRR") analyses consistent with the Settlement Agreement, 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 DSM/EE Rider.[3] In accordance with this order, on June 26, 2009, Duke Energy Carolinas filed the MIRR testimony and exhibit of Raiford L. Smith, the Director of Strategy and Collaboration for Duke Energy Business Services, LLC ("Duke Energy Business Services," an affiliate of Duke Energy Carolinas), and on July 2, 2009, the Public Staff filed the supplemental testimony and exhibits of Witness Maness.

[3] In this same order, the Commission decided to hold in abeyance any further consideration of the supplemental information filed by Duke Energy Carolinas on March 31, 2009.

On July 27, 2009, the Public Interest Intervenors filed the supplemental testimony of Witness Colton. On August 10, 2009, Duke Energy Carolinas filed the rebuttal testimony of Witness Smith in response.

On July 22, 2009, Air Products moved for the Commission to enter an order requesting comments on its petition to reconsider the Order, and if deemed necessary, scheduling an oral argument. On August 17, 2009, the Commission issued an order denying Air Products' petition to reconsider and its motion.

On July 30, 2009, the Commission entered a pre-hearing order requesting verified information from the Stipulating Parties, which the Company responded to on August 10, 2009. The Commission entered a second pre-hearing order requesting verified information from the Environmental Intervenors and the Public Staff on August 14, 2009, which both responded to on August 18, 2009.

The case came on for hearing as ordered on August 19, 2009. On August 28, 2009, Duke Energy Carolinas filed late-filed exhibits in response to questions by the Commission during the hearing. The Public Staff filed late-filed exhibits on September 1, 2009. The deadline for parties to file proposed orders and/or briefs was October 1, 2009.

Based upon consideration of the pleadings, testimony, and exhibits received into evidence at the hearing, and the record as a whole, the Commission makes the following:

<u>FINDINGS AND CONCLUSIONS</u>

1. Duke Energy Carolinas is a public utility with a public service obligation to provide electric utility service to customers in its service area in North Carolina and is subject to the jurisdiction of the Commission.

2. The Commission has jurisdiction over this Application and the Settlement Agreement pursuant to the Public Utilities Act. A utility must submit cost-effective demand-side management ("DSM") and energy efficiency ("EE") options that require incentives to the Commission for approval and may petition the Commission for approval of an annual rider to recover all reasonable and prudent costs incurred for the adoption and implementation of new DSM and EE measures pursuant to N.C. Gen. Stat. §62-133.9 and Commission Rules R8-68 and R8-69. The Commission concludes that it has the authority to consider and approve the relief the Company is seeking in this docket.

3. On May 7, 2007, Duke Energy Carolinas filed the Application for approval of the save-a-watt approach (the "Original Save-a-Watt Proposal"), EE rider ("Rider EE") and portfolio of EE and DSM programs (collectively, the "EE Plan") with the Commission. After the filing of testimony and exhibits and a fully litigated hearing, the Commission issued the Order, in which it resolved certain issues, requested information on unsettled matters, and allowed the proposed Rider EE to become effective subject to refund.

4. On June 12, 2009, the Stipulating Parties filed the Settlement Agreement, which resolves all issues between the Stipulating Parties associated with Docket No. E-7, Sub 831, including Duke Energy Carolinas' EE Plan and the Company's proposed compensation model, except for certain cost allocation issues, which the Stipulating Parties request the Commission decide in this proceeding and the issue of the interest rate to be applied to refunds to customers resulting from overcollection, which the Stipulating Parties request the Commission decide in the first annual true-up proceeding in which an overcollection occurs.

5. The Settlement Agreement proposes a "Modified Save-a-Watt Approach" whereby the Company will be compensated based on predetermined percentages of the

Company's capacity- and energy-related "avoided costs," an estimate of the cost of supplying electricity. These percentages include 75% of avoided capacity costs for DSM programs, and 50% of the net present value ("NPV") of the avoided energy costs plus 50% of the NPV of avoided capacity costs for EE programs. The Commission concludes that the level of avoided cost recovery proposed in the Settlement Agreement is reasonable and in the public interest.

6. The Modified Save-a-Watt Approach has a term of four years, and it is a pilot program.

7. The Settlement Agreement provides for increased energy savings targets as compared to the Original Save-a-Watt Proposal.

8. The Settlement Agreement includes a performance target of avoided cost savings based on projected EE and DSM results. The Company's avoided cost target, based on 100% participation, is $754 million[4] (nominal system dollars) and is tied to targeted capacity and cumulative energy savings for the life of the EE measures. The Commission concludes that the Company's performance targets under the Settlement Agreement are appropriate.

9. The earnings to the Company that result from the incentive compensation will be capped at a percentage of incurred program costs not to exceed 15%. The specific percentage applied to program costs to determine the earnings cap will be based on the percentage of the target avoided cost savings actually achieved. The earnings cap based on the Company's performance helps ensure that customers receive fair value and that their rates remain reasonable.

10. The Settlement Agreement and supporting testimony provide for the separate recovery of 36 months of net lost revenues, as defined by Commission Rule R8-68, resulting from EE measures only. The Commission authorizes the Company to recover net lost revenues

[4] As shown in the Company's Late-Filed Exhibits, the avoided cost target for North Carolina only is $547 million.

for 36 months for each installation of an EE measure during a given vintage year,[5] except that the recovery of net lost revenues will end upon Commission approval of an alternative recovery mechanism, or the implementation of new rates in a general rate case or comparable proceeding to the extent that rates set in a rate case or comparable proceeding are set to explicitly or implicitly recover those net lost revenues. Recovery of net lost revenues for vintage year installations not covered by the new rates will continue, subject to the 36 month limitation.

11. The cumulative jurisdictional revenue requirement for the four-year term of the Settlement Agreement is significantly less under the Settlement Agreement than under the Original Save-a-Watt Proposal. The rate impacts under the Agreement are reasonable in light of the Company's increased energy and capacity savings targets and the Company's revised Rider EE reflecting these rate impacts is in the public interest and approved.

12. After the conclusion of the four-year term of the Settlement Agreement, actual measured and verified avoided cost savings will be compared to the targeted avoided cost savings in a final true-up proceeding. The true-up process provides a reasonable means of ensuring that Duke Energy Carolinas does not collect revenues for its DSM and EE programs in excess of what is allowed under the Agreement.

13. **Duke Energy Carolinas Version**: Consistent with the requirement contained in N.C. Gen. Stat. §62-133.9(e) that the costs of DSM and EE programs are to be recovered only from those customers who directly benefit from such programs, the cost of a DSM or EE program or measure should be recovered from those customers eligible to participate in the program and to which the program is targeted. Because only retail customers are eligible to

[5] A vintage year is the twelve month period in which a specific DSM or EE measure is installed for an individual participant or a group of participants.

participate in the Company's DSM and EE programs, the costs of the DSM and EE programs should be allocated to retail jurisdiction only. Similarly, costs of residential programs should be allocated to the residential customer class and costs of nonresidential programs should be allocated to the nonresidential customer class.[6] **Public Staff Version**: 13. Consistent with Commission Rule R8-69(b)(1), costs approved for recovery by Duke Energy Carolinas shall be allocated to the North Carolina retail jurisdiction consistent with the system benefits provided by the new DSM and EE measures. The benefit of a DSM or EE program or measure to the utility system is the long-term reduction in cost of service which accrues to the benefit of all system customers. Therefore, for DSM programs, inputs will be allocated to the North Carolina retail jurisdiction based on contributions to total system peak by all system customers, retail and wholesale; and for EE programs, inputs should be allocated to the North Carolina retail jurisdiction based on kWh sales to all system customers, retail and wholesale. With regard to cost allocation to the customer classes, consistent with the requirement contained in N.C. Gen.Stat. § 62-133.9(e) that the costs of DSM/EE programs are to be recovered only from the customer class or classes that directly benefit from the programs, the costs of the DSM/EE programs at issue in this docket should be recovered from all customer classes, because all customer classes directly benefit from the reduction in the utility's cost of service resulting from the DSM/EE programs.

14. *The Settlement Agreement provides for the creation of a Regional Efficiency* Advisory Group (the "Advisory Group") to review the measurement and verification process, collaborate on new program ideas, and review changes to existing programs. The Commission concludes that the establishment of this Advisory Group is in the public interest.

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[6] The Environmental Intervenors have no position as to the appropriate jurisdictional allocation methodology.

15. Pursuant to Commission Rule R8-27(a)(2), the Commission authorizes the Company, for North Carolina jurisdictional regulatory accounting purposes, to utilize *Account 182.3 – Other Regulatory Assets* to record the difference between the level of revenues estimated to be ultimately recoverable under the Settlement Agreement and the level of revenues then currently billed under Rider EE when it is probable that such ultimately recoverable revenues will be greater than the currently billed revenues, and *Account 254 – Other Regulatory Liabilities* to record the difference between the level of revenues then currently billed customers and the level of revenues that is estimated to be ultimately recoverable when it is probable that such currently billed revenues are in excess of the revenues ultimately recoverable.

16. The Commission intends that the methods and criteria to be utilized in determining the interim and ultimate rates charged for the term of the Settlement Agreement, including the true-up processes discussed in the Evidence in Support of Findings & Conclusions No. 12, are to be those set forth within the Settlement Agreement and the provisions of Commission Rule R8-69. Accordingly, the Commission's approval of the Settlement Agreement in this Order is sufficient to support deferral accounting for North Carolina jurisdictional regulatory purposes.

17. The Commission concludes that the Public Interest Intervenors have not presented any new evidence justifying revision of the Company's EE and DSM programs that were approved in the Order. The Public Interest Intervenors' request for rejection and/or modification of the Settlement Agreement should be denied.

18. The Settlement Agreement is reasonable and appropriate and in the public interest. The incentives proposed by the Stipulating Parties, including net lost revenues and the Modified Save-a-Watt Approach, are reasonable and appropriate and in the public interest.

EVIDENCE FOR FINDINGS AND CONCLUSIONS Nos. 1 & 2

The evidence in support of these findings of fact can be found in the Application, Settlement Agreement, pleadings, testimony and exhibits in this docket, and the statutes, case law, and rules governing the authority and jurisdiction of this Commission. These findings are informational, procedural, and jurisdictional in nature.

Prior to the passage of Senate Bill 3, the Commission's authority to authorize cost recovery pursuant to a rider for DSM and EE programs was unclear. The Commission requested comments on its authority to consider the Company's Application and eventually consolidated Docket No. E-7, Sub 831 with the Company's general rate proceeding. (*Order Requesting Comments* in Docket No. E-7, Sub 831 (May 31, 2007); *Order Consolidating Issues for Hearing* in Docket No. E-7, Sub 831 (August 2, 2007)). Although the Commission acknowledged that the pending Senate Bill 3 would expressly address whether the Commission possessed this authority, because enactment was possibly several weeks away, the Commission consolidated the dockets, reserving the right to reconsider its decision. (*See Order Consolidating Issues for Hearing*, at p. 7). Duke Energy Carolinas requested reconsideration of consolidation shortly after the General Assembly ratified Senate Bill 3. Senate Bill 3 became law soon thereafter, and the Commission accordingly granted the Company's request and bifurcated E-7, Sub 831 from Duke Energy Carolinas' general rate case.

Among other things, Senate Bill 3 *contains the new* N.C. *Gen. Stat. §62-133.9,* which concerns cost recovery for DSM and EE programs. This specific statute grants the Commission the authority to approve an annual rider, outside of a general rate case, for recovery of reasonable and prudent costs incurred in the adoption and implementation of new DSM and EE measures.

N.C. Gen. Stat. §62-133.9(c) specifically provides that utilities shall submit DSM and EE programs that require incentives to the Commission for approval.

Commission Rule R8-68 establishes guidelines for the application of N.C. Gen. Stat. §62-133.9. Under this Rule, a utility must obtain Commission approval before implementing any new or modified DSM or EE measure. Rule R8-68 sets forth detailed filing requirements and outlines what the Commission may consider in deciding whether to approve a new measure or program. The Rule also provides that reasonable and prudent costs of new DSM or EE programs approved by the Commission shall be recovered through the annual rider described in N.C. Gen. Stat. §62-133.9 and Rule R8-69. The Commission may also consider in the annual rider proceeding whether to approve any utility incentive pursuant to §62-133.9(d)(2)a-c.

Commission Rule R8-69 outlines the procedure whereby a utility applies for and the Commission establishes an annual DSM/EE rider. The Rule defines DSM/EE rider as "a charge or rate established by the Commission annually pursuant to N.C. Gen. Stat. 62-133.9(d) to allow the electric public utility to recover all reasonable and prudent costs incurred in adopting and implementing new demand-side management and energy efficiency measures after August 20, 2007, as well as, if appropriate, utility incentives, including net lost revenues." Rule R8-69(a)(2). Rule R8-69(c) allows a utility to apply for recovery of incentives for which the Commission will determine the appropriate ratemaking treatment.

N.C. Gen. Stat. §62-133.9, Rule R8-68 and Rule R8-69 establish a procedure whereby an electric public utility files an application in a unique docket for the Commission's approval of an annual rider for recovery of reasonable and prudent costs of EE and DSM programs as well as appropriate utility incentives, including specifically "[a]ppropriate rewards based on capitalization of a percentage of avoided costs achieved by demand-side management and energy efficiency measures." The incentives the Company seeks under the Modified Save-a-Watt Approach are based upon paying the Company a percentage of the avoided capacity costs achieved by DSM measures, and a separate percentage of the NPV of avoided capacity costs and avoided energy costs achieved by EE measures. In addition, the Settlement Agreement provides for a limited period of recovery of the Company's net lost revenues resulting from implementation of its EE measures. The Commission concludes that it has the authority to consider and approve the relief the Company is seeking in this docket.

EVIDENCE FOR FINDINGS AND CONCLUSIONS No. 3

The evidence in support of this finding can be found in the Application, the proposed order and brief the Company submitted October 7, 2008, and the Order issued by the Commission on February 26, 2009 in this docket.

On May 7, 2007, the Company filed its Application in this docket proposing its EE Plan. By this filing, Duke Energy Carolinas requested approval of its Original Save-a-Watt Proposal, a portfolio of EE programs, and Rider EE to compensate and reward it for verified DSM and EE results and to recover the amortization of, and a return, on 90% of the costs avoided by the EE Plan. More specifically, the Company requested that the Commission, after hearing, issue an order approving (1) the implementation of the Original Save-a-Watt Proposal; (2) the portfolio of proposed EE programs; (3) the implementation of the proposed Rider EE, including the proposed initial charges for customers; (4) the deferral of program costs and amortization of such costs over the life of the applicable program, with an acknowledgement that the revenues established in Rider EE based on avoided costs specifically include the recovery of incurred program costs; (5) the closing of designated existing programs; and (6) the proposed manner of accounting for the impacts of the Original Save-a-Watt Proposal in the Company's Quarterly Surveillance Reports (NCUC Form ES-1 Reports) to the Commission.

The Commission held hearings on the Company's Application in July and August 2008.

On February 26, 2009, the Commission entered the Order in this docket. By that Order, the Commission granted Duke Energy Carolinas' request for approval of its portfolio of proposed EE programs. The Commission also approved the Company's DSM program Power Manager, provided that current customers on Rider LC be given the option to discontinue participation before being transferred automatically to Power Manager. Similarly, the Commission approved the PowerShare DSM program, provided that existing current customers on Rider IS and Rider SG be allowed to continue to participate in those programs at their current contract levels. The Commission granted Duke Energy Carolinas' request to close certain existing programs. In addition, Duke Energy Carolinas' proposed measurement and verification plan was approved by the Commission, as were its settlement agreements with Piedmont and PSNC. The Commission also ordered that certain types of program changes would require Commission approval. The Commission rejected Duke Energy Carolinas' proposed accounting and reporting procedures, and specified a different approach in the Order. Finally, the Commission allowed the Company's proposed Rider EE to become effective subject to refund.

The Commission determined that the record was not adequate to allow it to reach a decision regarding certain issues concerning the appropriateness of Duke Energy Carolinas' save-a-watt, avoided cost-based compensation mechanism. Accordingly, the Commission required Duke Energy Carolinas to provide certain supplemental information and data, and deferred ruling on the proposed compensation mechanism. Duke Energy Carolinas filed this supplemental information, and several intervenors submitted their comments thereto, but the

Commission decided to hold in abeyance its consideration of this supplemental information pending consideration of the Settlement Agreement.

EVIDENCE FOR FINDINGS AND CONCLUSIONS No. 4

The evidence in support of this finding can be found in the Settlement Agreement and the testimony of Duke Energy Carolinas Witness Stephen Farmer.

On June 12, 2009, the Stipulating Parties filed the Settlement Agreement, which resolves all issues between the Stipulating Parties associated with Docket No. E-7, Sub 831, including the Company's proposed compensation model, except for certain cost allocation issues which the Stipulating Parties request the Commission to decide in this proceeding and the issue of the interest rate to be applied to refunds to customers resulting from overcollection, which the Stipulating Parties request the Commission decide in the first annual true-up proceeding in which an overcollection occurs.

The Settlement Agreement retains many features of Duke Energy Carolinas' Original Save-a-Watt Proposal. For example, the Agreement provides for compensation to Duke Energy Carolinas for successful implementation of DSM and EE programs on the basis of a discount to the "avoided costs" of a power plant rather than on the basis of what the Company spends on DSM and EE programs. This compensation is based upon actual DSM and EE savings achieved, measured and verified by an independent third party as described in the testimony of Duke Energy Carolinas Witnesses Dr. Richard D. Stevie and Nick Hall, filed in this docket on April 4, 2003.[7] As in the Original Save-a-Watt Proposal, Duke Energy Carolinas bears the risk, based

[7] The Commission approved Duke Energy Carolinas' proposed Measurement & Verification Plan in *Order Resolving Certain Issues, Requesting Information on Unsettled Matters, and Allowing Proposed Rider to Become Effective Subject to Refund*, at p. 64 (February 26, 2009).

upon its actual performance, for recovery of its DSM and EE program costs, as well as any management incentive.

The Settlement Agreement incorporates a number of provisions that are important to the Environmental Intervenors. For example, the Agreement contains performance targets pursuant to which Duke Energy Carolinas is eligible to receive a higher level of incentive based its performance in achieving actual demand and energy reductions that result in bill savings for customers, as well as environmental benefits. The performance targets reflect a significant increase in energy savings when compared to the Original Save-a-Watt Proposal. To protect consumers and encourage strong performance, Duke Energy Carolinas' earnings opportunity is tied to the Company's performance in achieving its targets, and is capped at preset percentages of return on investment on program costs, ranging from 5% to 15%.

Along with certain of the provisions listed above, the Settlement Agreement also incorporates additional provisions that are important to Duke Energy Carolinas, the Public Staff and the Environmental Intervenors. First, the Company proposes the Modified Save-a-Watt Model as a four year limited term pilot, which limits the exposure of the parties to unintended consequences that can occur with a new regulatory approach. Second, the Company's revenues recovered on the basis of percentages of avoided costs are limited to the amount necessary to produce an after-tax return on program costs between 5% and 15%, depending on Duke Energy Carolinas' success in reaching the targeted aggregate DSM and EE avoided cost savings level. Third, the amount of net lost revenues that the Company may recover is limited to those incurred within 36 months of implementation of a particular measure. The Settlement Agreement and supporting testimony provide for the separate recovery of these net lost revenues resulting from

EE programs only.[8] The Settlement Agreement defines net lost revenues consistently with Commission Rule R8-68, which results in greater transparency. Fourth, unlike the Original Save-a-Watt Proposal, which tied revenue recovery for DSM and EE programs to variable supply-side costs, the Agreement locks in the per MWh and per MW-year avoided costs. Finally, the Settlement Agreement provides for the return, with interest, to ratepayers of any revenues collected in excess of what is allowed under the Settlement Agreement. Under the Settlement Agreement, any overcollection will be returned to the customers with interest, at a rate to be determined by the Commission in the first true-up proceeding in which an overcollection occurs.

EVIDENCE IN SUPPORT OF FINDINGS AND CONCLUSIONS Nos. 5 & 6

The evidence in support of these findings is found in the Settlement Agreement, as well as the testimony and exhibits of Public Staff Witness McLawhorn and Duke Energy Carolinas Witnesses Schultz and Farmer.

Theodore E. Schultz, Vice President of EE for Duke Energy Business Services, testified that the Company initially proposed that revenue requirements reflect 90% of the avoided capacity and energy costs produced by both DSM and EE programs – as compensation for program costs, lost revenues, and a management incentive. (Tr. Vol. 1, p. 18). He explained that three primary changes were made in the Settlement Agreement to the avoided cost percentage contained in the Original Save-a-Watt Proposal. (*Id.* at pp. 18-19). First, Mr. Schultz stated, separate avoided cost percentages were developed for DSM and EE programs to ensure that the Company would be indifferent to implementation of either kind of program relative to the portfolio's overall profitability. (*Id.* at p. 19). Second, the recovery of lost revenues was carved

[8] The June 19, 2009 testimony of Stephen Farmer and Duke Energy Carolinas' August 10, 2009 Responses to Commission's Pre-Hearing Order Requiring Verified Information clarify that recovery of net lost revenues under the Settlement Agreement is limited EE programs only.

out of the avoided cost compensation and treated as a direct recovery cost. (*Id.*). And third, the percentages were lowered from 90% to 75% of the avoided capacity costs for DSM achievements, and to 50% of the NPV of avoided lifetime capacity and energy costs for EE programs. (*Id.*). Witness Schultz explained why the Company believes it is appropriate to capture the NPV of EE savings in the year in which the Company spends money on the EE measure: "[W]e spend the money up front on energy efficiency. All the costs are actually incurred in the first year. There's a stream of [future] benefits, and it's appropriate from our point of view to bring those benefits back to present value...in the year in which the program was installed." (*Id.* at p. 51). The Company does not use NPV for its DSM percentage because, according to Mr. Schultz, DSM programs do not create future benefits: "Demand-side management programs are a benefit for the year in which they occur. So, in other words, they're equivalent to a peaking station. So every year you can look at those and they're either there or they're not. And if they're there, they have benefit for the year that they're there."[9] (*Id.* at p. 52).

Chairman Finley asked Mr. Schultz why the Company uses a higher avoided cost recovery percentage for DSM programs than for EE programs. (*Id.* at p. 63). Mr. Schultz explained that the different percentages were designed to put EE and DSM on a "level playing field" so that they both earn a similar return. (*Id.*). He testified that "if you look at the 75 percent applied to the portfolio for demand-side management resources, you're going to get a [maximum] return per the Settlement Agreement...of 15% after tax for program cost." (*Id.* at pp. 63-64). He went on to say that while EE appears lower at 50%, "[y]ou've got to remember

[9] In Comments filed in this docket on June 12, 2009, the Public Staff indicated that it disagreed with the Company's position that DSM programs do not create future benefits beyond one year. This disagreement, however, did not prevent the Public Staff from entering into the Settlement Agreement.

it's the present value of all those benefits coming back and lost margins are separated out. So lost margins occur with energy efficiency programs. They're treated separately, which would lower the avoided cost percentage. And then that 50 percent again will return about a 15 percent after tax return on the program cost." (*Id.* at p. 64).

Witness Schultz testified that avoided capacity costs will be based on Duke Energy Carolinas' filed avoided cost rate, as the Company initially proposed, with one modification. (*Id.* at p. 18). He explained that instead of updating the avoided costs with the bi-annual filed avoided cost rates, the avoided capacity costs under the Settlement Agreement will remain fixed using the 2007 approved avoided costs in Docket No. E-100, Sub 106. (*Id.*). James S. McLawhorn, Director of the Electric Division of the Public Staff, explained that in the Original Save-a-Watt Proposal, the Company proposed to tie its revenue recovery for implementing DSM and EE programs to its avoided supply-side costs, which can vary over time. (*Id.* at p. 164). 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 if they were not receiving any additional energy or demand reduction savings. (*Id.*). Witness McLawhorn testified that the Settlement Agreement shields ratepayers from this risk by "locking in" the avoided cost rate for the term of the Agreement. (*Id.*).

Witness Schultz testified that the calculation of the avoided energy costs will be the same as initially proposed by the Company and will be based on the avoided energy costs per the Company's Integrated Resource Plan. (*Id.* at p. 18). He added that the avoided cost rates will not be otherwise updated during the term of the Settlement Agreement unless the filed biennial avoided capacity and energy cost rates change by more than 25%. (*Id.*).

Witness McLawhorn testified that the Public Staff believed that the Company's initial proposal to recover 90% of avoided costs achieved by its proposed EE and DSM programs would have resulted in excessive earnings by Duke Energy Carolinas and insufficient savings on energy by ratepayers. (*Id.* at p. 159). He explained that the Settlement Agreement addresses these concerns by providing that the Company's revenues are now to be recovered on the basis of separate percentages of avoided costs for DSM and EE programs. (*Id.*). Witness McLawhorn noted that the recovery of these percentages of avoided costs is intended by Duke Energy Carolinas to cover its costs for adopting and implementing DSM and EE programs, along with providing a financial incentive for doing so. (*Id.* at p. 160).

He testified that the Settlement Agreement also addresses the Public Staff's concerns by limiting the cost recovery period for the Modified Save-a-Watt Approach. (*Id.* at p. 157). Specifically, the Settlement Agreement has a term of four years, and it is a pilot program. (*Id.*). Witness McLawhorn testified that at the conclusion of this four-year period, actual measured and verified avoided cost savings will be compared to the targeted avoided cost savings in a final true-up proceeding. (*Id.*).

The Settlement Agreement preserves the Company's concept that compensation for implementation of EE and DSM programs should be based on a discount to the avoided costs of a power plant, but modifies the compensation mechanism to provide for a more reasonable level of avoided cost recovery. The Stipulating Parties have demonstrated that the percentages of avoided costs under the Modified Save-a-Watt Approach provide an appropriate incentive to the Company without resulting in excessive earnings. The Commission concludes that the levels of avoided cost recovery under the Settlement Agreement are in the public interest.

EVIDENCE IN SUPPORT OF FINDINGS AND CONCLUSIONS Nos. 7-9

The evidence in support of these findings can be found in the Settlement Agreement, as well as the testimony and exhibits of Environmental Intervenors Witness Wilson, Public Staff Witness McLawhorn, and Duke Energy Carolinas Witness Schultz.

Company Witness Schultz provided testimony regarding the Settlement Agreement's performance targets and earnings caps. (Tr. Vol. 1, pp. 19-20). He explained that under the Settlement Agreement, the Company is eligible to receive a higher level of incentive based on how well it performs. (*Id.* at p. 16). Specifically, the Company's earnings opportunity is capped and is tied to the percentage of the target energy and capacity savings achieved. (*Id.*). The Settlement Agreement provides for an energy savings target for each vintage year. (Agreement, Ex. B, D.3(a)). This energy savings target is then converted to a sum of monetary savings that reflects the cost of energy and capacity avoided as a result of the EE measures, over the life of each measure. (*Id.*). The resulting avoided cost savings target is determined by multiplying the savings by year by the full avoided costs, which include generation capacity, fuel, and fixed and variable operations and maintenance savings. (*Id.*). The target amount of avoided cost savings dollars for the DSM component will be calculated based on an assumed amount of capacity avoided through DSM programs and the avoided costs in effect at the time the Settlement Agreement is approved by the Commission. (Agreement, Ex. B, D.3(b)).

The Company's avoided cost target is $754 million (nominal system dollars) based on programs implemented during the four year term of the Agreement and is tied to the following targeted MW and cumulative MWh system savings: 234,132 MWh and 368 MW in Year 1; 490,634 MWh and 548 MW in Year 2; 872,548 MWh and 736 MW in Year 3; 1,439,742 MWh and 844 MW in Year 4; and 6,833,078 MWh and 259 MW beyond Year 4. (Tr. Vol. 1, pp. 19-20).

As Witnesses McLawhorn, Schultz and Wilson testified, the Settlement Agreement provides for increased energy savings targets when compared to the Original Save-a-Watt Proposal. (Tr. Vol. 1, pp. 15, 162; Tr. Vol. 2, p. 9). Witness Wilson testified that the energy savings targets contained in the Settlement Agreement represent a commitment by Duke Energy Carolinas to ramp up its EE offerings in the Carolinas to levels that will make the Company a leader in the industry. (Tr. Vol. 2, p. 10). For example, Duke Energy Carolinas' target incremental reduction in annual energy use by year 4 under the Agreement is equal to 0.75% of its forecast sales for that year – 250% of the year 4 target in the Original Save-a-Watt Proposal. (*Id.*). In addition, Witnesses Wilson and McLawhorn testified that Settlement Agreement provides that no more than 35% of the target may be met by DSM programs, providing an emphasis on EE programs that the Original Save-a-Watt model lacked. (Tr. Vol. 1, p. 165; Tr. Vol. 2, p. 15).

Further, Witness McLawhorn testified that measures implemented in each vintage year of this Settlement Agreement are expected to continue to operate and produce energy savings throughout the four-year term. (Tr. Vol. 1, p. 162). Witness Wilson explained that if the Company meets its savings targets the cumulative reduction in annual energy consumption by year 4 will be almost 2% of annual sales in that year and over 8% within 10 years. (Tr. Vol. 2, p. 10).

Based on these targeted portfolio savings, the Settlement Agreement contains tiered earnings caps based upon varying levels of performance. (Tr. Vol. 1, p. 20). The Company's revenues recovered on the basis of percentages of avoided costs are limited to the amount necessary to produce an after-tax return on program costs between 5% and 15% depending on its success in reaching a targeted aggregate DSM and EE avoided cost savings level. (*See id.*). Specifically, if the Company achieves 90% or greater of its avoided cost target, its earnings will be capped at a 15% return on program costs; if the Company achieves 80% to 89% of its avoided cost target, its earnings will be capped at a 12% return on program costs; if the Company achieves 60% to 79% of its avoided cost target, its earnings will be capped at a 9% return on program costs; and if the Company achieves less than 60% of its avoided cost target, its maximum earnings opportunity will be a 5% return on program costs. (*Id.*). Witness Schultz testified that program costs will include marketing and advertising expenses, incentives paid to customers, and the costs of impact evaluation studies. (*Id.*). The return on program costs will be simply a calculation of the after tax percent return on investment on program costs on a net present value basis. (*Id.*).

The Stipulating Parties have demonstrated that the Settlement Agreement provides for a significant increase in the amount of energy and capacity savings the Company aims to achieve. Any incentive earned by the Company will depend upon the Company's ability to actually achieve these targeted savings on behalf of customers. The Commission concludes that these performance targets are appropriate, and that the earning caps tied to these targets help ensure that customers receive fair value and that their rates remain reasonable.

EVIDENCE FOR FINDINGS AND CONCLUSIONS No. 10

The evidence in support of this finding is found in the Settlement Agreement, as well as the testimony and exhibits of Public Staff Witnesses Maness and McLawhorn, Duke Energy Carolinas Witness Farmer, and Environmental Intervenors Witness Wilson.

The Settlement Agreement provides for the separate recovery of net lost revenues resulting from EE, but not DSM, measures. (*See* Tr. Vol. 1, pp. 82, 92). Net lost revenues are also net of any increases resulting from any activity by the Company's public utility operations that causes a customer to increase demand or energy consumption, whether or not that activity has been approved pursuant to Rule R8-68. (Agreement, Ex. B, G.1; Tr. Vol. 1, p. 160). The amount of net lost revenues the Company may recover is limited to those incurred within 36 months of implementation of any particular measure. (Tr. Vol. 1, p. 158 .).

Public Staff Witness Maness confirmed that recovery of net lost revenues act to make a company whole, and act to replace revenues that the Company has lost from enacting an EE program. (*Id.* at p. 221). He added, "I think another way of saying that is that without that net lost revenue compensation there would be a disincentive to proceed with those types of programs." (*Id.* at p. 222).

Company Witness Farmer testified that the Original Save-a-Watt Proposal did not call for the explicit recovery of net lost revenues, but rather the recovery of net lost revenues was embedded in the revenue requirement calculations that were based on 90% of estimated avoided capacity and energy costs. (*Id.* at p. 92). As such, it was not readily evident what portion of the revenues were compensating the Company for incurred DSM and EE program costs, net lost revenues, and additional incentives. (*Id.* at p. 163). Witness McLawhorn testified that under the Settlement Agreement net lost revenues are now subject to measurement and verification and are recovered separately from program costs and incentives. (*Id.*). Witness Schultz testified that recovery of lost revenues separate from the percentage of avoided cost payment will result in greater transparency. (*Id.* at p. 15).

Environmental Intervenors Witness Wilson testified that a mechanism to recover lost revenues is important because it mitigates the disincentive to pursue EE created by the existing electric rate structure in North Carolina. (Tr. Vol. 2, p. 11). According to Witness Wilson, limiting this mechanism to three years ensures that Duke does have a strong incentive to adjust its supply-side resources (power plants and contracts) to reflect reduced demand. (*Id.*). Witness Wilson further testified that limiting lost revenue recovery to 36 months will help ensure that customers receive fair value and that their rates remain reasonable. (*Id.*).

With regard to the limited period of time for recovery of net lost revenues, Witness McLawhorn testified that the Settlement Agreement recognizes the Public Staff's view that revenues that are "lost" due to an EE program do not continue in perpetuity, but are offset in time by revenue gains, resulting, for example, from customer growth or other increases in demand. (Tr. Vol. 1, p. 158). He testified that the Public Staff believes that 36 months is a reasonable amount of time for the recovery of net lost revenues and noted that this limited time period is similar to one contained in the Agreement and Stipulation of Partial Settlement, filed by the Public Staff, PEC and Wal-Mart in Docket No. E-2, Sub 931, and approved by the Commission by Order dated June 15, 2009. (*Id.* at pp. 158-59).

Witness Farmer explained that the recovery of net lost revenues applicable to EE programs for vintage years three and four will extend two-years beyond the initial four-year cost recovery period assuming such recovery does not terminate or is not reduced as a result of approval of a decoupling or alternative recovery mechanism or an order in a general rate proceeding that provides for the recovery of net lost revenues. (Tr. Vol. 1, pp. 82-83). As Witness Maness testified, "[W]hen you have vintage year three and four, installations of measures that caused net lost revenues, the 36 months for those installations will extend beyond year four and, therefore, there are net lost revenues to be recovered in years five and six." (*Id.* at pp. 217-18).

Witness Farmer testified that the estimated amount of net lost revenues to be collected from North Carolina customers totals $151 million at 85% achievement. (*Id.* at p. 91). He clarified that the recovery of net lost revenues will be subject to adjustment (either up or down) based on the level of verified kW and kWh reductions actually realized. (*Id.*). For example, at a savings level that equals 100% of target achievement the recovery of lost revenues would total approximately $178 million. (*Id.*).

Witness Farmer provided testimony explaining how the Company will calculate net lost revenues under the Settlement Agreement. (*Id.* at p. 92). He explained that the calculation of net lost revenues (sometimes referred to as lost margins) was estimated by multiplying the portion of the Company's tariff rates that represent the recovery of fixed costs by the estimated kW and kWh reductions applicable to EE programs. (*Id.*). The Company calculated the portion of retail tariff rates representing the recovery of fixed costs by deducting the recovery of fuel costs from its tariff rates. (*Id.*). The calculation of net lost revenues does not apply to DSM programs. (*Id.*). Witness Farmer testified that Company is not seeking recovery of net lost revenues for DSM programs because the demand response essentially covers the cost of the program. (*Id.* at p. 108). In other words, if the Company spends a dollar on a DSM program, the Company in turn will not have to provide the amount of electricity needed at the peak period. (*Id.*). Mr. Farmer then clarified that there are some net lost revenues as peaks are reduced by DSM programs. (*Id.* at p. 109). In particular, if a customer lowers its demand, then the revenue from that customer will be lower. (*Id.* at pp. 109-10). Notwithstanding the net lost revenues resulting from DSM programs, the Company has chosen not to ask for recovery of these net lost revenues. (*Id.* at p. 110).

The Commission recognizes that reductions in energy use resulting from EE programs may impair the Company's ability to recover sufficient revenues to cover its fixed costs. The evidence shows that in the near term, the reduction in electricity sales resulting from EE programs will result in net lost revenues, which present a financial disincentive to the Company to implement EE programs. In order encourage implementation of the EE programs approved in the Order, the Commission authorizes the Company to recover net lost revenues for 36 months for each installation of an EE measure during a given vintage year, except that the recovery of net lost revenues will end upon Commission approval of an alternative recovery mechanism, or the implementation of new rates in a general rate case or comparable proceeding to the extent that rates set in a rate case or comparable proceeding are set to explicitly or implicitly recover those net lost revenues. Recovery of net lost revenues for vintage year installations not covered by the new rates will continue, subject to the 36 month limitation.

EVIDENCE IN SUPPORT OF FINDING AND CONCLUSION No. 11

The evidence in support of this finding is found in the Settlement Agreement, as well as the testimony and exhibits of Duke Energy Carolinas Witness Farmer.

Witness Farmer provided testimony regarding the differences in jurisdictional revenue requirement and customer rate impacts between the Original Save-a-Watt Proposal and the Modified Save-a-Watt Approach proposed in the Settlement Agreement. He testified that the cumulative jurisdictional revenue that will be billed North Carolina retail customers under the

Settlement Agreement is $27.4 million (8.0%) less than the Original Save-a-Watt Proposal over the four-year recovery period.[10] (Tr. Vol. 1, p. 81).

Witness Farmer explained that this is in part because the Original Save-a-Watt Proposal provided for the recovery of lost revenues and program costs spread out over the life of the DSM and EE programs that gave rise to avoided cost savings. (*Id.* at p. 82). For example, if an EE program had a life of ten years, the recovery of program costs would have occurred over ten years. (*Id.*). In contrast, under the provisions of the Settlement Agreement, the recovery of program costs applicable to a particular vintage of EE programs will occur during the program vintage year. (*Id.*). In addition, Mr. Farmer testified, the recovery of net lost revenues, which also would have occurred over the life of an approved EE program under the Company's original proposal, will now be limited to the level of estimated net lost revenues that are expected to occur during the 36-month period that begins as of each initial vintage year of customer participation in Company sponsored programs. (*Id.*). Witness Farmer also attributed the lower jurisdictional revenue requirement to the lower percentage of avoided cost recovery, fixed avoided capacity cost rates, and the earnings cap. (*Id.* at pp. 84-85).

According to Witness Farmer, the Settlement Agreement jurisdictional revenue requirement assumes the Company achieves 85% of the avoided cost savings targeted across the Duke Energy Carolinas' system. (*Id.* at p. 83). He explained that any difference between amounts due the Company based on actual avoided cost savings realized by customers and

[10] Mr. Farmer clarified that if the recovery of net lost revenues for years 5 and 6 were included when comparing the Original Save-a-Watt Proposal to the Modified Save-a-Watt Approach, the revenue requirement under the Settlement would exceed that of the first four years of the Original Save-a-Watt Proposal. (Tr. Vol. 1, pp. 132-34). However, under the Original Save-a-Watt Proposal, the revenue requirement extended out a number of years – up to 18 years or more. (*Id.* at p. 133). He explained that a fair comparison would necessarily entail comparing the revenue requirement over the life of the original EE measures to the modified proposal under the Settlement Agreement. (*Id.*).

amounts billed customers at 85% of target achievement will be collected from or refunded to customers as part of the rider true-ups. (*Id.* at pp. 83-84).

Witness Farmer's testimony and exhibits included calculations of monthly billing factors for residential and non-residential customers that he used to evaluate the impact of the recovery of EE costs on individual customers. (*Id.* at pp. 89-91; Farmer Settlement Ex. Nos. 1-3). He testified that the monthly billing factor for a residential customer taking service under Rate RS is estimated to be $0.001206 per kWh during the first year of the four-year cost recovery period. (Tr. Vol. 1, p. 91; Farmer Settlement Ex. No. 3). The estimated monthly billing factor increases to $0.004207 per kWh in the last year of the four-year cost recovery period.[11] (*Id.*). The monthly bill of a typical residential customer using 1,000 kWh will increase by $1.21 and $4.03, respectively, during the first and fourth years. (*Id.*).

Because the Public Staff and Duke Energy Carolinas disagree regarding the allocation of costs among the customer classes and the retail/wholesale jurisdictions, Witness Maness also calculated monthly billing factors, reflecting the Public Staff's positions. Maness Exhibit No. 2 shows that the monthly billing factor for a residential customer is estimated to be $0.000710 per kWh during the first year of the four-year cost recovery period and that the estimated monthly billing factor increases to $0.02289 per kWh in the last year of the four-year cost recovery period.[12] These exhibits show that the monthly bill for a typical residential customer using 1,000 kilowatt-hours would increase by an estimated $0.71 and $2.29, respectively, during the first and fourth years, using the Public Staff's cost allocation methods, as described by Witness Maness and discussed further with regard to Finding of Fact No. 13.

[11] Monthly billing factor includes gross receipts tax and North Carolina regulatory fee.
[12] Monthly billing factors include gross receipts tax and North Carolina regulatory fee.

Mr. Farmer testified that residential and non-residential rates will increase by 1.47% and 0.68%, respectively, during the first year of the four-year cost recovery period when compared to 2008 annual jurisdictional revenues. (Tr. Vol. 1, p. 90; Farmer Settlement Ex. No. 2). Residential and non-residential rates will increase by 4.93% and 2.14%, respectively, during the fourth year. (*Id.*). Witness Farmer added that these rate impacts do not include the savings that will be realized by customers who participate in Company sponsored programs. (Tr. Vol. 1, p. 90). He pointed out that customers who participate in programs offered by the Company will likely, depending on the level of participation, reduce their net bill below the level that would have been incurred had the Company's DSM and EE programs not been in place. (*Id.*). Customers who do not participate in programs offered by the Company will benefit to the extent the Company's DSM and EE programs lower the marginal cost of energy and capacity below the level that would have been incurred had the Company not been able to realize avoided cost savings. (*Id.*). In addition, Mr. Farmer explained that the impacts of customers "opting out" of Rider EE (NC) are not included in these rate impacts. (*Id.*). In sum, the percentage change in individual customer rates caused by the implementation of Rider EE (NC) will be dependent on the level of power consumed by the individual customer. (*Id.*).

The Stipulating Parties have shown that the cumulative jurisdictional revenue requirement is significantly less under the Settlement Agreement than under the Original Save-a-Watt Proposal due to lower avoided cost recovery percentages, earnings caps, and the limited recovery period for net lost revenues. While rates and monthly billing factors will increase slightly under the Modified Save-a-Watt Proposal compared to rates prior to the four-year cost recovery period, these rate impacts do not take into account the bill reductions participants in the Company's DSM and EE programs will likely experience. These rate impacts are reasonable in light of the Company's increased energy and capacity savings targets, and as such, the Commission concludes that the Company's revised Rider EE reflecting these rate impacts is in the public interest and approved.

EVIDENCE IN SUPPORT OF FINDINGS & CONCLUSIONS No. 12

The evidence in support of this finding is found in the Settlement Agreement, as well as the testimony and exhibits of Public Staff Witness McLawhorn and Duke Energy Carolinas Witness Farmer.

Public Staff Witness McLawhorn testified that the Settlement Agreement provides a true-up process to shield ratepayers from the risk of Duke Energy Carolinas collecting revenues for its DSM and EE programs in excess of what is allowed under the Agreement. (Tr. Vol. 1, p. 161). Witness Farmer described this true-up process. He testified that the Agreement provides for a series of true-ups that will be conducted to update revenue requirements based on actual customer participation results. (*Id.* at p. 93). According to Mr. Farmer, revenues will be collected from customers based on the participation true-up results plus an updated forecast of customer participation in the Company's DSM and EE programs. (*Id.*). He added that a final true-up process, based on independently measured and verified results will take place after the evaluation of the program results when the four-year period is complete. (*Id.*). At that time, amounts due the Company based on the terms of the Settlement Agreement will be compared to revenues collected from customers. (*Id.*). Witness Farmer testified that the Stipulating Parties have agreed to mitigate any potential overbilling of costs to customers by initially billing customers at a rate that assumes the Company will achieve 85% of its targeted avoided cost savings goals. (*Id.* at p. 83). He explained that the true-up process will capture the difference between revenues billed customers based on 85% of targeted DSM and EE program avoided cost savings billed customers and revenues due the Company based on the applicable percentage of verified DSM and avoided cost savings actually realized. (*Id.* at pp. 93-94). If there are amounts owed to customers, such amounts will be refunded with interest at a rate to be determined by the Commission in the first true-up proceeding in which an overcollection occurs. (*Id.* at p. 93). He further testified that the outstanding balance of net lost revenues will be adjusted based on the actual measured and verified lost revenues determined in the final true-up process. (*Id.* at p. 94).

In addition, Mr. Farmer testified that the true-up process will include calculations that ensure that the level of compensation recovered by the Company is capped so that the after-tax rate of return on actual program costs applicable to DSM and EE programs does not exceed the predetermined earnings cap levels set out in the Settlement Agreement. (*Id.*). Witness Farmer explained that if the rate of return on actual program costs is less than the capped level provided for in the Settlement Agreement, then no further adjustment will be made. (*Id.* at p. 95). If, on the other hand, the rate of return on actual program costs incurred exceeds the level provided for in the Agreement, then the excess earnings level will be refunded to customers. (*Id.*).

Witness Farmer emphasized that the Settlement Agreement does not guarantee or ensure that the Company will realize or achieve the earnings levels set out in the Agreement. (*Id.* at p. 94). In other words, the Company assumes the risk that projected savings will not materialize and that revenues received from customers based on the percentage of avoided cost savings retained by the Company will not result in any management incentive or cover the costs of DSM and EE programs. (*Id.*).

The Commission concludes that the Stipulating Parties have demonstrated that the true-up process contained in the Settlement Agreement adequately protects ratepayers from the recovery of revenues in excess of what is permitted by the Agreement.

EVIDENCE IN SUPPORT OF FINDINGS & CONCLUSIONS No. 13

Duke Energy Carolinas Version[13]

The evidence in support of this finding is based upon the Settlement Agreement, as well as the testimony and exhibits of Duke Energy Carolinas Witness Farmer and Public Staff Witness Maness.

Paragraph H.8 of Exhibit B to the Settlement Agreement reads as follows:

> The North Carolina retail revenue requirement applicable to demand-side management, energy efficiency programs, and net lost revenues will be determined by allocating the various inputs to the revenue calculation (avoided costs, program costs, net lost revenues, etc.) to the North Carolina retail jurisdiction and then applying the percentages and other revenue requirement determinants set forth in this agreement.
>
> The Stipulating Parties will present the issue of the appropriate jurisdictional allocation method to the Commission through testimony in this matter. For purposes of determining the North Carolina retail revenue requirement, Duke Energy Carolinas and the Environmental Intervenors agree that (1) for demand-side management programs, inputs will be allocated between the North Carolina and South Carolina retail jurisdictions based on contributions to system retail peak demand by all system retail customers based on the cost of service study, and (2) for energy efficiency programs and net lost revenues, inputs will be assigned to the North Carolina and South Carolina retail jurisdictions based on kWh sales to system retail customers from the cost of service study. The program costs allocated under this methodology will be used to calculate the earnings cap.
>
> The Public Staff does not agree with the allocation methodology proposed by Duke and the Environmental Intervenors and instead proposes that (1) for demand-side management programs, inputs will be allocated to the North Carolina retail jurisdiction based on contributions to total system peak demand by all system customers, retail and wholesale, and (2) for energy efficiency programs, inputs should be allocated to the North Carolina retail jurisdiction based on kWh sales to all system customers, retail and wholesale.

[13] The Environmental Intervenors have no position as to the appropriate jurisdictional allocation methodology.

The Stipulating Parties accept, generally, the allocation of EE revenue requirements based on kilowatt-hour sales and the allocation of DSM revenue requirements based on contribution to peak demand but disagree on certain issues related to both jurisdictional allocations and customer class allocations. (*Id.* at pp. 77-78, 88, 199).

Company Witness Farmer testified that Duke Energy Carolinas proposes that the revenue requirement be allocated to North Carolina and South Carolina retail customers only and that no portion of the Settlement Agreement revenue requirement be allocated to wholesale customers. (*Id.* at p. 86). He explained that because the Company's DSM and EE programs included in the portfolio of programs approved in this proceeding are programs directed specifically to Duke Energy Carolinas' retail customers, the Company believes it is appropriate to recover the costs of such programs only from these customers. (*Id.* at pp. 86-87). Like PEC and the Commission, Duke Energy Carolinas interprets N.C. Gen. Stat. §62-133.9(e) to mean that costs of new DSM and EE programs should "be recovered only from those customer classes eligible to participate in the program and to which the program is targeted." *Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Commission-Required Modifications*, Docket No. E-2, Sub 931, at 30 (June 15, 2009) ("PEC Order"). (Tr. Vol. 1, p. 87).

Witness Farmer did not dispute the fact that all customers likely will receive indirect benefits from the Company's DSM and EE programs, but pointed out that to comply with N.C. Gen. Stat. §62-133.9(e) the costs of a program or measure should only be recovered from those customers eligible to participate in the program. (*Id.*). Duke Energy Carolinas believes its allocation methodology is more consistent with the North Carolina General Assembly's use of the words "only" and "directly" in this statute, which provides that:

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

N.C. Gen. Stat. §62-133.9(e).

Witness Farmer also testified that Duke Energy Carolinas proposes in the Settlement Agreement that inputs applicable to DSM programs be allocated between North Carolina and South Carolina retail jurisdictions based on contributions to system retail peak demand by all system retail customers based on the Company's cost of service study. (Tr. Vol. 1, pp. 85-86). The North Carolina retail amount would be further allocated between residential and non-residential customer classes based on the relative contribution of each customer class to the North Carolina retail peak demand. Inputs for EE programs and net lost revenues would be assigned to the North Carolina and South Carolina retail jurisdictions based on kWh sales to system retail customers also from the cost of service study, but, as explained below, in a manner such that residential customers pay for residential programs and non-residential customers pay for non-residential programs. (*Id.* at 86). Program costs applicable to DSM and EE programs would be allocated between North Carolina and South Carolina jurisdictions on the same basis as revenue requirements. (*Id.*).

Witness Maness testified that the Public Staff believes that N.C. Gen. Stat. §62-133.9(e) does not control the jurisdictional allocation of system DSM and EE costs and revenues to North Carolina retail operations. (Tr. Vol. 1, p. 193). He testified that §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. (*Id.*). Witness Maness noted that in Rule R8-69(b)(1), the Commission refers to jurisdictional allocation and class assignment as separate processes, and associates §62-133.9(e) only with class assignment. (*Id.* at p. 194). Further, he pointed out that 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. (*Id.* at pp. 194-95).

Witness Maness explained that 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. (*Id.* at p. 195). According to Mr. Maness, 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. (*Id.* at pp. 195-96). He testified that this reduction in cost can typically be expected to accrue to the benefit of all system customers, because the costs themselves, if incurred, would be allocated to the entire system, including the wholesale jurisdiction. (*Id.* at p. 196). 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. (*Id.* at p. 198).

Witness Farmer clarified the difference in opinion between the Public Staff and the Company as to the allocation of costs between residential and nonresidential customers. (*Id.* at p. 77). He explained that the Company believes that residential customers should pay the cost of the residential programs and that nonresidential customers ought to pay for the nonresidential programs. (*Id.* at pp. 77-78). Because DSM programs for residential and non-residential customers are similar in nature, the Company's proposed allocation of DSM costs across system retail customers based on system peak demand accomplishes this objective. In the case of EE programs, however, residential and non-residential costs and benefits can be quite different in nature. Accordingly, the Company's proposed cost recovery mechanism captures the cost of residential EE programs offered to retail customers across the system separately from the cost of non-residential EE programs offered to retail customers across the system. For the residential class and the non-residential class, separately, the North Carolina portion of retail system EE costs would be determined based on the North Carolina kWh sales for the customer class relative to the system retail kWh sales for the customer class. (*Id.* at p. 86 and Farmer Settlement Exhibits 3 and 4). The rider amounts proposed in Farmer Settlement Exhibit 3 and Farmer's settlement testimony reflect the allocation methods as proposed by the Company. Program costs applicable to DSM and EE programs would be allocated between North Carolina and South Carolina jurisdictions on the same basis as revenue requirements. (*Id.*).

The Public Staff, on the other hand, believes that allocation of both system DSM and system EE revenues and costs to the North Carolina jurisdiction should precede any allocation of revenues and costs to customer classes. Then, after jurisidictional allocation, allocation of North Carolina retail revenues and costs between residential and non-residential customers should be based on relative residential and non-residential contributions to kWh sales and peak load within *the North Carolina jurisdiction itself, not on a determination of the customer class at which a* program is targeted. (*Id.* at pp. 77, 200). In other words, the Public Staff recognizes that class allocation is governed by §62-133.9(e), but interprets this provision to mean that allocation of North Carolina 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. (*Id.* at p. 200). The Public Staff acknowledged that the Commission has recently disagreed with it on the class allocation issue, in Docket No. E-2, Sub 931, but requested that the Commission reach a different conclusion in this proceeding. (*Id.*).

In the PEC Order, the Commission concluded as follows:

> It is a well-established principle of statutory interpretation in North Carolina that a statute should not be interpreted in a manner which would render any of its words superfluous. Each word of a statute is to be construed as having meaning, where reasonable and consistent with the entire statute, because it is always presumed that the Legislature acted with care and deliberation. *State v. Haddock*, ____, N.C. App. ____, 664 S.E.2d 339, 345 (2008); *State v. Ramos*, ____, N.C. App. ____, 668 S.E.2d 357, 363 (2008).
>
> The Commission agrees with the Public Staff that, to some degree, all customers benefit from the implementation of new DSM and EE programs. To conclude, however, that this general benefit encompasses the direct benefit contemplated by the General Assembly [in G.S. 62-133.9(e)] fails to interpret the statute in a logical manner. Accordingly, the Commission agrees with PEC that to interpret the statute in the manner proposed by the Public Staff would render the words "directly" and "only" meaningless. Clearly, the General Assembly intended for those words to have meaning and the most logical meaning they can have is that the cost of a new DSM/EE program is to be recovered only from those customer classes eligible to participate in the program and to which the program is targeted. While the Public Staff is correct that all retail customer classes benefit from DSM/EE programs, the Commission is of the opinion that there would have been no need for such a statutory provision if not to direct the Commission to allocate these costs in a different manner. The Commission concludes that the law favors PEC's interpretation and disfavor's the Public Staff's position.

(PEC Order, p. 30). The Commission is unaware of any change in the law, nor has the Public Staff brought forth any new evidence or arguments since the Commission's June 15, 2009 PEC Order that convinces the Commission that it should change its position on this issue. Accordingly, for the reasons stated in the PEC Order, the Commission sides with the Company and concludes that the costs of residential programs should be borne by the residential customer class and costs of nonresidential programs should be borne by the nonresidential customer class and the Company's proposed methods for determining the costs for North Carolina residential and non-residential classes are appropriate.

As to the issue of inclusion of wholesales in the jurisdictional cost allocation, the Commission notes that the Public Staff was one of the Stipulating Parties in Docket No. E-2, Sub 931, and as such, agreed that PEC's expenses for DSM and EE measures should be allocated to the North Carolina and South Carolina retail jurisdictions and not the wholesale jurisdiction. In this proceeding, the Public Staff did not agree to so stipulate and is making similar arguments to those of the Attorney General that were rejected in the PEC Order. (*See* PEC Order, p. 31). Again, the Public Staff has presented no evidence or arguments to lead the Commission to decide differently here. The Commission finds that the costs and incentives at issue are for DSM and EE programs targeted to retail customers. Wholesale customers cannot participate directly in these programs. Any benefit that wholesale customers receive is clearly an indirect benefit. Finally, Duke Energy Carolinas' North Carolina wholesale customers are electric power suppliers covered by Senate Bill 3. Just like Duke Energy Carolinas, they are required to meet their own requirements for the use of renewable energy and EE. As they do so, it is reasonable to assume that their retail customers will pay for their programs, just like the Company's retail customers will pay for its programs.

EVIDENCE IN SUPPORT OF FINDING S AND CONCLUSIONS No. 13

Public Staff Version

The evidence in support of these findings is based upon the Settlement Agreement, as well as the testimony and exhibits of Duke Energy Carolinas witness Farmer and Public Staff witness Maness.

Paragraph H.8 of Exhibit B to the Settlement Agreement reads as follows:

> The North Carolina retail revenue requirement applicable to demand-side management, energy efficiency programs, and net lost revenues will be determined by allocating the various inputs to the revenue calculation (avoided costs, program costs, net lost revenues, etc.) to the North Carolina retail jurisdiction and then applying the percentages and other revenue requirement determinants set forth in this agreement.
>
> The Stipulating Parties will present the issue of the appropriate jurisdictional allocation method to the Commission through testimony in this matter. For purposes of determining the North Carolina retail revenue requirement, Duke Energy Carolinas and the Environmental Intervenors agree that (1) for demand-side management programs, inputs will be allocated between the North Carolina and South Carolina retail jurisdictions based on contributions to system retail peak demand by all system retail customers based on the cost of service study, and (2) for energy efficiency programs and net lost revenues, inputs will be assigned to the North Carolina and South Carolina retail jurisdictions based on kWh sales to system retail customers from the cost of service study. The program costs allocated under this methodology will be used to calculate the earnings cap.
>
> The Public Staff does not agree with the allocation methodology proposed by Duke and the Environmental Intervenors and instead proposes that (1) for demand-side management programs, inputs will be allocated to the North Carolina retail jurisdiction based on contributions to total system peak demand by all system customers, retail and wholesale, and (2) for energy efficiency programs, inputs should be allocated to the North Carolina retail jurisdiction based on kWh sales to all system customers, retail and wholesale.

The Stipulating Parties accept, generally, the allocation of EE revenue requirements based on kilowatt-hour sales and the allocation of DSM revenue requirements based on contribution to peak demand but disagree on certain issues related to both jurisdictional allocations and customer class allocations. (*Id.* at pp. 77-78, 88, 199).

Company Witness Farmer testified that Duke Energy Carolinas proposes in the Settlement Agreement provides that inputs applicable to DSM programs be allocated between North Carolina and South Carolina retail jurisdictions based on contributions to system retail peak demand by all system retail customers based on the Company's cost of service study. (Tr. Vol. 1, pp. 85-86). However, as evidenced in the Company's proposed rider amounts calculations for EE programs offered to retail customers across its system, the Company proposes to separate residential revenue requirements from non-residential revenue requirement prior to jurisdictional allocation. Inputs for residential and non-residential EE programs and net lost revenues would then be separately allocated to the North Carolina and South Carolina retail jurisdictions based on kWh sales to system retail customers. (*Id.* at p. 86 and Farmer Settlement Exhibits 3 and 4). Program costs applicable to EE and DSM programs would be allocated between North Carolina and South Carolina jurisdictions on the same basis as revenue requirements. (*Id.*).

Witness Farmer testified that Duke Energy Carolinas proposes that the revenue requirement be allocated to North Carolina and South Carolina retail customers only and that no portion of the Settlement Agreement revenue requirement be allocated to wholesale customers. (*Id.* at p. 86). He explained that because the Company's EE and DSM programs included in the portfolio of programs approved in this proceeding are programs directed specifically to Duke Energy Carolinas' retail customers, the Company believes it is appropriate to recover the costs of such programs only from these customers. (*Id.* at pp. 86-87). Witness Farmer further testified that, like PEC and the Commission in Docket No. E-2, Sub 931, Duke Energy Carolinas interprets N.C. Gen. Stat. § 62-133.9(e) to mean that costs of new EE and DSM programs should "be recovered only from those customer classes eligible to participate in the program and to which the program is targeted." *Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Commission-Required Modifications*, Docket No. E-2, Sub 931, at 30 (June 15, 2009) ("PEC Order"). (Tr. Vol. 1, p. 87).

Witness Farmer did not dispute the fact that all customers likely will receive benefits from the Company's EE programs (which he describes as "indirect"), but pointed out that to comply with N.C. Gen. Stat. § 62-133.9(e) the costs of a program or measure should be recovered from those customers eligible to participate in the program. (*Id.*). Duke Energy Carolinas believes its allocation methodology is more consistent with the North Carolina General Assembly's use of the words "only" and "directly" in this statute, which provides that:

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

N.C. Gen. Stat. § *62-133.9(e)*.

Witness Maness testified that the Public Staff disagrees with the Company's reliance on N.C. Gen. Stat. 62-133.9 to support its position on jurisdictional allocation. According to Witness Maness, the Company appears to believe that because N.C. Gen. Stat. 62-133.9 requires the assignment of new DSM and EE program costs only to customer classes that directly benefit from the programs, or, under the Company's position, customer classes that directly *participate* in the programs, the statute likewise applies to the allocation of costs to the jurisdictions that directly benefit. Witness Maness explained that N.C. Gen. Stat. § 62-133.9(e) does not control the jurisdictional allocation of system DSM and EE costs and revenues to North Carolina retail operations. (Tr. Vol. 1, p. 193). He testified that N.C. Gen. Stat. 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. (*Id.*). Furthermore, he noted that it is a long-standing regulatory practice in this State that jurisdictional allocations and customer class allocations are separate, albeit related, ratemaking procedures for electric public utilities. According to Witness Maness, jurisdictional allocation methods are first applied to system revenues and costs to determine the appropriate charge to total North Carolina retail revenues necessary to attain the total North Carolina retail revenue requirement. After the jurisdictional allocation is complete, then the North Carolina retail revenue requirement is assigned or allocated to specific customer classes. Witness Maness noted that the Commission appeared to interpret N.C. Gen. Stat. 62-133.9 consistently with this long-standing regulatory practice by treating jurisdictional cost allocation and customer class allocation separately in its adoption of Commission Rule R8-69(b)(1). Moreover, Witness Maness noted that 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. (*Id.* at pp. 194-95). Witness Maness concluded that the N.C. Gen. Stat. 62-133.9(e), therefore, does not control the jurisdictional allocation of system DSM and EE costs and revenues to North Carolina retail operations, noting that if the General Assembly's purpose in creating that statutory provision was to protect certain customer classes from having DSM and EE costs unreasonably allocated to them, the allocation of costs to the wholesale jurisdiction does not advantage or disadvantage any North Carolina retail customer class relative to any other. (*Id.* at p. 195).

Witness Maness explained that 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 as contemplated by Commission Rule R8-69(b)(1). (*Id.* at p. 195). According to Mr. Maness, 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. (*Id.* at pp. 195-96). These are the benefits that are measured in the Utility Cost Test and Total Resource Cost Test - the marginal supply-side resource acquisition and operation costs avoided as a result of implementing a DSM or EE program. Witness Maness testified that this reduction in cost can typically be expected to accrue to the benefit of all system customers, because the costs themselves, if incurred, would be allocated to the entire system, including the wholesale jurisdiction. (*Id.* at p. 196). He explained that the costs that are avoided through operating cost-effective DSM and EE programs are for the most part demand- and energy-driven generation and transmission costs, both capitalized and expensed. The Company operates its generation and transmission on a total system basis. The Commission has *traditionally not directly assigned system-level general and transmission costs to particular* jurisdictions, but instead has allocated those costs to jurisdictions on the basis of demand at the system peak and annual energy usage as percentages of total system peak demand and annual energy usage, respectively. If the costs avoided by DSM and EE programs had instead been incurred, they likely would have been handled for ratemaking purposes by aggregating them with other generation and production costs on a total system basis and then allocating the total to all jurisdictions. This treatment would allocate the costs incurred at the margin to all jurisdictions, not just the jurisdictions where demand and energy growth had occurred. Witness Maness concluded that if demand and energy growth at the North Carolina retail level is avoided through the use of DSM and EE programs, the resulting benefits of avoiding supply-side costs at the margin are also spread among the jurisdictions. Therefore, 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. (*Id.* at p. 198).

Witness Maness also testified that the Public Staff has maintained this position on jurisdictional cost allocation since his direct testimony was filed on June 26, 2008. He noted that, in rebuttal testimony filed on July 21, 2008, Duke Energy Carolinas Witness Farmer did not oppose or object to his recommendation because it was based on standard cost of service principles, although Witness Farmer did note that the language of G.S. 62-133.9(e) made the Public Staff's recommendation "problematic."

Witness Farmer clarified the difference in opinion between the Public Staff and the Company as to the allocation of costs between residential and nonresidential customers. (*Id.* at p. 77). He explained that the Company believes that residential customers should pay the cost of the residential programs and that nonresidential customers ought to pay for the nonresidential programs. (*Id.* at pp. 77-78). Because DSM programs for residential and non-residential customers are similar in nature, the Company's proposed allocation of DSM costs across system retail customers based on system peak demand accomplishes this objective. In the case of EE programs, however, residential and non-residential costs and benefits can be quite different in nature. Accordingly, the Company's proposed cost recovery mechanism captures the cost of residential EE programs offered to retail customers across the system separately from the cost of non-residential EE programs offered to retail customers across the system. For the residential class and the non-residential class, separately, the North Carolina portion of retail system EE costs would be determined based on the North Carolina kWh sales for the customer class relative to the system retail kWh sales for the customer class. (*Id.* at p. 86 and Farmer Settlement Exhibits 3 and 4). The rider amounts proposed in Farmer Settlement Exhibit 3 and Farmer's settlement testimony reflect the allocation methods as proposed by the Company. Program costs applicable to DSM and EE programs would be allocated between North Carolina and South Carolina jurisdictions on the same basis as revenue requirements. (*Id.*).

The Public Staff, on the other hand, believes that allocation of both system DSM and system EE revenues and costs to the North Carolina jurisdiction should precede any allocation of revenues and costs to customer classes. Then, after jurisdictional allocation, allocation of North Carolina retail revenues and costs between residential and non-residential customers should be based on relative residential and non-residential contributions to kWh sales and peak load within the North Carolina jurisdiction itself, not on a determination of the customer class at which a program is targeted. (*Id.* at pp. 77, 200). In other words, the Public Staff recognizes that class allocation is governed by §62-133.9(e), but interprets this provision to mean that allocation of North Carolina 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. (*Id.* at p. 200). The Public Staff acknowledged that the Commission has recently disagreed with it on the class allocation issue, in

Docket No. E-2, Sub 931, but requested that the Commission reach a different conclusion in this proceeding. (*Id.*)

North Carolina's DSM/EE policy as set forth in Senate Bill 3 is focused on obtaining lower-cost demand-side resources to meet growing load, not on simply reducing the demand and energy requirement of the relatively small number of program participants. Because essentially all customer classes benefit from the utility obtaining lower-cost demand-side resources to meet growing load, the costs of the programs that help achieve this goal should be allocated to all customer classes. Duke Energy Carolinas' argument that only certain customer classes benefit from DSM and EE programs, based on their eligibility to participate, is not persuasive in light of a reading of the whole of Senate Bill 3. Under Duke Energy Carolinas' proposal, if all customers in a class participated in a DSM or EE program that paid an incentive, the Commission would allocate the total costs of that program to that particular customer class. This allocation of the costs back to those customers would result in the customers returning that incentive to the utility in addition to paying the utility for the administrative costs of that program. In short, the participants would be paying to participate in the program, which is logically inconsistent with all customers sharing the system benefits of least cost planning.

Further, the Commission notes that if the General Assembly had intended for the Commission to assign costs only to those classes that are eligible to participate in a DSM or EE program, it could have directed the Commission to do so. It did not, even though in the very next provision of §62-133.9, the General Assembly specifically enables the industrial and large commercial classes to opt out of participating in the entire rider, regardless of whether the DSM or EE programs of a particular utility are targeted to an industrial or large commercial class. Accordingly, the Commission accepts the recommendation of Witness Maness to use the same demand and energy allocation factors that the Commission would use to allocate the supply-side costs, if they were not avoided.

Similarly, the Commission rejects the view that DSM/EE costs and incentives should be allocated only to those jurisdictions that are eligible to participate in a DSM or EE program. The Commission agrees with the Public Staff that §62-133.9(e) applies to assignment of costs to customer *classes*, not allocation of costs to customer *jurisdictions*. Rather, Rule R8-69 is controlling, and provides that

> Those expenses approved for recovery shall be allocated to the North Carolina retail jurisdiction consistent with the system benefits provided by the new demand-side management and energy efficiency measures and shall be assigned to customer classes in accordance with G.S. 62-133.9(e) and (f).

The Commission agrees with the Public Staff that this Commission Rule recognizes the long-standing regulatory practice of completing jurisdictional cost allocation before customer class allocation.[14] The question is then what system benefits in particular are appropriate for determining jurisdictional cost allocation pursuant to Rule R8-69(b)(1).

The primary benefits sought by a utility in implementing DSM and EE programs are the utility cost reductions that will accrue in some amount to the entire system, including wholesale operations, through the freeing up of existing system capacity and energy resources to serve growth in system demand and energy requirements. The utility is thereby relieved of the burden of serving that growth through the construction or purchase of additional supply-side resources at marginal cost. Because achieving those system benefits is the essential purpose of the DSM and EE programs, those benefits should be the basis for determining which DSM and EE program

[14] The Commission notes that Commission Rule R8-68 similarly distinguishes between jurisdictional and class allocation when it directs electric public utilities filing for approval of DSM or EE measures to describe "how the electric public utility proposes to allocate the costs and benefits of the measure among the customers classes and jurisdictions it serves."

costs and incentives are assigned or allocated to the North Carolina retail jurisdiction. Those benefits include benefits accruing to the wholesale jurisdiction. Accordingly, the Commission concludes that the appropriate and reasonable manner of allocating costs and incentives reflected in Rider EE is to treat those costs and incentives as total system costs, and allocate them across the total system, including the wholesale jurisdiction.

The Commission disagrees with Duke Energy Carolinas that its conclusions in its *Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Commission-Required Modifications* (PEC Order) in Docket No. E-2, Sub 931, require it to interpret N.C. Gen. Stat. §62-133.9(e) as the Company proposes. The General Assembly did not prescribe a blanket rule on cost allocation §62-133.9(e), although it could have done so. Instead, it appeared to leave it to the Commission to determine how costs would be allocated on case-by-case basis. The Commission recognized this in its rulemaking order in Docket No. E-100, Sub 113 when, in reviewing Commission Rule R8-69(b)(1), it stated that "[t]he appropriate resolution of cost allocation issues almost always requires evidentiary proceedings." (*Order Adopting Final Rules*, Docket No. E-100, Sub 113, at p, 112, Feb. 29, 2008). Therefore, the Commission is not bound by cost allocation determinations made in a previous order in another docket.

With respect to the jurisdictional cost allocation question contained in the PEC Order, the Commission was reviewing a negotiated settlement among PEC, Wal-Mart Stores, East, LP, and the Public Staff, in which the parties had agreed, as part of the negotiated settlement, that costs would not be allocated to the wholesale jurisdiction. The Stipulating Parties in that docket did not argue or brief the issue before the Commission. The Attorney General's Office challenged that portion of the settlement on the grounds that wholesale customers directly benefit from such programs. The Commission found that PEC's proposed programs were not targeted to the wholesale jurisdiction; consequently, the wholesale customers received only an indirect benefit from them. Because of the negotiated terms of the settlement, however, the issue of whether N.C. Gen. Stat. §62-133.9(e) or Commission Rule R8-69(b)(1) applies to jurisdictional allocation was not squarely before the Commission in the PEC Order as it is in the instant case. Therefore, the Commission is not bound by its conclusions in the PEC Order with regard to this docket.

Based upon the foregoing, the Commission agrees with the Public Staff and concludes that (1) for demand-side management programs, inputs will be allocated to the North Carolina retail jurisdiction based on contributions to total system peak demand by all system customers, retail and wholesale, and (2) for energy efficiency programs, inputs should be allocated to the North Carolina retail jurisdiction based on kWh sales to all system customers, retail and wholesale.

With respect to customer class allocation, the Commission agrees with the Public Staff and concludes that, consistent with N.C. Gen. Stat. §62-133.9(e), the costs of the DSM/EE programs at issue in this docket should be recovered from all customer classes, because all customer classes directly benefit from the reduction in the utility's cost of service resulting from the DSM/EE programs.

EVIDENCE FOR FINDINGS AND CONCLUSIONS No. 14

The evidence in support of this finding is based upon the Settlement Agreement and testimony of Duke Energy Carolinas Witness Schultz and Environmental Intervenors Witness Wilson.

Witness Schultz explained the terms in the Settlement Agreement relating to the Advisory Group. He testified that, as in the Company's initial proposal, the Settlement Agreement recognizes that the successful development and implementation of EE programs requires constant monitoring and modification, and that an advisory group is helpful in that regard. (Tr. Vol. 1, p. 20). Specifically, the Settlement Agreement provides that the Advisory Group will be established for the term of this Settlement Agreement. (*Id.* at pp. 20-21). Witness Schultz testified that the role of the Advisory Group is to collaborate on new program ideas, review modifications to existing programs, ensure greater public understanding of the programs and funding, and review the measurement and verification process. (*Id.* at p. 21). Witness Wilson also testified that the Advisory Group is intended to ensure transparency and encourage new ideas. (Tr. Vol. 2, p. 19). The Stipulating Parties envision that the Advisory Group will be comprised of a broad spectrum of regional stakeholders that represent balanced interests in the programs, as well as national EE advocates and experts. (Tr. Vol. 1, p. 21). The Advisory Group will meet at least twice each year and may establish working groups on specific topics. (*Id.*). A third party will facilitate the Advisory Group's discussions. (*Id.*).

The Commission finds that the Advisory Group provides an important forum for the Company to receive input from a variety of stakeholders. The implementation of the Advisory Group will facilitate innovation and accountability. Accordingly, the Commission concludes that the Advisory Group is in the public interest.

EVIDENCE IN SUPPORT OF FINDINGS AND CONCLUSIONS Nos. 15 & 16

The evidence in support of this finding can be found in the Settlement Agreement, as well as the testimony and exhibits of Duke Energy Carolinas Witness Wiles.

Company Witness J. Danny Wiles, Duke Energy Business Services' Vice President of Franchised Electric & Gas Accounting, described changes to the accounting and reporting treatment originally requested by the Company as a result of the Settlement Agreement and the Commission's Order. He explained that in compliance with the Order, the Company will include actual program revenues and actual program costs for purposes of calculating and reporting its regulated earnings to the Commission in its quarterly ES-1 reports. (Tr. Vol. 1, pp. 68-69). It will provide supplementary schedules setting forth the Company's jurisdictional earnings excluding the effects of its DSM and EE programs. (*Id.* at p. 69). The Company also will provide schedules separately stating the costs associated with each program or activity, and actual revenues received from the DSM and EE programs. (*Id.*). Witness Wiles testified that Duke Energy Carolinas will provide detailed calculations supporting these as schedules. (*Id.*).

Witness Wiles then discussed the financial accounting issues that relate to the EE Plan. Accounting rules and regulations require that the Company monitor, on an ongoing basis, the difference between financial results applicable to the save-a-watt programs that are expected ultimately to be realized based on the terms of the Settlement Agreement and the financial results recorded on the Company's books that result from the recovery of costs via Rider EE. (*Id.*). Witness Wiles explained that the Company will record a regulatory asset on its books if it appears that the level of revenues that will ultimately be recoverable based on the terms and provisions of the Settlement Agreement, is greater than the level of revenues billed under the rider. (*Id.*). On the other hand, the Company will record a regulatory liability if the level of revenues billed customers is in excess of the level of revenues that is estimated to be ultimately recoverable. (*Id.*).

Witness Wiles explained that in those situations where the Company owes customers, the Company will record a reduction to revenues in recognition of the fact that the Company has an obligation to return the overcollected amounts to customers. (*Id.* at p. 70). He then described the recommended method of accounting for amounts owed the utility under alternate rate recovery plans, such as save-a-watt. (*Id.*). He explained that the Emerging Issues Task Force ("EITF") reached consensus that once specific events have occurred that provide for future customer billings, then the utility can recognize the additional revenues if certain conditions are met. (*Id.*). First, the program must be established by an order from the Commission that allows for the automatic adjustment of future rates. (*Id.*). Witness Wiles clarified that verification of the adjustment to future rates by the Commission would not preclude the adjustment from being considered automatic. (*Id.*). Second, the amount of additional revenues for the period must be objectively determinable and probable of recovery. (*Id.*). Finally, the additional revenues must be collected within 24 months following the end of the annual period in which they are recognized. (*Id.* at pp. 70-71). Witness Wiles testified that while the terms of the Agreement meet these conditions, a Commission order approving the Agreement should acknowledge clearly that future rates may be adjusted in accordance with these provisions. (*See id.* at p. 71).

Mr. Wiles further testified that based on Commission Rule R8-27(a)(2), Duke Energy Carolinas requests that the Commission include an ordering paragraph for regulatory accounting purposes authorizing the Company to use a regulatory asset and a regulatory liability account for the purposes described in Witness Wiles' testimony. (*Id.*).

No Intervenor offered any evidence to contradict Witness Wile's settlement testimony. In addition, no intervenors cross-examined Mr. Wiles, nor was he asked any questions by the Commission.

The Commission concludes that the accounting methods described by Witness Wiles are reasonable and consistent with its February 26, 2009 Order. Consequently, pursuant to Commission Rule R8-27(a)(2), the Commission authorizes the Company, for North Carolina jurisdictional regulatory accounting purposes, to utilize *Account 182.3 – Other Regulatory Assets* to record the difference between the level of revenues estimated to be ultimately recoverable under the Settlement Agreement and the level of revenues then currently billed under Rider EE, when it is probable that such ultimately recoverable revenues will be greater than the currently billed revenues, and *Account 254 – Other Regulatory Liabilities* to record the difference between the level of revenues then currently billed customers and the level of revenues that is estimated to be ultimately recoverable when it is probable that such currently billed revenues are in excess of the revenues ultimately recoverable.

The Commission concludes that the methods and criteria that are intended by this Order to be utilized in determining the interim and ultimate rates charged for the term of the Settlement Agreement, including the true-up processes discussed in the Evidence in Support of Findings & Conclusions No. 12, are to be those set forth within the Settlement Agreement and the provisions of Commission Rule R8-69. Accordingly, the Commission concludes that its approval of the Settlement Agreement in this Order is sufficient to support deferral accounting for North Carolina jurisdictional regulatory purposes.

EVIDENCE IN SUPPORT OF FINDINGS AND CONCLUSIONS No. 17

The evidence in support of this finding can be found in the Commission's February 26 Order, the testimony of Public Interest Intervenors Witness Colton, Public Staff Witness McLawhorn and the rebuttal testimony of Duke Energy Carolinas Witness Smith.

Witness Colton testified that the Settlement Agreement as proposed is unreasonable and not in the interest of Duke Energy Carolinas' low-income customers. (Tr. Vol. 2, p. 55). He further stated that the Agreement should be rejected by the Commission absent modifications he recommends. (*Id.*). For example, he suggested that Duke Energy Carolinas commit to implementing certain low-income programs that have been successful in Indiana and Ohio. (*Id.* at p. 58). He also requested that the Advisory Group submit a plan to deliver certain EE services to the Commission within 60 days of the Commission's final order in this proceeding. (*Id.* at p. 59). In addition, Witness Colton testified that the Advisory Group's plan should include a specific dollar commitment to low-income programs. (*Id.*). Among other things, Mr. Colton recommended that Duke Energy Carolinas commit to deliver EE services to households with income below 150 percent of the federal poverty level. (*Id.* at p. 60). He also testified that Duke Energy Carolinas should commit to implement a program directed toward rental properties, and to pursue electric baseload reduction programs, including refrigerator replacements. (*Id.* at pp. 59-60).

The concerns expressed by Witness Colton in his supplemental testimony are no different from the recommendations he made during the August 2008 evidentiary hearing in this docket. As noted by Witness Smith, the Company addressed those concerns in its testimony as well as its October 7, 2008 proposed order. (*Id.* at p. 86). Furthermore, the Commission ruled on the recommendations made by Witness Colton in its February 26, 2009 Order. Specifically, at pages 21 and 22 of the Order the Commission discussed Witness Colton's testimony as follows:

> ...Colton criticized Duke's proposed portfolio of EE programs as failing to serve low-income households, and described a number of exemplary programs that he suggested the Company model its programs after instead. Specifically, witness Colton expressed concern that the Low Income Energy Efficiency and Weatherization Program will not be widely available to low-income households because its application is restricted to households with incomes of 150% to 200% of the federal poverty level and is limited to owner-occupied, single-family, all-electric residences. Witness Colton criticized the Company for assuming that weatherization agencies are available to distribute and install weatherization and starter kits. He based this criticism on his assumption that Duke is planning to leverage federal funds for these purposes, and federal regulations disallow federal weatherization assistance for households above 125% of poverty level. Witness Colton cited the Public Service of Indiana (now Duke Energy Indiana) low-income program as an exemplary program that Duke should emulate.

The Commission concluded that it was "...of the opinion that Duke's Low Income Energy Efficiency and Weatherization Assistance Program strikes an appropriate balance between assisting low-income customers and maintaining cost-effectiveness...and that the Low Income Energy Efficiency and Weatherization Assistance Program, as proposed, is in the public interest and will benefit Duke's customer body as a whole. As such, the Commission approves this program." (Order at 23).

While Mr. Colton urged the Commission to require the Company to commit to implement a refrigerator replacement program, the Company's Commission-approved Low Income Energy Efficiency and Weatherization Assistance Program already contains a refrigerator replacement component. Further, as Public Staff Witness McLawhorn testified, the Settlement Agreement contains a provision requiring the Company to make residential programs available to low-income customers without regard to whether they own or rent homes. (Tr. Vol. 1, p. 165). According to Mr. McLawhorn, the Company has also committed to pursuing partnerships with third-party agencies to implement programs and offer assistance to low-income customers. (*Id.*). He further stated that the Public Staff will continue to monitor extension of EE programs and benefits to all customers, regardless of income, through its involvement in stakeholder groups or other mechanisms. (T. Vol. 1, p. 178).

The Commission concludes that Mr. Colton has not presented any new or different evidence in his supplemental testimony to justify changes for low-income customer programs, and has not presented a case for modification or rejection of the Settlement Agreement.

EVIDENCE IN SUPPORT OF FINDINGS AND CONCLUSIONS No. 18

The evidence in support of this finding can be found in the Settlement Agreement, as well as the exhibits and testimony of Public Staff Witness McLawhorn, Environmental Intervenors Witness Wilson, and Company Witnesses Schultz and Farmer.

Witness Schultz testified that the Settlement Agreement furthers the important goal of providing an incentive to the Company and its customers to be aggressive in developing new EE and DSM programs. (Tr. Vol. 1, p. 16). The Agreement also reflects the Company's concept that compensation for successful implementation of EE and DSM programs should be predicated on a discount to the "avoided costs" of a power plant in order to place EE and DSM on a level playing field with supply-side resources. (*Id.* at p. 17). He emphasized that EE and DSM programs enable the Company to avoid future generation costs, benefiting all customers. (*Id.* at p. 21). In addition, Mr. Schultz explained that DSM and EE programs allow the Company to meet customer demand for electricity with a zero-emission resource and to lower usage and bills for customers who participate in these programs. (*Id.*).

As noted by Witness Schultz, the Agreement sets an aggressive target for the Company to deliver $754 million of avoided future generation costs. (*Id.*). This is a dramatic increase in results from EE and DSM programs in comparison with the Original Save-a-Watt Proposal. Witness McLawhorn testified that considering the increase in the projected energy savings, the Public Staff believes that the incentives that Duke Energy Carolinas has the opportunity to recover under the Settlement Agreement are more reasonable than those set forth in the Original Save-a-Watt Proposal. (*Id.* at p. 162).

Environmental Intervenors Witness Wilson agreed that the Settlement Agreement protects ratepayers and the environment while providing the Company with a reasonable incentive to pursue EE, and is therefore in the public interest. (Tr. Vol. 2, p. 8). He explained that the revised level of avoided cost recovery is in the public interest because it is set at a level that gives Duke Energy Carolinas the ability to recover its program costs plus achieve a reasonable level of earnings under the cap. (*Id.* at p. 9). However, if the Company's costs are higher than expected, then it might not achieve the full level of earnings allowed under the cap. (*Id.*). Witness Wilson asserted that in combination with the earnings cap, the avoided costs recovery structure provides customers with an assurance that the Company has an incentive to control costs. (*Id.* at p. 10). Further, as Witness Schultz explained, under the Settlement Agreement, the Company will only get paid for implementing programs that produce actual energy and capacity savings, as measured and verified by an independent third party. (Tr. Vol. 1, p. 17). In other words, Duke Energy Carolinas assumes the risk of recovering its EE and DSM program costs or any management incentive based upon its performance. (*Id.*).

One question that was raised during the Settlement Hearing was whether the Commission should mandate that Duke Energy Carolinas achieve the targets set out in the Settlement Agreement. (*See e.g.*, Tr. Vol. 1, pp. 40, 173). Witness Schultz responded that the Company has "taken a different tack from the mandate approach to create something that really aligns all parties and their interests." (*Id.* at pp. 40-41). In addition, as Witness Farmer explained, the Company's results are dependent upon customer acceptance of the Company's DSM and EE programs: "If customers don't participate in the programs then there are no results." (*Id.* at p. 55). Further, it would be difficult for the Company or the Commission to mandate customer performance in these programs. (*See id.* at p. 182). Regardless, Witness Farmer testified that the Company has an incentive to achieve these targets not only to increase its chances to recover its program costs and a management incentive, but also because these targets are reflected in the

Company's Integrated Resource Plan. (*See id.* at p. 55). To fall short of achieving these targets would "*put us in a...spot. It's tough to build a plant in that kind of a time frame, so you end up* in the short term...looking at some alternative regarding purchase power," testified Mr. Farmer. (*Id.* at p. 56).

In response to questioning by Chairman Finley, Witness McLawhorn testified that Senate Bill 3 contains the Renewable Energy and Energy Efficiency Portfolio Standard ("REPS") that functions as a mandate. (*See id.* at pp. 182-83). Part of the ability of Duke Energy Carolinas and other North Carolina utilities to meet this mandate is by implementing EE programs. (*Id.* at p. 183). Chairman Finley asked, "So Senate Bill 3 has both carrots and sticks? It has mandates and it has incentives?" to which Witness McLawhorn answered affirmatively. (*Id.*). The Commission sees no need to supplement this legislative scheme by ordering Duke Energy Carolinas to reach the DSM and EE targets set out in the Settlement Agreement, especially where results are so dependent on customer participation, and where the Company has plenty of incentive to achieve these targets without a Commission directive.

The North Carolina General Assembly has recognized that an increased emphasis on EE is necessary, by declaring through the enactment of Senate Bill 3 that the promotion and development of DSM and EE resources in North Carolina is in the public interest. To implement this policy, the General Assembly authorized the Commission to approve a broad array of incentives, including "rewards based on capitalization of a percentage of avoided costs achieved" and "[a]ny other incentive that the Commission determines to be appropriate." N.C. Gen. Stat. § 62-133.9(d). In addition, Commission Rules R8-68 and R8-69 implementing Senate Bill 3 expressly provide that the Commission will review and evaluate, as a package, proposed DSM and EE programs, cost recovery, lost revenue, and management incentive mechanisms. Under

Commission Rules R8-68 and R8-69 recovery of lost revenues and management incentives are appropriate considerations within a least cost framework. The Modified Save-a-Watt Approach, including limited recovery of net lost revenues and a management incentive based on a percentage of avoided costs, is consistent with N.C. Gen. Stat. §62-133.9(d) and Rules R8-68 and R8-69.

The Commission believes that the decision on the issue of incentives is by nature a balancing act. The incentives should not be excessive, but they must be sufficient to motivate the Company to deploy DSM and EE programs effectively and aggressively. The Stipulating Parties have demonstrated that the Modified Save-a-Watt Approach strikes the right balance between incentivizing the Company to pursue DSM and EE, and protecting customers' interests in fair rates. Moreover, the Agreement provides increased energy savings for customers, while offering a fair earnings opportunity for investments in DSM and EE. Further, the Agreement creates greater transparency to the Company's earnings opportunity by making lost revenues a direct recovery component of the rider and true-up calculations. Finally, there are performance targets tied to earnings caps that will ensure the Company's profits are just and reasonable. The Commission therefore concludes that the Settlement Agreement is in the public interest and should be accepted by the Commission as a fair and reasonable resolution of the issues in this proceeding.

IT IS, THEREFORE, ORDERED as follows:

1. That the Commission hereby approves the Agreement and Joint Stipulation filed by Duke Energy Carolinas, the Environmental Intervenors, and the Public Staff;

2. That the Commission hereby approves Rider EE (NC) as revised to incorporate the provisions of the Settlement Agreement and as illustrated in Farmer Exhibit No. 4;

Duke Energy Carolinas Version

3. That the costs of the Company's approved DSM programs shall first be allocated to the North Carolina and South Carolina retail jurisdictions and such North Carolina retail costs shall then be allocated across residential and non-residential classes, both of which are targets of the DSM programs, based on relative contribution to retail system peak demand. Tbe costs of the Company's approved EE programs should be recovered from only the class or classes of retail customers to which the program is targeted, by first separating them between residential and non-residential classes, and then allocating them among North Carolina and South Carolina retail customers. No costs of any approved DSM or EE program shall be allocated to the wholesale jurisdiction;

Public Staff Version

3. That the costs of the Company's approved DSM and EE programs shall be allocated to all system customers, retail and wholesale, and such costs shall then be recovered from residential and nonresidential customer classes based on relative residential and nonresidential contributions to kWh sales and peak demand within the North Carolina jurisdiction;

4. That the Commission's approval of the Settlement Agreement in this Order is sufficient to support deferral accounting for North Carolina jurisdictional regulatory purposes;

5. That the Company is authorized to utilize for North Carolina jurisdictional regulatory accounting purposes, *Account* 182.3 – *Other Regulatory Assets* to record the difference between the level of revenues estimated to be ultimately recoverable under the Settlement Agreement and the level of revenues then currently billed under Rider EE when it is probable that such ultimately recoverable revenues will be greater than the currently billed

revenues, and *Account 254 – Other Regulatory Liabilities* to record the difference between the level of revenues then currently billed customers and the level of revenues that is estimated to be ultimately recoverable when it is probable that such currently billed revenues are in excess of the revenues ultimately recoverable;

6. That Duke Energy Carolinas' proposed manner of accounting for the impacts of the Modified Save-a-Watt Approach in the Commission's Quarterly Surveillance Reports is hereby approved.

This ____ day of ___________, 2009.

THE NORTH CAROLINA UTILITIES COMMISSION

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Renné C. Vance, Chief Clerk

CERTIFICATE OF SERVICE

I certify that a copy of the Stipulating Parties' Proposed Order in Docket No. E-7, Sub 831 has been served by electronic mail (e-mail), hand delivery or by depositing a copy in the United States Mail, first class postage prepaid, properly addressed to parties of record.

This the 7th day of October, 2009.

Robert W. Kaylor

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