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November 26, 2007

HAND DELIVERED

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: *The Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company Demand-Side Management for the Review, Modification, and Continuation of Energy Efficiency Programs and DSM Cost Recovery Mechanisms*
Case No. 2007-00319

Dear Ms. O'Donnell:

Enclosed please find and accept for filing the original and ten copies of Louisville Gas and Electric Company's and Kentucky Utilities Company's Joint Responsive Comments in the above-referenced matter. Please confirm your receipt of this filing by placing the stamp of your Office with the date received on the enclosed additional copies and return them to me in the enclosed self-addressed stamped envelope.

Should you have any questions please contact me at your convenience.

Yours very truly,

W. Duncan Crosby III

WDC:ec
Enclosures
cc: Parties of Record

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY DEMAND-SIDE MANAGEMENT FOR THE REVIEW, MODIFICATION, AND CONTINUATION OF ENERGY EFFICIENCY PROGRAMS AND DSM COST RECOVERY MECHANISMS	)	**CASE NO. 2007-00319**

JOINT RESPONSIVE COMMENTS OF LOUISVILLE GAS AND ELECTRIC COMPANY AND <u>KENTUCKY UTILITIES COMPANY TO INTERVENERS' COMMENTS</u>

Louisville Gas and Electric Company and Kentucky Utilities Company (collectively "Companies"), by counsel, hereby respond to the Comments of the Attorney General of the Commonwealth of Kentucky (Office of Rate Intervention) ("AG"), the Comments of the Community Action Counsel of Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc. ("CAC"), and the Comments of the Kentucky Association for Community Action, Inc. ("KACA"). For their Responsive Comments, the Companies state:

I. INTRODUCTION AND SUMMARY

In his comments, the AG criticizes the Companies' proposed portfolio of Energy Efficiency and Demand Side Management ("DSM") programs ("Energy Efficiency Portfolio"), but does so using a method of benefit-cost analysis that is overly simple, flawed, and biased. Among other shortcomings, the AG's method ignores capacity savings and long-term program benefits, and utterly disregards the four long-standing, Commission-mandated benefit-cost tests that have been industry standard for decades. In contrast, the Companies applied the four established tests, which indicate that the Energy Efficiency Portfolio on balance is cost-effective and should be approved as filed. The following two tables demonstrate the prejudice of the AG's analysis, the first of which shows the dramatic difference in the total benefits the Commission-approved methods produce compared to the AG's contrived analysis:

TABLE 1: TOTAL BENEFITS					
	Commission-Approved Benefit-Cost Tests[1]				
Program	**Participant Test**	**Utility Cost Test**	**Total Resource Test**	**Ratepayer Impact Test**	**AG Savings Calculation[2]**
Residential Conservation	$ 11.6	$ 5.8	$ 10.5	$ 5.8	$ 6.4
Residential Load Management	51.2	138.5	155.0	138.5	14.6
Commercial Load Management	5.1	10.9	12.5	10.9	0.7
Res. Low Income Weatherization	30.8	8.5	23.9	8.5	10.1
Commercial Conservation/Rebates	274.1	204.6	204.6	204.6	88.5
Residential High Efficiency Lighting	116.0	86.3	86.3	86.3	88.7
Residential New Construction	15.1	9.3	13.4	9.3	3.5
Residential HVAC Tune Up	2.9	3.0	3.0	3.0	1.2
Commercial HVAC Tune Up	6.6	4.2	4.2	4.2	2.0
Customer Education & Public Information	*	*	*	*	
Dealer Referral Network	*	*	*	*	
Program Development and Admin.	*	*	*	*	
Overall Portfolio	$ 500.3	$ 471.0	$ 504.6	$ 471.0	$ 215.7
All values are in millions of dollars					

The table below, which takes into account not only total benefits but also costs, further shows that the AG's flawed analysis is clearly out of step with the results of the Commission's approved benefit-cost tests:

[1] All data for Commission-approved tests drawn from Application, Appendix B, and are present-valued to 2007.

[2] All data for the AG's Savings Calculation are drawn from his Amended Comments, and are in nominal, not present-valued, dollars.

TABLE 2: BENEFIT/COST RATIOS	Commission-Approved Benefit-Cost Tests[3]				
Program	Participant Test	Utility Cost Test	Total Resource Cost Test	Ratepayer Impact Test	AG Savings Calculations[4]
Residential Conservation	4.19	1.37	1.50	0.60	1.23
Residential Load Management	Infinity	2.67	3.75	1.90	0.21
Commercial Load Management	Infinity	4.52	6.12	2.09	0.23
Res. Low Income Weatherization	Infinity	0.81	2.28	0.37	0.78
Commercial Conservation/Rebates	4.30	11.21	3.64	0.89	3.95
Residential High Efficiency Lighting	11.04	4.40	2.87	0.64	3.68
Residential New Construction	2.23	1.49	1.09	0.61	0.45
Residential HVAC Tune Up	7.66	1.13	1.10	0.62	0.41
Commercial HVAC Tune Up	20.32	2.04	1.79	0.53	0.76
*Customer Education & Public Information	-	-	-	-	-
*Dealer Referral Network	-	-	-	-	-
*Program Development & Administration	-	-	-	-	-
Overall Portfolio	**7.02**	**3.31**	**2.80**	**0.89**	**1.19**
*Benefits are captured in analysis of supported programs					

Among the AG's most blatant analytical errors is his assertion that anticipated energy reductions from the proposed programs do not produce "lost revenues" for the Companies and that lost sales are a "fiction." This is simply false, and flies in the face of express language in the Kentucky statute and established Commission precedent allowing recovery for lost sales. Though the Companies' overall sales are increasing, the Energy Efficiency Portfolio will allow sales to increase less than they otherwise would absent the programs, just as the Companies' current DSM programs in fact have done. Moreover, the Companies propose in this proceeding to recover lost revenue for only 36 months instead of the full benefit period that the Energy Efficiency Portfolio programs will be in effect. By any objective measure, this is a modest proposal, authorized by statute, and wholly in accord with the Commission's past DSM orders. It should not be rejected.

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[3] All data for Commission-approved tests drawn from Application, Executive Summary at 8.

[4] Ratios calculated by dividing the AG's proposed savings by program costs.

The AG further asserts that the Commission should deny the Companies an economic incentive for certain elements of the Energy Efficiency Portfolio. This proposal also ignores Commission precedent. A piecemeal, cafeteria-style approach to calculating the DSM incentive is inappropriate because all aspects of the Energy Efficiency Portfolio are directed toward encouraging customers to reduce demand and to use less energy – which is the only product offered by the utility. To motivate the Companies to do what otherwise would be against their interest (i.e., to encourage less energy use) is precisely why the General Assembly created the DSM incentive, and the Commission should approve its application to the entire Energy Efficiency Portfolio.

The AG fundamentally errs again in his comments when he asserts that the Load Control program does not "avoid" but "merely delays" the need for capacity additions. Although new generation will be needed in the future to supply the demand of new industry and a growing customer base, the incremental capacity savings from the load control program are permanent – so long as the program remains in place. The program has been very successful to date by avoiding the need to build in excess of 100 MW of additional capacity, and should be approved as proposed.

Although the AG states that he "emphatically" supports energy efficiency education, the AG's comments in fact emphasize curtailing program promotion and consumer education. Promotion and education about energy efficiency is especially critical in Kentucky, where energy costs are generally low and the potential for energy efficiency is well recognized as significant. Promotion and education are necessary for the sustainability and growth of energy efficiency in the Commonwealth and should be approved as filed.

The AG proposes numerous modifications to particular programs in the Energy Efficiency Portfolio, nearly all of which would create barriers to participation or otherwise reduce program effectiveness. The Companies designed the Energy Efficiency Portfolio programs to remove participation barriers and to optimize program effectiveness. Therefore, the AG's proposed reductions in subsidies, rebates, or incentives should not be approved.

The AG proposes that much of the Program Development and Administration effort be disallowed, yet such activities are necessary for the sustainability of the Energy Efficiency Portfolio programs (i.e., for the growth of existing programs and the development and implementation of new programs). The Program Development and Administration program should be approved as filed.

With respect to the comments of the CAC and KACA, the CAC proposes that the entities that operate the DOE weatherization programs should be awarded operation of the WeCare program. The Companies, however, believe that a competitive bidding process is the only appropriate method for determining the most reasonable third-party vendor and to provide customers a cost-effective program. Should the Commission agree with the CAC on this point, certain safeguards described herein must be implemented to protect the interests of the Companies' ratepayers at large.

In summary, the Companies believe that energy efficiency is nothing less than critical for their operations in the short- and long-term, and that significant, even unprecedented initiatives in this area are essential. The AG's position presents a stark contrast to the Companies' application. He recommends eliminating certain programs entirely, including proven demand-reducing programs like Residential and Commercial Load Control, and significantly cutting back important support programs, such as the Customer Education and Public Information and

Program Development and Administration programs. But to terminate such programs would eliminate the very components that are necessary to ensure the ongoing support and growth of these important and effective programs.

Simply put, the AG's recommendations, if accepted, in no way support or promote energy efficiency; they will halt the progress of, and indeed will cause a retreat, from the advancement of energy efficiency, leaving Kentucky unable to take advantage of this important resource.

The Companies proposal is significant in scale but not unconventional in scope. The proposal, while of greater scale than the presently approved set of programs, adheres to conventional ratemaking methods and cost-effectiveness criteria. The proposal promotes energy efficiency in Kentucky and should be approved as filed by the Commission.

II. RESPONSE TO THE AMENDED COMMENTS OF THE AG

A. General Comments

Though the Companies appreciate the AG's overall "applau[se]" for the Companies' Energy Efficiency Portfolio,[5] the AG's Comments contain several points of significant misunderstanding concerning the DSM programs.

1. The AG Dramatically Understates the Overall Economic Benefit of the Proposed DSM Programs.

    a. On the AG's Own Flawed Benefit-Cost Analysis, the Companies' Proposed DSM Programs Produce a Net Benefit.

As shown below, the AG's method for calculating the savings the Companies' proposed DSM programs will generate is highly flawed and had never been approved by the Commission:

> Additionally, upon review of the application, the Companies estimate the energy savings from its programs to be 3,346,213 MWh (303 MW) for electricity, and 13,322 MCF of natural gas.

[5] AG's Amended Comments at 28.

> Using the residential tariff rates approved by the Commission and posted on the Companies' website, the Companies propose to save approximately $201,943,954.00 dollars worth of electricity and $13,813,715.00 dollars worth of natural gas as a result of the proposed programs. ... The Companies propose to spend $182 million of ratepayer provided funds to achieve $215.7 million dollars of energy savings. Put another way, ratepayers will spend approximately 0.84 dollars for every dollar saved under the program.[6]

Yet the AG curiously states:

> Although it is acknowledged that DSM/Energy Efficiency programs may not "pay for themselves" given Kentucky's historically low energy rates, the Attorney General's position is that DSM/Energy Efficiency programs should be as cost-efficient as possible given that ratepayers are ***required*** to participate in the program.[7]

Even on the AG's own benefit-cost calculation, the DSM programs will, in fact, "pay for themselves," and will result in a net economic benefit.

b. The AG Uses a Flawed Method for Calculating the Proposed DSM Programs' Benefits that Excludes Several Important Categories of Economic Benefits.

The AG's second significant error is his method for calculating the savings the DSM programs will create, which dramatically understates economic savings. In addition to using average rates and the erroneous assumption that retail rates will not change through 2014, the AG's chosen method for calculating DSM program benefits ignores such significant categories of saving as: (1) the value of avoiding the acquisition of additional generation; (2) the durable savings the programs will produce beyond 2014 (e.g., an Energy-Star-compliant house will produce energy cost savings for more than seven years); (3) reduced reserve margin requirements associated with reduced demand; and (4) time value of money or net present value. Taking into account such categories of savings, the proposed programs will produce total

[6] AG's Amended Comments at 29.
[7] AG's Amended Comments at 29-30 (emphasis in original).

benefits in the range of $471 - $505 million, (present valued to 2007).[8] This is a dramatic – and accurate – savings, which shows that the proposed DSM programs will do far more than just pay for themselves; they will produce large net economic gains.

c. In Addition to Being Inaccurate and Under-inclusive, the AG's Novel Method for Calculating DSM Program Savings Has Never Been Recognized by the Commission and Is Not One of the Four Benefit-Cost Tests Required by the Commission.

Though not a computational concern per se, the AG's method of calculating the benefit-cost ratio of the proposed DSM programs is not one of the four benefit-cost tests the Commission explicitly requires in DSM proceedings: "Any new DSM program or change to an existing DSM program shall be supported by … [t]he results of the four traditional DSM cost-benefit tests [Participant, Total Resource Cost, Ratepayer Impact, and Utility Cost tests]."[9] These tests are the industry-accepted standards for evaluating DSM programs, and are those contained in the California Standard Practice Manual.[10] In accord with the Commission's requirements, the Companies performed the four traditional DSM benefit-cost tests, which show that each of the proposed programs passed the Participant and Total Resource Cost tests.[11]

d. Recently Enacted Kentucky Law Shows a Clear State Policy Interest by the General Assembly for Programs Like the Companies' Proposed DSM Programs.

The General Assembly of Kentucky recently passed, and the Governor signed into law, House Bill 1, which deals extensively with matters of energy policy, and which encourages cost-effective demand and energy usage reduction.[12] In certain portions of House Bill 1, the General Assembly demonstrates a clear understanding of the objectives the Companies seek to achieve

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[8] Application, Volume II, Appendix B-1, page 1, line item "Total Benefits".
[9] *In the Matter of the Joint Application of the Members of the Louisville Gas and Electric Company Demand-Side Management Collaborative for the Review, Modification, and Continuation of the Collaborative, DSM Programs, and Cost Recovery Mechanism*, Case No. 1997-00083, Order at 20 (Apr. 27, 1998).
[10] AG's Amended Comments at 4.
[11] Application, Executive Summary at 8.
[12] *See* http://www.lrc.ky.gov/record/07S2/HB1.htm.

with their DSM programs, which is to avoid building new generation by using cost-effective DSM programs to reduce the rate of increasing demand and energy usage. [13] As shown in their Application, the Companies project that their proposed DSM programs will reduce demand by 303 MW as compared to having no DSM programs in place. This is precisely the kind of DSM strategy House Bill 1 contemplates, and is another reason why the Commission should approve the Companies' proposed DSM programs as filed.

2. <u>The Companies' Proposed Advertising Expenditures Are Necessary to Produce Sufficient Customer Participation to Ensure the Success of the DSM Programs</u>.

Another of the AG's objections to the proposed DSM programs is that the Companies propose to spend approximately $40.7 million in "advertising."[14] The AG believes this amount is excessive, partly because some of the proposed DSM programs "have been in existence for nearly a decade and consumers should be aware of their existence at this point."[15] This objection, however, overlooks several important facts. First, because of public concerns over climate change, energy efficiency promotion and education is much more likely to have a significant impact now than it had a decade ago. Second, several of the proposed DSM programs are new, such as the Residential High-Efficiency Lighting Program, and thus will be unknown unless the Companies communicate their existence to their customer base. Third, several features of the existing DSM programs have changed, which changes the Companies must communicate to their customers. Fourth, because people move in and out of the Companies' service territories, among other reasons, the Companies' customers a decade ago are not the

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[13] *See* http://www.lrc.ky.gov/record/07S2/HB1.htm.
[14] AG's Amended Comments at 30-31.
[15] AG's Amended Comments at 31.

same customers they have now, and the Companies must inform those customers about their DSM programs, both new and old.

But the fifth, and perhaps most compelling, reason that the Companies' proposed promotion and education costs are reasonable and prudent is the relatively low energy efficiency exhibited in Kentucky, which could be markedly improved by the wide acceptance and use of the Companies' proposed DSM programs. Out of the fifty states and District of Columbia, Kentucky is the eighth highest in terms of total energy consumption (BTUs) per capita, and is the sixth highest in retail electric sales (BTUs) per capita.[16] Additionally, as noted in the Application, Kentucky ranked 35th out of 50 states on spending on energy efficiency, achieving a score of only 0.5 out of a possible 15 points.[17] Clearly, there is room for improvement in terms of reducing per capita energy consumption, and making customers aware of programs like the Residential High-Efficiency Lighting Program and other DSM efforts will help to reduce both energy consumption and demand.

Finally, the AG asserts that the Companies ought to bear part of the cost of the proposed DSM advertising and education programs because, "[T]he Companies recognize a benefit, however intangible, for sponsoring such advertising."[18] Precisely how such promotion could be beneficial to the Companies is unclear at best, however. The AG's comments only offer the unsupported speculation that the advertisements would be the type that is paid by the Companies to promote their image and create goodwill. The promotion and education programs the Companies propose in this proceeding have the sole purpose and objective to *reduce* the amount of the Companies' products their customers consume and would have a different purpose than

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[16] *See* http://www.eia.doe.gov/emeu/states/sep_sum/html/sum_btu_res.html and http://www.census.gov/popest/national/files/NST_EST2006_ALLDATA.csv.
[17] Application, Executive Summary at 3.
[18] AG's Amended Comments at 31.

the previous advertisements referenced by the AG. And however desirable intangible benefits may be, as is the case with any business, the Companies require actual revenue to function. If the Companies' ads have the desired effect, they will result in shrinking revenue streams to the Companies from sales, or at least will slow the growth of them, which will serve only to limit the growth of the Companies, which intangibles cannot offset.

Moreover, the Commission's administrative regulations and precedent support the Companies' recovery of the cost to advertise and to educate customers concerning the Companies' proposed energy efficiency programs. The Commission's advertising regulation, 807 KAR 5:016, states in relevant part:

> Section 2. Advertising Allowed. (1) No advertising expenditure of a utility shall be taken into consideration by the commission for the purpose of establishing rates *unless such advertising will produce a material benefit for the ratepayers.*
>
> ...
>
> Section 3. Material Benefit. (1) Advertising expenditures by gas or electric utilities which produce a 'material benefit' include, but are not limited to the following:
>
> (a) Advertising limited exclusively to demonstration of means for ratepayers to reduce their bills or conserve energy;
>
> ...
>
> (c) Advertising which furnishes factual and objective data programs to educational institutions on the subject of energy technology[.]

The Companies' designed their proposed promotional and educational programs precisely to educate consumers about how they can help conserve energy and reduce demand, which will help reduce their bills, and to educate children on the importance of energy conservation and the means by which they can help achieve it. These are costs that squarely fit in the categories that are recoverable under 807 KAR 5:016.

Commission precedent also supports approval of the Companies' promotional and educational programs. For example, in a recent base rate proceeding, the Commission approved Cumberland Valley Electric, Inc.'s recovery of energy conservation advertising costs, as well as the costs of "Kentucky Living Magazine," which contained relatively little instructional material.[19] The Commission explicitly allowed rate recovery of $5,384 for "advertising electric thermal storage ('ETS') systems and a 'Button Up' home energy audit program," stating:

> Advertising to encourage energy conservation produces a material benefit to ratepayers and is consistent with the provisions of 807 KAR 5:016, Section 3(1). Therefore, the Commission finds these expenses have been properly classified as conservation advertising and will include the expenses for rate-making purposes.[20]

The Companies therefore respectfully submit that the Commission should follow its recent precedent by approving as-filed the Companies' proposed energy efficiency advertising and educational programs.

3. <u>Kentucky Statute Entitles the Companies to an Incentive as Part of Their DSM Programs</u>.

The AG states that the Companies should not receive an economic incentive for two DSM programs, the Responsive Pricing Pilot and the Program Development and Administration programs, and that an incentive "*<u>may</u>* [emphases in original] be appropriate for the proposed Residential HVAC Diagnostics and Tune-Up Program."[21] Yet this position is directly opposed to Kentucky's DSM statute:

> The commission may determine the reasonableness of demand-side management plans proposed by any utility under its jurisdiction. Factors to be considered in this determination include, but are not limited to, the following:
>
> . . .

[19] *In the Matter of: Application of Cumberland Valley Electric, Inc. for an Adjustment of Rates*, Case No. 2005-00187, Order at 17-22 (May 2, 2006).
[20] *Id.* at 21-22.
[21] AG's Amended Comments at 32.

> (c) A utility's proposal to recover in rates the full costs of demand-side management programs, *any net revenues lost due to reduced sales resulting from demand-side management programs, and incentives designed to provide positive financial rewards to a utility to encourage implementation of cost-effective demand-side management programs*[.][22]

The plain intent of this statutory language is to allow the Companies to have cost recovery of reasonable DSM programs, *plus* net revenues lost due to reduced sales from DSM programs, *plus* an economic incentive to encourage them to implement cost-effective DSM programs. As already discussed herein and as shown in the Companies' Application and supporting evidence, the proposed programs, including the HVAC Diagnostics and Tune-Up Program, are cost-effective.[23] The Program Development and Administration program, which serves all of the DSM programs and is properly allocable to all of them, is cost-effective because the entire portfolio of DSM programs is cost-effective.[24] Because all of these are cost-effective DSM programs, the DSM statute is clear: The Companies are entitled to a positive financial incentive with respect to all the proposed DSM programs, not just cost recovery.

4. Kentucky Statute and Commission Precedent Entitle the Companies to Recovery of Revenues Lost Due to the Implementation of DSM Programs.

The AG's last general objection to the Companies' proposed DSM programs is, like the rest of his objections, rooted in fundamental misunderstandings of Kentucky statute, Commission precedent, and utility operations.[25] The AG states in his Amended Comments that the Companies should not recover any lost sales revenue for their proposed DSM programs because the programs do not "eliminate demand increases entirely as envisioned by the statute."[26] As discussed in the previous section, the relevant Kentucky statute, KRS 278.285,

[22] KRS 278.285 (emphasis added).
[23] Application, Executive Summary at 8.
[24] Application, Executive Summary at 8.
[25] AG's Amended Comments at 34-37.
[26] AG's Amended Comments at 35.

explicitly states that the Companies are entitled to recover "net revenues lost due to reduced sales resulting from demand-side management programs"; the statute says nothing about "eliminat[ing] demand increases entirely." Moreover, continually increasing demand does not mean that the Companies' DSM programs do not or will not reduce demand relative to what demand would have been absent the programs; indeed the Companies project that by 2014 their DSM programs will reduce demand 303 MW below what demand otherwise would be. This results in real cost savings in terms of avoided construction or energy purchase costs.

The AG goes on to argue that the Companies will experience no "lost sales" because they forecast that demand will continue to increase even if the proposed DSM programs are in place, and that the Companies will use whatever excess capacity they have to make off-system sales.[27] There are several fundamental errors in the AG's reasoning. First, Commission precedent shows the fallacy of the AG's argument that the Companies experience no lost sales as a result of their DSM programs. The Companies' demand has consistently grown and the Companies have made off-system sales in the past, yet the Commission has rightly held in the Companies' prior DSM proceedings that the Companies would indeed lose sales as a result of their DSM programs.[28] This is intuitively obvious for programs such as the Residential High-Efficiency Lighting Program. If the program helps the Companies' customers to use more Compact Fluorescent Lights, which use about 25% of the energy of standard incandescent bulbs,[29] then by definition the Companies will sell those customers about 75% less energy for lighting. So there is ample

[27] AG's Amended Comments at 35-36.
[28] *See, e.g.*, In the Matter of the Joint Application of the Louisville Gas and Electric Company and Kentucky Utilities Company for the Review, Modification, and Continuation of DSM Programs and Cost Recovery Mechanisms, Case. No. 2000-00459, Order (May 11, 2001).
[29] *See* http://www.energystar.gov/index.cfm?c=cfls.pr_cfls ("ENERGY STAR qualified bulbs use about 75 percent less energy than standard incandescent bulbs . . ..").

justification for the Companies' recovery of revenue for lost sales, which are anything but a "fiction."

Second, the Companies do not build capacity or acquire capacity to engage in off-system sales; rather, they ensure sufficient capacity to provide for their reasonably foreseeable load. Thus, decreasing projected load through DSM programs allows the Companies to build or acquire less capacity than they would otherwise have to by a given time. Not having that additional capacity due to reduced demand means that (1) the Companies will have reduced sales to their native load customers precisely because of the effect of the DSM programs and (2) the Companies will not have built or acquired the additional capacity with which to make off-system sales.

Third, the Companies credit to their customers millions of dollars of off-system sales margin annually in base rates. In other words, the Companies' shareholders do not enjoy any benefit from the Companies' off-system sales until the Companies have earned significant off-system sales margins each year. Therefore, under the Companies' current base rates, the assertion that the Companies do not actually lose sales due to DSM programs is true only when the Companies have achieved the amount of off-system sales margins embedded in base rates each year. The AG's recommendation that the Commission require that the DSM lost sales component "should subtract off-system energy sales by the Compan[ies] prior to the calculation of any incentive" is duplicative and, therefore, fundamentally flawed.

Finally, the Companies have proposed to recover lost sales revenue only for 36 months instead of the full benefit period that the Energy Efficiency Portfolio programs will be in effect. Given the statutory authority under KRS 278.285 to seek recovery of all lost net revenues, which will extend beyond 2014, the Companies believe their lost sales recovery proposal is modest and worthy of approval as filed.

B. Program Comments

1. Residential Conservation Program.

The AG appears not to oppose the Residential Conservation Program ("RCP") per se, but rather advocates for a higher charge for on-site audits, as well as for a disallowance of the RCP's associated office supply costs and expenses, and for a significant reduction in the advertising budget of the RCP program.[30] The AG notes that even with these costs fully budgeted into the program, the RCP is still cost-effective using the AG's method, producing a dollar of savings for every $0.82 spent.

Concerning the AG's proposal that the Companies charge more for on-site RCP audits, the Companies are not strongly opposed to increasing the charge, but note that the program is cost-effective even with a charge of only $25 per audit (as compared to the approximately $200 cost to the Companies for an on-site audit). The Companies' motivation in keeping the audit cost low is to encourage a broad array of customers to seek audits to improve the energy efficiency of their homes. Raising the charge for such audits creates a barrier to participation that could prevent those who might otherwise have taken advantage of the RCP audit program from doing so.

With respect to the office supply costs to which the AG objects – $7,000 total over seven years[31] – the Companies respond simply that such supplies are necessary to implementing and managing such programs. The $49,000 in office supplies and equipment included in the Program Development and Administration Program ("PDAP"), discussed further below, is for

[30] AG's Amended Comments at 38-39.
[31] AG's Amended Comments at 39.

the implementation and administration of the Companies' entire portfolio of proposed DSM programs, all of which is necessary to the functioning of each of the programs. It is not unusual to have program-specific costs (such as the $7,000 to which the AG objects) and broader, more general administration costs (i.e. the $49,000 for office supplies and equipment in the PDAP), all of which are necessary to administer programs. The Commission should not, therefore, disallow the $7,000 for office supplies and equipment to which the AG objects.

The Commission likewise should not reduce the advertising budget of the RCP. As the Companies stated in the previous section concerning advertising costs more generally, the fact that a program is not new does not mean that promotion is not necessary. For RCP, program details have changed, such as the newly increased on-site audit charge, the addition of blower door testing, and the just-introduced online conservation audits. Also, the Companies' customers are not all the same people today as they were in 1998. The Companies' proposed RCP advertising budget is therefore reasonable and should be approved.

2. Residential and Commercial Load Management Program.

The AG's recommendation that the Commission end this program "as expeditiously as possible" demonstrates a clear lack of understanding of capacity savings and related benefits, and is the clearest example of the AG's fundamental misunderstanding of the proper benefit-cost analysis of DSM programs, as well as the purpose of demand reduction programs per se. Using his faulty energy-savings-only method of calculating benefits, and using only retail rates, the AG claims that this program will create only $15.3 million in savings over seven years, but at a cost of approximately $71.8 million: "[T]he Companies propose to collect and spend over $4.70 of ratepayer funds for every dollar saved under the program."[32] This obviously flawed analysis, as fully critiqued in Sections II.A.1.b & c herein, flies in the face of the four traditional, industry-

[32] AG's Amended Comments at 40-41.

standard, and Commission-approved benefit-cost analyses for this program. Indeed, of all the programs in the Companies' proposed Energy Efficiency Portfolio, the four traditional analyses are *most favorable* for this program.[33] In other words, the AG's analysis is completely contrary to the Commission-approved and –mandated benefit-cost analyses of this program, and demonstrates why the Commission should give no weight to the AG's method of analysis.

One of the reasons the load control program garners such favorable results from the Commission-mandated benefit-cost tests is that it provides *permanent* demand reductions – so long as the program is in effect. And it is the only program in the Energy Efficiency Portfolio that allows the Companies to reduce demand literally at the flip of a switch. That degree of control over a known quantity of demand ensures that the Companies do not have to build or acquire capacity to serve that increment of peak load.

The rest of the AG's attacks on this program are merely restatements of the flawed arguments the AG made in its General Comments section. These arguments are shown to be specious in Section II.A above.

In short, load control is a classic and exemplary DSM program, and is one of the longest-standing and most successful of the Companies' DSM programs. For the AG to suggest that such a program should be eliminated demonstrates such an absence of clear understanding of the purpose and function of DSM programs that the weight of his comments must be severely discounted.

3. <u>Residential Low Income Weatherization Program (WeCare)</u>.

The AG recommends that the WeCare program not be approved, preferring that the program be merged into the Residential Conservation Program, which also provides on-site

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[33] *See* Application, Executive Summary at 8.

energy efficiency audits, and that the on-site audit charge be eliminated entirely for the RCP.[34] The AG further notes that, using his flawed benefit-cost analysis, the Companies will collect and spend over $1.29 for each dollar of savings the WeCare program creates.

In recommending that the Commission not approve the WeCare program, the AG effectively is advocating a decrease in the number of low-income homes that receive energy efficiency improvements. As shown in the Companies' Application, relatively few households that receive RCP audits actually implement any of the recommended improvements beyond what is provided to them by the program. Because the customers eligible for the WeCare program are less financially able to implement any such improvements, doing away with the WeCare program would likely be the equivalent of ensuring that such households, if they elected to receive audits through the RCP, could never implement the recommendations supplied in the audits. When audit recommendations are not implemented, no energy or demand savings are provided, which reduces the impact and cost-effectiveness of the audit program itself.

Concerning the cost-effectiveness of the WeCare program, the Companies note that the program passes the Participant and Total Resource Cost Tests.[35] Also, the Commission has previously approved this program.[36]

4. Commercial Conservation Program.

The AG recommends approving this program subject to the implementation of a service charge for the audits the Companies will provide commercial customers under the program.[37] On the AG's benefit-cost analysis, the Companies will collect and spend only $0.25 for each

[34] AG's Amended Comments at 44-47.
[35] *See* Application, Executive Summary at 8.
[36] *See, e.g.*, In the Matter of the Joint Application of the Louisville Gas and Electric Company and Kentucky Utilities Company for the Review, Modification, and Continuation of DSM Programs and Cost Recovery Mechanisms, Case. No. 2000-00459, Order (May 11, 2001).
[37] AG's Amended Comments at 47-49.

dollar of savings.[38] As shown in the Companies' Application, this program passes the Participant, Utility Cost, and Total Resource Cost Tests.[39]

Although the Companies agree with the AG that this program should be approved, they oppose the AG's recommendation concerning implementing a service charge. Such a charge will create a barrier to participation in the program. Unlike the case with the Residential Conservation Program, a commercial customer's audit takes place during business hours, which means some degree of interruption to the customer's business. The Companies believe this is a sufficient hurdle to prevent commercial customers from frivolously requesting energy efficiency audits.

6. Residential High Efficiency Lighting Program.[40]

The AG recommends approval of this new DSM program, and further recommends that the Commission require the Companies to evaluate directly mailing a CFL to each residential customer in lieu of as much advertising and coupon-mailing.[41]

On the AG's benefit-cost analysis, this new program would result in the Companies' collecting and spending $0.29 for each dollar of savings.[42] Also, the program passes the Participant, Utility Cost, and Total Resource Cost Tests.[43]

The Companies accept the AG's recommendation and will, if the Commission approves, evaluate the cost-effectiveness of mailing each residential customer a CFL in lieu of an equal dollar amount of promotion and coupon-mailing. The Companies will aim to explore other alternatives for promoting more efficient lighting on an on-going basis as lighting technology enhancements continue to emerge.

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[38] AG's Amended Comments at 49.
[39] *See* Application, Executive Summary at 8.
[40] Sections numbered to match AG's Amended Comments.
[41] AG's Amended Comments at 49-51.
[42] AG's Amended Comments at 50.
[43] *See* Application, Executive Summary at 8.

One additional concern the AG expresses in his comments is that program advertising goes up from 50% (it is actually 54%) to 70% of program costs over seven years, while rebates drop from 39% to 24% of program costs.[44] The main reason for this percentage drop in rebate expenditures is the projected decrease in customer response rate to the coupons as the market becomes more saturated with CFLs. The Companies' proposed promotional expenses actually stay flat (except for inflation adjustments and costs required to reach a growing number of customers), because the Companies plan to mail a coupon to each residential customer four times per year throughout the life of the program. The program anticipates that the coupons will be redeemed for over 1,000,000 CFLs in 2008, with the customer take-rate dropping each year thereafter, resulting in coupons being redeemed for just over 650,000 CFLs in 2014. The same level of promotional activity (adjusted up for inflation and additional customers) and a 37% reduction in bulbs purchased by 2014 result in promotion being a larger percentage of the program and rebates being a smaller percentage in later years.

7. Residential New Construction Program.

The AG recommends that this program be reconfigured to encourage homebuyers to purchase Energy Star-compliant homes rather than to encourage homebuilders to build such homes and to provide the necessary support, training, and infrastructure to develop the necessary number of Energy Star inspectors.[45]

On the AG's flawed benefit-cost analysis, the Companies will collect from customers and spend $2.20 for each dollar of savings achieved.[46] This program, as proposed by the Companies

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[44] *See* AG's Amended Comments at 50.
[45] AG's Amended Comments at 52-54.
[46] AG's Amended Comments at 53.

and as shown in the Companies' Application, passed the Participant, Utility Cost, and Total Resource Cost Tests.[47]

The Companies will evaluate the AG's recommendation to provide incentives to homebuyers to purchase Energy Star-compliant homes; however, the Companies' belief, based on discussions with industry representatives in various venues, is that the issue is currently one of supply more than of demand. Encouraging the building of these homes by ensuring there are sufficient Energy Star inspectors available is necessary to ensuring that there are both sufficient supply and demand for such homes.

8. Residential and Commercial HVAC Diagnostics and Tune-Up Program.

The AG supports this program, but recommends providing only a 25-33% discount off of the prices of such services for the Companies' residential and commercial customers, rather than providing HVAC equipment inspection and tune-up services at 25-33% of the cost of those services.[48] According to the AG's faulty benefit-cost analysis, the Companies' program, as proposed, would require the Companies to collect from customers and to spend $1.23 for every dollar of savings.[49] As shown in the Companies' Application, this program passes the Participant, Utility Cost, and Total Resource Cost Tests.[50]

The Companies proposed to discount significantly these services in order to induce customers actually to use the services offered. As with any incentive program, the Companies will monitor closely the level of participation achieved with the proposed discount level. If it

[47] *See* Application, Executive Summary at 8.
[48] AG's Amended Comments at 55-58.
[49] AG's Amended Comments at 57.
[50] *See* Application, Executive Summary at 8. The AG's Amended Comments at 56 asks how the Companies' proposed HVAC Tune-Up Program passes these benefit-cost tests, whereas a previously proposed version of the program did not. The Companies' response is that program costs and benefits changed somewhat from the Companies' 2005 IRP. The primary reason is that the capacity cost and hourly energy cost estimates increased resulting in the benefit-cost ratio for all the programs being higher in the Companies' Application in this proceeding than in the 2005 IRP. For example, in the IRP, the cost of a combustion turbine unit was used for capacity cost, while in this proceeding the Companies use the average of all generation for capacity cost.

appears that similar participation levels can be achieved with a less significant discount, the Companies will adjust the discount offered accordingly.

9. Customer Education and Public Information Program.

The AG attacks both the proposed full-time energy efficiency school outreach employee and the Companies' proposed mass media campaign to apprise customers of the DSM programs available to them, asserting that both components are more likely to achieve "goodwill" for the Companies than they are to achieve any meaningful education or energy conservation.[51] The AG states that this program will cost $23.5 million over seven years, with "no discernable energy savings."[52]

As argued more fully in Section II.A.2 above, these education costs are necessary to the success of the whole portfolio of the Companies' proposed DSM programs. The Companies expect that public information and education is essential to the sustainability of cost-effective energy efficiency in our service territory and across the Commonwealth. Moreover, they are cost-effective when factored into the whole of the proposed Energy Efficiency Portfolio, which passes the Participant, Utility Cost, and Total Resource Cost Tests.[53] The Commission should, therefore, approve this program.

10. Dealer Referral Network.

The AG supports this program but states that the Companies should be vigilant in dealer oversight and make clear to customers on their dealer referral website that the Companies do not endorse or recommend the listed contractors, nor do the Companies guarantee the listed contractors' quality of work or accept liability for same.[54]

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[51] AG's Amended Comments at 58-62.
[52] AG's Amended Comments at 58.
[53] *See* Application, Executive Summary at 8.
[54] AG's Amended Comments at 62-64.

The Companies agree with the AG's recommendation and will take steps to ensure that the dealer referral website contains the appropriate disclaimers, prominently displayed.

11. Program Development and Administration.

The AG describes this program as a "new ... support program" that "incorporates and captures generic development and administrative costs and functions that are common to the Companies' other [DSM] programs . . .," which will cost approximately $5.6 million over seven years, and which provides no direct energy impacts or incentives.[55] The AG states that nearly all the kinds of costs that are accounted for in this program should be disallowed as "simply too remote to provide any direct benefit to ratepayers" or as "primarily benefit[ing] the Companies and their personnel."[56]

First, this program is not "new." The Companies have always had program development and administration costs.

Second, the Companies strongly disagree with the AG's recommendation for disallowing most of the costs this program is designed to recover because they are necessary to grow and manage existing DSM programs and to develop new programs. Indeed, the management budget of the Companies' DSM department (which is currently subject to full DSM ratemaking treatment in the presently-approved program) is included in this program. Also, like the Companies' proposed advertising and education program, the costs addressed in this program are necessary to the sustainability of the Energy Efficiency Portfolio overall. As noted above and shown in the Companies' Application, the Companies' proposed Energy Efficiency Portfolio,

[55] AG's Amended Comments at 65.
[56] AG's Amended Comments at 65.

including this program as proposed, passes the Participant, Utility Cost, and Total Resource Cost Tests.[57]

Moreover, the specific costs to which the AG objects are clearly necessary to the development and administration of the portfolio. Though consultant costs for new program concept, design, research, and technical evaluation appear to the AG to be "remote" to benefits to the Companies' customers, they are necessary elements for introduction of new energy efficiency technologies and DSM programs which ultimately benefit customers. If such costs are disallowed, there will be fewer DSM programs to benefit customers by combating increasing demand and rising energy costs.

Also, items such as development of key personnel, membership in trade associations, and subscriptions to educational and trade publications, all of which the AG says the Commission should disallow, are, in fact, all related to development of energy efficiency knowledge and are necessary to provide the on-going, effective delivery of energy efficiency programming. They are reasonable and nominal levels of spending given the magnitude of the Companies' energy efficiency initiatives and should be recovered.

Market research spending under this program is dedicated to market research for future programming opportunities and to evaluate customer opinions and attitudes toward overall energy efficiency. Market research costs under individual program budgets, on the other hand, are limited to evaluating customer opinion and attitudes toward each specific existing program. The same is true for office supplies and equipment, thus answering the AG's assertion that these costs contained in this program and line items for them in other programs are somehow duplicative; they are not duplicative, but rather all are necessary to the functioning of these programs and should be recoverable.

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[57] *See* Application, Executive Summary at 8.

III. RESPONSE TO THE COMMENTS OF THE CAC AND THE KACA, AND TO THE SUPPLEMENTAL COMMENTS OF THE CAC

CAC and KACA use the bulk of their Comments and Supplemental Comments to criticize various elements of the Companies' current WeCare program to reach a set of recommendations concerning the Companies' *proposed* WeCare program. In summary, CAC and KACA recommend that the Commission approve the Companies' WeCare program, subject to the following conditions:

- There must be a single, common intake process for WeCare and the federal weatherization program.[58] CAC administers the federal weatherization program.[59]
- To prevent unnecessary duplication of services, there should be a single energy audit for the WeCare and federal weatherization programs.[60] The Commission should require the Companies to ensure that the National Energy Audit Tool is used in the audit, which tool CAC uses in its audits for the federal weatherization program.[61]
- WeCare recipients should receive energy education and information from one source and should be coordinated with the federal weatherization program to prevent duplication.[62]
- Inspections and evaluations of WeCare work should be performed by Kentucky-certified inspectors in heat systems and weatherization.[63]
- The WeCare program evaluation should use actual, not engineered, savings.[64]
- The WeCare program should be administered using actual, not contractually fixed, costs in order to prevent the WeCare program contractor from making a profit on the program.[65]

The Companies appreciate CAC's and KACA's recommendations, and agree that there should be close coordination between the party that ultimately receives the contract to provide WeCare services and all agencies that administer the federal weatherization programs in order to

[58] CAC's Supplemental Comments at 5.
[59] Comments of Community Action Council at 2.
[60] CAC's Supplemental Comments at 5-6.
[61] CAC's Supplemental Comments at 5-6.
[62] CAC's Supplemental Comments at 6.
[63] CAC's Supplemental Comments at 6.
[64] CAC's Supplemental Comments at 7.
[65] CAC's Supplemental Comments at 7.

minimize unnecessary duplication of services. In order to ensure that coordination, and to ensure a prudently operated and cost-effective WeCare program, the Companies plan to use a Request for Proposals ("RFP") process to examine and select a WeCare program vendor, just as the Companies have done in the past with the WeCare program.

In that vein, the Companies cannot agree with CAC and KACA's recommendation that WeCare be administered on an "actual cost" basis. The purpose of the Companies' RFP process is to ensure that WeCare services are provided on a reliable and low-cost basis; if the winning vendor can make a profit by reliably providing such low-cost services, it does not change the fact that WeCare recipients benefit by receiving cost-effective services. Regardless, the Companies believe that an RFP process is the appropriate means for choosing a WeCare services provider, and therefore cannot endorse CAC's recommendation that the Commission "require that the program be contracted to the operators of the federal Department of Energy Weatherization program [i.e., to CAC and KACA]."[66]

In the interest of formulating an RFP that does not preordain CAC/KACA as the selected vendor, however, the Companies must also oppose two other criteria CAC proposes that the Commission make requirements for the WeCare vendor. First, the Companies oppose any requirement that the WeCare vendor to use the National Energy Audit Tool in conducting energy efficiency audits. Any audit procedure and software that adequately perform energy audits should be permissible. Second, because the Kentucky certification for heat systems and weatherization inspectors is operated by the State Division of Family Support and is only available to weatherization assistance agencies such as CAC and KACA, a comparable certification available to private vendors, such as the national certification from the Building Performance Institute, should be permissible as well.

[66] Comments of Community Action Council at 11.

In the alternative, if the Commission agrees with the CAC/KACA and requires that the program be contracted to the operators of the federal Department of Energy Weatherization program (i.e., to CAC and KACA), thus determining that the Companies need not use an RFP process to choose a WeCare vendor for the proposed program, the Companies expect the provider of WeCare services to meet the following criteria:

- Program must meet energy efficiency, budgetary, and cost effectiveness goals of this filing;
- Program may be coordinated with, but must be operated and accounted for separately from, other Weatherization Assistance Programs;
- Program may serve LG&E and KU residential customers only;
- Provider must meet all reporting requirements of the Companies;
- Provider must be subject to company initiated audits to ensure appropriate utilization of and accounting for funds;
- Provider must be subject to independent program evaluation initiated by the Companies to ensure energy savings and cost effectiveness objectives are achieved.

Finally, concerning the recommendation to use actual, not engineered, energy savings, the Companies will use the services of an independent evaluator to determine how well the WeCare program is performing. It will be the evaluator's choice as to what is the most reliable and accurate means of measuring and reporting energy savings.

IV. CONCLUSION

Based upon the Companies' Application and other evidence submitted in this proceeding, including the results of the four Commission-approved benefit-cost tests, the Companies respectfully request that the Commission approve the Companies' Application.

Dated: November 26, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Joint Response was sent to the following attorneys of record by U.S. mail, postage prepaid, on this 26th day of November, 2007.

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