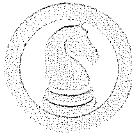

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May 30, 2008

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PUBLIC SERVICE
COMMISSION

VIA HAND DELIVERY

Stephanie L. Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RE: ***An Investigation of the Energy and Regulatory Issues in Section 50 of Kentucky's 2007 Energy Act***
Administrative Case No. 2007-00477

Dear Ms. Stumbo:

Enclosed please find and accept for filing the original and ten copies of the Kentucky Utilities Company's and Louisville Gas and Electric Company's Post-Hearing Brief 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.

Sincerely,

W. Duncan Crosby III

WDC:ec
Enclosures as mentioned
cc: Parties of Record

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In re the Matter of:

AN INVESTIGATION OF THE ENERGY AND REGULATORY ISSUES IN SECTION 50 OF KENTUCKY'S 2007 ENERGY ACT	))))	**ADMINISTRATIVE CASE NO. 2007-00477**

BRIEF OF KENTUCKY UTILITIES COMPANY AND LOUISVILLE GAS AND ELECTRIC COMPANY

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FILED: **May 30, 2008**

I. Introduction

In Section 50 of Kentucky's 2007 Energy Act, the General Assembly directed the Kentucky Public Service Commission ("Commission") to examine its statutes and to issue a report to the Legislative Research Commission ("LRC") on four issues:

- Eliminating impediments to the consideration and adoption by utilities of cost-effective demand-management strategies for addressing future demand prior to Commission consideration of any proposal for increasing generating capacity;
- Encouraging diversification of utility energy portfolios through the use of renewables and distributed generation;
- Incorporating full-cost accounting that considers and requires comparison of life-cycle energy, economic, public health, and environmental costs of various strategies for meeting future energy demand; and
- Modifying rate structures and cost recovery to better align the financial interests of the utility with the goals of achieving energy efficiency and lowest life-cycle energy costs to all classes of ratepayers.

Kentucky Utilities Company ("KU") and Louisville Gas and Electric Company ("LG&E") (collectively, the "Companies") respectfully submit that the record of this proceeding demonstrates that Kentucky's electric utilities, and particularly LG&E and KU, are (1) pursuing and implementing significant demand-side management ("DSM") and energy efficiency programs, (2) conscientiously pursuing cost-effective renewables, (3) implementing true cost accounting, and (4) supportive of additional incentives for DSM and energy efficiency programs.

In addition to this already promising state of affairs, the Companies respectfully submit that, under KRS 278.285 and the Commission's general rate-making authority, the Commission has the statutory authority necessary to address the issues posed in Section 50. In particular, the Commission has the authority to approve new and innovative DSM and energy efficiency programs, as well as the cost recovery, lost sales recovery, and financial incentives needed to implement cost-effective DSM and energy efficiency programs.

II. The Commission currently has ample statutory authority to remove the impediments, if any, to the "consideration and adoption by utilities of cost-effective demand-management strategies for addressing future demand."

There are three reasons the Companies respectfully submit that in response to the first topic the General Assembly asks the Commission to consider, "Eliminating impediments to the consideration and adoption by utilities of cost-effective demand-management strategies for addressing future demand prior to Commission consideration of any proposal for increasing generating capacity," the Commission should recommend no statutory changes. First, the Commission requires no new statutory authority to determine which DSM and energy efficiency programs are cost-effective. Second, the Commission already has the authority it needs to enable utilities to overcome the chief impediment to adoption of cost-effective DSM and energy efficiency programs, which is economics, and has used that authority to approve an impressive array of such programs across the Commonwealth. Third and finally, under its current statutory authority concerning integrated resource planning, the Commission has required utilities to consider DSM and energy efficiency programs.

A. The Commission Has the Authority Under KRS 278.285 – and Has Exercised that Authority – to Establish Criteria to Determine Which DSM and Energy Efficiency Programs Are Cost-Effective.

The Commission has the authority under KRS 278.285(1) to determine what makes a DSM or energy efficiency program cost-effective:

> 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:
>
> ...
>
> (b) The cost and benefit analysis and other justification for specific demand-side management programs and measures included in a utility's proposed plan;

The Commission exercised its authority decisively over ten years ago, when it stated, "Any new DSM program or change to an existing DSM program shall be supported by ... [the results of the four traditional DSM cost-benefit tests [i.e., the Participant, Total Resource Cost, Ratepayer Impact, and Utility Cost tests]."[1] These tests are the industry-standard metrics for evaluating the cost-effectiveness of DSM and energy efficiency programs. Because the Commission has already established these tests, Overland Consulting's recommendation that the Commission "should develop a set of standards for how to evaluate the benefits of proposed DSM programs," is moot.[2] These are the accepted and established industry standards. Regardless of whether the Commission determines to adopt additional or entirely different criteria for evaluating the reasonableness, including the cost-effectiveness, of DSM and energy efficiency programs, the point of overriding importance is that the Commission already possesses the authority to establish such tests under KRS 278.285; no additional legislation is needed.

That notwithstanding, there is one suggestion concerning criteria for evaluating the efficacy of DSM and energy efficiency programs that the Companies oppose, which is the proposal to use "actual" results of DSM and energy efficiency programs to evaluate the programs, rather than using "engineered" results.[3] Though the use of "actual" energy savings is facially appealing, in fact they are impracticable to obtain. Even comparing historical energy usage to more recent usage does not guaranty that the results will be meaningful; without knowing all of a customer's behavioral changes, adjusting for weather and other environmental

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[1] *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).
[2] Overland Consulting Report at 53.
[3] AG's Comments at 3-5.

factors, and other sources of energy consumption or savings in a customer's residence (e.g., a new Energy Star-approved appliance), it simply is not reasonably practicable to calculate accurately a customer's actual energy savings derived from a particular DSM or energy efficiency program. For that reason, the Companies oppose the proposal to move to using "actual" energy savings data exclusively for evaluating DSM and energy efficiency programs, but instead support the standard approved in the settlement of the Companies' most recent DSM and energy efficiency programs proceedings before the Commission: "[U]se of engineered savings with a billing analysis component, including a statistically representative sampling of actual energy consumption data (as available), is a reasonable and appropriate means of evaluating the efficacy of energy efficiency measures ...." This standard relies primarily on engineered savings, which are most easily and reliably calculated, but leaves room for an actual savings component where that information can be relevantly and reliably included.

B. The Commission Has the Authority It Needs Under KRS 278.285 to Offer the Financial Incentives Necessary to Overcome Obstacles to Implementing Cost-Effective DSM and Energy Efficiency Programs.

Kentucky's demand-side management ("DSM") program statute, KRS 278.285, already provides the Commission the authority needed to address the only significant impediment to utilities' consideration and implementation of "cost-effective demand-management strategies for addressing future demand": economics. In the absence of energy efficiency DSM statutes or regulations, traditional cost-of-service-based utility rates provide a significant disincentive to implementing energy efficiency or DSM programs. Under traditional rate structures, electric utilities have a strong financial incentive to produce efficiently and to sell as much of their product as possible, just like any other business. This basic fact of economics presents the greatest single obstacle to the development and implementation of energy efficiency initiatives.

But KRS 278.285 gives the Commission the authority it needs to overcome this obstacle; namely, the power to approve the recovery of lost revenues and financial incentives for implementing cost-effective DSM and energy efficiency programs:

> A proposed demand-side management mechanism including:
>
> (a) Recover[y] [of] the full costs of commission-approved demand-side management programs and revenues lost by implementing these programs;
>
> (b) … [I]ncentives designed to provide financial rewards to the utility for implementing cost-effective demand-side management programs; or
>
> (c) Both …
>
> may be reviewed and approved by the commission ….[4]

Using this authority, the Commission recently approved a new portfolio of cost-effective DSM and energy efficiency programs for the Companies, including residential and commercial load control programs, heating and cooling tune-ups, residential and commercial energy audits, a high efficiency lighting program, and a program for customer education concerning energy efficiency.[5] As shown in the Overland Consulting, Inc. report, the Companies are not alone in having robust DSM and energy efficiency programs. It therefore appears that KRS 278.285 provides the authority the Commission needs to overcome the sole significant impediment to the consideration and implementation of cost-effective DSM and energy efficiency programs in Kentucky.

With the authority it now possesses under KRS 278.285, though, the Commission can do more to provide incentives for electric utilities to consider and implement new and innovative

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[4] KRS 278.285(2).

[5] *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, Order (March 31, 2008).

DSM and energy efficiency programs and initiatives. In this proceeding, the Companies have proposed several additional kinds of incentives:

- Annual reviews of utilities' financial results, with rate adjustments, to ensure utilities' revenues remain consistent with their approved rate designs
- Capitalization of all non-expense components of energy efficiency programs to be recovered as part of energy efficiency program filings
- Durable incentive rates of return on equity ("ROE") for capital investments in energy efficiency programs, which both the Governor's Office of Energy Policy and Overland Consulting recommend[6]
- Fair, reasonable, and equitable distributions of energy efficiency program savings between customers and utility applicants

If proposed by electric utilities and approved by the Commission, one or more of these kinds of incentives could provide strong incentive for utilities to bolster their DSM and energy efficiency portfolios. The Commission could approve any or all of them today under KRS 278.285.

C. The Commission Already Requires Utilities to Consider DSM Programs and Renewable Energy Sources in their Integrated Resource Plans, Which Utilities Use to Guide their Applications for Certificates of Public Convenience and Necessity.

In addition to the Commission's authority to provide utilities the needed financial incentive to implement cost-effective DSM and energy efficiency programs, the Commission currently has the authority--and has exercised its authority--to require utilities to consider and evaluate alternatives to traditional generation in their Integrated Resource Plans ("IRPs"), which serve as utilities' blueprints for seeking certificates of public convenience and necessity ("CPCNs") to construct new facilities. In regulation 807 KAR 5:058 Section 8(2), the Commission requires:

> The utility shall describe and discuss all options considered for inclusion in the plan including:

[6] GOEP Comments at 3; Overland Consulting Report at 106.

> . . .
>
> (b) Conservation and load management or other demand-side programs not already in place;
>
> . . .
>
> (d) Assessment of nonutility generation, including generating capacity provided by cogeneration, technologies relying on renewable resources, and other nonutility sources.

Therefore, IRP processes already provide the appropriate forum for considering energy efficiency and DSM strategies for meeting demand.

Because the Commission currently requires utilities to consider and evaluate such programs in their IRPs, and because utilities generally seek CPCNs in accord with their established IRPs, the Companies oppose as redundant Overland Consulting's recommendation to modify "[t]he current statute defining the CPCN process ... to require the consideration of demand and supply-side alternatives."[7] As shown, CPCN proceedings are effectively preceded by energy efficiency and DSM considerations by way of utilities' IRPs processes.

Overland Consulting also recommends "revis[ing] the DSM statute to expressly authorize the KPSC to act on its own initiative or direction to investigate and direct utilities to implement particular DSM programs."[8] Compelling utilities to implement programs is different than ordering utilities to change their traditional rates. As the Commission recognized when implementing the Earnings Sharing Mechanism, "incentives will only work if they are fully supported by [the utility]."[9] If the Commission considers recommending that it be given such authority, though, the Companies propose that utilities that have demonstrated a high level of

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[7] Overland Consulting Report at 84.

[8] Overland Consulting Report at 54.

[9] See e.g,, *The Application of Kentucky Utilities Company for Approval of an Alternative Method of Regulation of Its Rates and Service*, Case No. 98-474, Order, at 45 (January 7, 2000)

commitment to such programs, as the Companies have, be exempted from any additional requirements to implement DSM or energy efficiency programs.

III. The Commission Should Abstain from Recommending Additional Renewable Energy and Distributed Generation Statutory Requirements.

The Companies stated their objections to mandatory, statewide renewable energy and distributed generation standards in Administrative Case No. 2007-00300,[10] and have maintained that position in this proceeding.[11] With respect to renewable energy, the Governor's Office of Energy Policy ("GOEP") and Overland Consulting appear to agree with the Companies: "GOEP agrees with the Overland report's recommendation that any renewable portfolio standard be 'voluntary ... [and] ... be realistic and cost effective in light of Kentucky geological constraints ....' ... A mandatory requirement in Kentucky would impose undue burdens on ratepayers, especially those on low or fixed incomes."[12] Of course, the Companies have and will comply with all applicable federal, state, and local environmental regulations, some of which, such as possible carbon legislation, may change the economics of conventional coal-fired generation. Moreover, as the Companies have stated throughout this proceeding, they would not oppose the establishment of a task force to study the availability and advisability of, and the need for, additional renewable and distributed generation in Kentucky.

Turning to distributed generation, the Companies already have uniform distributed generation/interconnection standards in the form of certain tariffs (i.e., net metering, Small Qualifying Facilities, and Large Qualifying Facilities tariffs), negating the need for, or the

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[10] *In the Matter of: Consideration of the Requirements of the Federal Policy Act of 2005 Regarding Fuel Sources and Fossil Fuel Generation Efficiency*, Admin. Case No 2007-00300, Joint Comments of Kentucky Utilities Company and Louisville Gas and Electric Company at 4 (Sept 28, 2007) ("The Companies recommend that the Commission not take any action to adopt the federal fuel diversity standard set forth in EPAct 2005, Section 1251(12). ... [A] generation fuel diversity standard is not necessary and should not be adopted.").
[11] Joint Testimony at 5-6.
[12] GOEP Comments at 3-4 (quoting Overland Consulting Report at 69).

applicability to the Companies of, additional such standards. Notwithstanding that the Companies have the requisite tariffs in effect, *very* few customers are on them; as the Companies reported to the Commission in their Post-Hearing Data Request in this proceeding, a total of seven customers are currently using the Companies' net metering tariffs.[13]

Recently SB83 was signed by the Governor, which amended KRS 278.465 that relates to net metering of electricity. The Companies would encourage the Commission to include electric utilities and suppliers of retail electric power, representatives of customers, and the Office of the Attorney General when developing the interconnection and net metering guidelines as mentioned in KRS 278.476 (2).

IV. The Commission Should Refrain from Supporting New Statutes "Incorporating full-cost accounting that considers and requires comparison of life-cycle energy, economic, public health, and environmental costs of various strategies for meeting future energy demand," Which Would Arbitrarily Drive Up Consumers' Energy Costs.

There are several reasons the Companies oppose "full-cost accounting," most of which Overland Consulting and the GOEP echo, but all of which ultimately lead to the same conclusion; a move to "full-cost accounting" would result in arbitrarily higher energy costs for customers. First, the Companies already use true cost accounting, which is an accounting term of art and through which accounting the Companies already account for known and measurable costs and benefits. Second, the stated components of "full-cost accounting" are largely intangible societal goods that are by their nature incapable of objective derivation or calculation; utilities therefore cannot quantify or include such factors in the utilities' true cost accounting. Third, to the extent that society has quantified the cost of such factors through federal, state, and local governments, the Companies and other utilities already take into account such costs in their

[13] Response of LG&E and KU to Post-Hearing Data Request of Commission Staff (May 2, 2008).

true cost accounting associated with any generation, energy efficiency, or DSM proposal. Fourth, Companies already must comply with numerous federal, state, and local environmental requirements and restrictions independent of accounting standards (and the Companies already account for costs of complying with such requirements and restrictions). In sum, then, the Companies already account for all the known and measurable costs imposed upon them, including those concerning environmental impacts, but only insofar as the entities responsible for setting the costs of environmental and other impacts--namely federal, state, and local governments--have quantified the costs. Otherwise, to add costs to consumers through "full-cost accounting" would result in arbitrary energy price increases. Therefore, as Overland Consulting and GOEP recommend, "'[T]he Commission should not require the recognition of environmental or public health externalities in the IRP or certificate processes.'"[14]

V. The Commission Does Not Need Additional Statutory Authority to "Modify[] rate structures and cost recovery to better align the financial interests of the utility with the goals of achieving energy efficiency ...," and "lowest life-cycle energy costs" Are Too Ambiguous to Address in Statutes.

Turning first to "[m]odifying rate structures and cost recovery to better align the financial interests of the utility with the goals of achieving energy efficiency ...," as discussed above in Section II, there is no need for additional statutory authority. Kentucky's DSM statute, KRS 278.285, gives the KPSC authority to approve reasonable utility-proposed energy efficiency and DSM programs, and to approve for such programs: (1) cost-recovery; (2) recovery of lost sales revenues; and (3) "financial rewards" for implementing cost-effective programs. The Companies favor an array of incentives to encourage further development and implementation of DSM and energy efficiency programs, which incentives can "better align the financial interests of the utility with the goals of achieving energy efficiency ...."

[14] GOEP Comments at 4 (quoting Overland Consulting Report at 96).

Turning next to "lowest life-cycle energy costs," like the concept of "full-cost accounting" discussed above, the Companies respectfully recommend that the Commission reject "lowest life-cycle energy costs" as a factor in any rate structures or cost recovery because it is ambiguous and incapable of clear calculation.

A. Rate Caps on Utilities for Implementing DSM and Energy Efficiency Programs, as the Attorney General Proposes, Would Serve as a Significant Disincentive to Utilities Seeking to Implement Additional DSM and Energy Efficiency Programs.

The Companies oppose rate caps of all kinds, and particularly those proposed by the Attorney General, which would deny the deferral of any uncollected but approved DSM or energy efficiency costs (including carrying costs) for recovery at a later time. In addition to posing a serious obstacle to utilities' development and implementation of new and innovative DSM and energy efficiency programs, such a rate cap would almost certainly be challenged as an unconstitutional taking without compensation of the affected utility's (or utilities') property.[15] At the very least, it would severely undermine the expressed intent of the General Assembly in Section 50, which clearly is to encourage, not discourage, additional development and implementation of DSM and energy efficiency programs. The confiscation of property is not a valid incentive.

B. Although Overland Consulting Recommends a Generation Efficiency Surcharge, the Companies Do Not Believe Such a Surcharge Is Advisable at this Time.

Although improving the efficiency of their generating units is one of the Companies' ongoing high priorities, the Companies recognize, and respectfully submit the Commission should consider, the possible unintended consequences of many efficiency projects, as well as the difficulty with actually achieving efficiency goals and/or measuring their success. For

[15] *See, e.g.*, *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (U.S. 1989) ("The guiding principle has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so 'unjust' as to be confiscatory.").

example, actual savings may not be realized if there is a change in operating parameters, which can depend upon system load or other factors. Also, system conditions may force utilities to operate individual units inefficiently at times in order to maintain the reliability of the grid. In addition, changes in environmental regulations may require the addition of pollution control equipment that will both reduce overall efficiency due to increased auxiliary power requirements and add costs to the customers. Though some regulations may require utilities to change the operating parameters of a unit in order to reduce emissions, these changes can have the unintended effect of detrimentally impacting efficiency.

Another noteworthy concern with respect to generating efficiency improvement projects, in addition to operational and environmental challenges and concerns, is that it is possible that modifying existing generation facilities in an attempt to increase efficiency could necessitate federal New Source Review ("NSR") procedures, which likely would increase the cost of any efficiency project due to the Best Available Control Technology requirements of NSR.

C. Securitization Bond Funding Would, to Make the Bonds Marketable, Require Additional Statutory Restrictions on the Commission's Authority, and Would Not Further the Goal of Aligning Utilities' Financial Interests with those of DSM and Energy Efficiency.

Though the Companies believe it is within the Commission's current statutory authority to approve the issuance of securitized bonds for DSM and energy efficiency projects, the Companies further believe the bonds would be unmarketable without additional statutory assurances of the stability of the income that would secure the bonds. Investors would likely require clear statutory restrictions on the Commission's authority to terminate the surcharges associated with securitized bonds to ensure the continuation of the surcharge income that would presumably secure the bonds issued to fund DSM or energy efficiency projects. Without these

statutory assurances, the risk associated with such bonds would almost certainly make them unmarketable, or would require prohibitively high rates of interest to be paid on them.

Notwithstanding the additional statutory restrictions of the Commission's authority that likely would be necessary to allow for securitization bond funding of DSM and energy efficiency projects, such funding would not align utilities' financial interests with the goal of implementing additional cost-effective DSM and energy efficiency projects. Utilities would not be able to earn a return on the investment, which is a financial disincentive as compared to allowing utilities to earn incentive ROEs on capital investments associated with DSM and energy efficiency programs and projects. Also, the Commission and utilities must, even with securitized debt, be mindful of a utility's debt-to-equity ratio, noting that a utility's debt security financing can have an adverse affect on the utility's cost of capital or its ability to borrow in the future.

Finally, it is likely that, in the great majority of cases, securitized bond funding of DSM and energy efficiency projects would not be cost-advantageous to customers. Arranging securitized bond financing is very expensive and would therefore require a significant capital investment to justify its cost. For most DSM and energy efficiency projects, traditional utility financing will be more cost-effective for customers, in addition to providing utilities the proper financial incentive to invest in such projects.

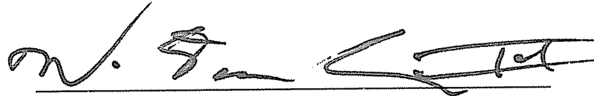
VI. Conclusion

Given what the Companies respectfully submit the Commission should do regarding the issues addressed herein--namely, to approve new, innovative, and cost-effective DSM and energy efficiency programs, as well as the cost recovery, lost sales recovery, and financial incentives needed to align utilities' interests with those of DSM and energy efficiency--the Companies believe that, under KRS 278.285 and the Commission's general rate-making authority, the Commission has the statutory authority necessary to address the issues posed in

Section 50. The Companies therefore respectfully request the Commission to report to the LRC that, though the Commission may exercise its statutory authority in the future to encourage further DSM and energy efficiency program development, no statutory changes are necessary at this time among the four issues Section 50 asks the Commission to consider.

Dated: May 30, 2008

Respectfully submitted,



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The undersigned hereby certifies that a true and correct copy of the foregoing Joint Brief was served on the following persons on the 30th day of May 2008, U.S. mail, postage prepaid:

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