COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE FEASIBILITY OF IMPLEMENTING DEMAND-SIDE MANAGEMENT COST RECOVERY AND INCENTIVE MECHANISMS	))))	ADMINISTRATIVE CASE NO. 341

O R D E R

On July 24, 1992, the Commission initiated this investigation into the feasibility of designing and implementing mechanisms for the recovery of costs related to electric utility demand-side management ("DSM") programs, the recovery of revenue losses resulting from DSM programs, and the provision of financial incentives to electric utilities that undertake cost-effective DSM programs. At that time the Commission found that such an investigation was necessary to ensure that the state's electric utilities are fully considering all reasonable and cost-effective demand-side resource options in the development of future resource plans.

In its July 24, 1992 Order, the Commission identified certain issues related to DSM program cost recovery, lost revenue recovery, and financial incentives that should be researched and analyzed in this investigation. The Commission ordered Big Rivers Electric Corporation ("Big Rivers"), East Kentucky Power Cooperative, Inc. ("East Kentucky"), Louisville Gas and Electric Company ("LG&E"), Kentucky Power Company ("Kentucky Power"), Kentucky Utilities

Company ("Kentucky Utilities"), and The Union Light, Heat and Power Company ("ULH&P") to submit certain information. Other interested parties were encouraged to submit information as well.

Big Rivers, Kentucky Power, Kentucky Utilities, and ULH&P ("Joint Utilities") submitted joint comments and responses. Kentucky Power and ULH&P also submitted separate comments and responses. LG&E, East Kentucky, Cumberland Valley Rural Electric Cooperative Corporation, Kentucky Industrial Utility Customers ("KIUC"), Kentucky Cabinet for Natural Resources and Environmental Protection's Division of Energy ("NREPC/Energy"), Kentucky Association for Community Action ("KACA"), and Louisville Resource Conservation Council ("LRCC") submitted separate responses and comments. The Office of the Attorney General and Jefferson County Government ("AG/Jefferson") filed joint comments which Lexington-Fayette Urban County Government adopted. Metro Human Needs Alliance, People Organized and Working for Energy Reform, Citizens Organized to End Poverty in the Commonwealth, Anna Shed, and Marvar Cowart ("Joint Intervenors") also submitted joint comments.

After reviewing these submittals, the Commission finds that additional information from all parties is required.

IT IS THEREFORE ORDERED that all parties shall file with the Commission within 30 days of the date of this Order an original and 12 copies of the following information. Careful attention should be given to copied material to ensure its legibility. Unless the question expressly states otherwise, all parties shall respond to each question.

1. Discuss whether the Commission presently has statutory authority to establish financial incentives to encourage a regulated utility's use of demand-side management ("DSM"). Include relevant legal authority in this discussion.

2. If the Commission presently lacks the statutory authority to establish financial incentives to encourage the use of DSM programs, identify and discuss the changes required to permit the Commission to establish such incentives.

3. In response to the Commission's Order of July 24, 1992, Item 4, East Kentucky stated: "[T]he argument has been made that the existence of ERAM [Electric Revenue Adjustment Mechanism] makes the utility less concerned about controlling costs and holding down rates since the adjustment clause maintains its earnings at the approved level and that this mechanism is susceptible to manipulation by the utilities for their own benefit." In its comments, NREPC/Energy stated that a benefit of the ERAM methodology is that utilities would continue to have an incentive to reduce operating expenditures.

a. **(All parties except East Kentucky and NREPC/Energy)** Comment upon the statements of East Kentucky and NREPC/Energy.

b. **(East Kentucky only)**

(1) Identify the source of your argument. Provide any report, article, or study in which this argument is found.

(2) Explain the basis for this argument.

(3) Comment upon NREPC/Energy's statement.

c. (NREPC/Energy only)

(1) Comment upon East Kentucky's statement.

(2) Explain how an ERAM would offer incentives to utilities to reduce operating expenses.

4. In their comments, AG/Jefferson advocate amending Commission Regulation 807 KAR 5:058 to provide for formal Commission review of integrated resource plans ("IRPs"). The Joint Utilities' comments indicate the Commission could link the level of DSM expenditures to the review of the IRPs and provide the utilities assurance that the expenditures would not be subject to later prudence reviews.

a. State whether 807 KAR 5:058 should be amended to provide formal Commission review and approval of utility IRPs.

b. State whether the Commission should review DSM expenditures as part of a formal review of a utility's IRP. Explain.

c. If amendments to 807 KAR 5:058 are required, identify and discuss the proposed amendments.

d. State whether, if 807 KAR 5:058 is amended to include a formal review process, the existing biennial IRP filing schedule should be retained.

e. (Joint Utilities only)

(1) Explain how, without amending 807 KAR 5:058, the current IRP review process can provide the assurance which the Joint Utilities seek concerning prudence reviews.

(2) Explain why the Joint Utilities are seeking assurance that DSM expenditures will not be subject to later prudence reviews.

5. On page 15 of their comments, the Joint Utilities listed their concerns about ERAM on a per customer basis, including higher costs of administration, the effect of changes in industrial demand, and the "counter-cyclical" nature of the mechanism.

a. **(All parties except Joint Utilities)** Comment upon the Joint Utilities' position on ERAM on a per customer basis.

b. **(Joint Utilities only)**

(1) Provide any report, study, analysis, or other documentation which supports the Joint Utilities' position that the ERAM on a per customer basis has higher administrative costs than the lost revenue adjustment methodology.

(2) Provide any report, study, analysis, or other documentation which supports the Joint Utilities' concerns about the potential impact of an ERAM on a per customer basis on large industrial loads.

(3) Provide any report, study, analysis, or other documentation which supports the Joint Utilities' concerns about the "counter-cyclical" nature of an ERAM on a per customer basis.

6. State whether the adoption of an ERAM on a per customer basis would require some type of weather normalization adjustment in rate cases. Explain.

7. In their comments, AG/Jefferson stated that a reconciled fuel adjustment clause ("FAC") serves to discourage DSM efforts and

suggested that the Commission consider reforming or eliminating the present FAC.

a. **(All parties except AG/Jefferson)** Comment upon the AG/Jefferson's position.

b. **(AG/Jefferson only)**

(1) Explain why a reconciled FAC discourages DSM efforts.

(2) Describe how the FAC should be reformed or eliminated.

(3) State when the reformation or elimination of the FAC should occur.

8. State whether the Commission should require the participation of all major natural gas distribution utilities within its jurisdiction in this proceeding. Explain.

9. State whether gas DSM programs implemented by combination utilities should be given the same regulatory treatment as electric DSM programs. Explain.

10. Describe how combination utilities should implement and measure DSM programs that affect both electricity and natural gas consumption.

11. State whether joint implementation and cost sharing of DSM programs by electric-only utilities and local gas distribution companies are feasible and realistic. Explain.

12. Describe the impact on combination utilities' operations if DSM program cost recovery, lost revenue recovery, or financial incentive mechanisms are allowed for electric DSM programs only.

13. List all fuel switching programs which combination utilities or traditionally competing gas-only and electric-only utilities could implement to achieve peak reductions, strategic conservation or valley filling objectives which might benefit all energy providers.

14. State the advantages and disadvantages of using a collaborative process to design DSM programs.

15. List the criteria which should be used to select members of a collaborative group or state-level panel to design DSM programs or review existing DSM programs.

16. State the reasons, if any, why a utility would not pursue cost-effective DSM programs when mechanisms are in place to ensure DSM program cost recovery, lost revenue recovery, or financial incentives. Explain.

17. Identify the cost-effectiveness tests (e.g. total resource cost, ratepayer impact measure, utility costs, societal) which the Commission should use to determine which DSM programs will be included in any program cost recovery, lost revenue recovery, or financial incentive mechanisms. Explain.

18. State whether customer participation in DSM programs should be mandatory or voluntary. State whether, if participation is voluntary, DSM program costs should be recovered only from program participants. Explain.

19. Provide any additional comments concerning other parties' responses to the Commission's Order of July 24, 1992.

20. (Joint Utilities only) On page 14 of their comments, the Joint Utilities stated that an ERAM removes the incentive for utilities to provide for economic growth and development.

a. State whether electric utilities have any responsibility to provide for economic development and growth in their service territories. Explain.

b. Explain why electric utilities must be provided with an incentive to promote economic development and growth in their service territories.

c. Explain how the adoption of an ERAM methodology removes an electric utility's incentive to promote economic development and growth.

21. (Joint Utilities only) On page 17 of their comments, the Joint Utilities state that a difficult aspect of the lost revenue adjustment methodology is the need to quantify and verify the reduction in KWH sales attributable to the DSM options.

a. List and describe the difficulties which the Joint Utilities anticipate in establishing reasonable methods to quantify and verify actual reductions in KWH sales attributable to DSM programs.

b. State how such a verification should be performed.

c. Describe how over- or under-estimations of KWH sales should be addressed.

d. Explain why the use of the lost revenue adjustment method will not result in considerable time and resources being expended to address the reasonableness of DSM impact measurement.

e. State how potential disputes over DSM impact measurement may be minimized.

22. (Joint Utilities only)

a. Describe the guidelines which the Joint Utilities will use to determine whether a DSM expenditure should be capitalized or expensed.

b. Describe how amortization periods will be determined for capitalized DSM expenditures.

23. (Joint Utilities only)

a. State whether an annual surcharge should be used to collect projected DSM program costs. Explain.

b. State whether any annual surcharge should be limited to actual DSM program costs. Explain.

24. (Joint Utilities only) State how often DSM program costs collected through an annual surcharge should be reviewed for prudency.

25. (Joint Utilities only) State whether an ERAM is likely to be a net cost to customers over time (i.e. customers will pay more in the form of rate increases than they receive in the form of rate decreases). Explain.

26. (Joint Utilities only) On page 12 of their comments, the Joint Utilities state that a surcharge mechanism could be implemented through the tariff process without amending existing regulations or statutes. Explain how a surcharge would be implemented through the tariff process.

27. (East Kentucky only) In its response to the Commission's Order of July 24, 1992, Item 2, East Kentucky stated: "It should be noted that some cooperative financing experts believe that the risks and uncertainties of DSM may require a slightly higher TIER [Times Interest Earned Ratio] than normal."

a. Identify these financing experts. Provide any reports or articles in which they express this position.

b. Explain why the risks and uncertainties of DSM may require higher TIERs.

28. (East Kentucky only) In its response to the Commission's Order of July 24, 1992, Item 6, East Kentucky stated that, if a decoupling method such as ERAM on a per customer basis is used, higher utility rates may cause industrial customers to bypass a utility's system for less expensive self-generating alternatives.

a. Explain this statement. Provide any reports, articles, or other documentation which discuss this position.

b. Describe the current potential of East Kentucky's industrial customers to pursue self-generating alternatives. Provide any studies which East Kentucky has conducted to estimate this bypass potential.

29. (East Kentucky only) In its response to the Commission's Order of July 24, 1992, Item 14, East Kentucky stated that financial incentives to reward stockholders are not relevant to cooperatives. State whether financial incentives directed toward cooperative management should be considered instead.

30. (Kentucky Power only) In its supplemental comments, Kentucky Power expressed the opinion that once DSM programs are implemented, all prudently incurred DSM costs, resultant lost revenues, and financial incentives should be fully recoverable from ratepayers.

a. State whether a utility should bear any of the risks associated with DSM programs. Explain.

b. State whether DSM costs, resultant lost revenues, and financial incentives should be recoverable from program participants only. Explain.

c. Explain why the shareholders of investor-owned utilities should not share in the DSM costs, resultant lost revenues, and financial incentives.

31. (Kentucky Power only)

a. State the current status of the actions pertaining to the recording of lost revenues and incentives by the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force.

b. State whether FASB's recently established accounting and financial reporting requirements on lost revenues and incentives constitute official FASB policy.

32. (Kentucky Power only) Explain why Kentucky Power should receive 15 percent of the estimated net savings associated with proposed DSM programs and 5 percent of actual DSM expenditures. Provide any reports, studies, or analyses which discuss these suggested percentages.

33. (LG&E only) Explain why LG&E should be allowed to recover no less than 25 percent of the net resource savings from DSM programs. State and discuss all assumptions used to obtain this percentage.

34. (ULH&P only) In its response to the Commission's Order of July 24, 1992, Item 3, ULH&P stated that a decoupling mechanism would add an unnecessary administrative burden compared to the proposed balancing-account mechanism. Provide any reports, studies, analyses, or other documentation which support this statement.

35. (ULH&P only) In its response to the Commission's Order of July 24, 1992, ULH&P referred to the unique problems posed by its membership in Cincinnati Gas and Electric Company's integrated system. State how this Commission should address potential conflicts between its approach to DSM and those of other state utility regulatory commissions.

36. (ULH&P only) List and discuss the issues pertaining to the inter-jurisdictional allocation of DSM costs and benefits.

37. (AG/Jefferson only)

a. List the states currently using an Allowance for Funds Used to Conserve Energy ("AFUCE").

b. Describe how the AFUCE is used in each state.

38. (AG/Jefferson only) In its response to the Commission's Order of July 24, 1992, Item 3, AG/Jefferson suggested that an "aggregate average number of customers" could be used in an ERAM on

a per customer basis in Kentucky as has been used in other states. Explain how the aggregate number of customers is determined.

39. (AG/Jefferson only) Describe in detail New York's experience with lost revenue and decoupling mechanisms.

40. (AG/Jefferson only) Explain how a lost revenue adjustment would tend to encourage the use of load shifting and load building programs and discourage the development of energy conservation programs.

41. (KACA only)

a. Explain why a rate structure which provides a minimum level of usage at the lowest rate is a DSM program.

b. Discuss how such a rate structure would co-exist with DSM programs which are designed to encourage conservation by adjusting electric rates to send proper pricing signals to consumers.

42. (KACA only) Explain why a formula should be established which requires that utility investment in conservation be tied to the percentage of the number of customers in each class.

43. (KACA only) Explain why an arrearage reduction program and a moratorium on collection activities qualify as conservation or DSM programs.

44. (Joint Intervenors only) In their response to the Commission's Order of July 24, 1992, Item 17, the Joint Intervenors stated that there should be a penalty for failure to meet designated performance levels if a bounty system is used. State whether the Joint Intervenors support the concept of awarding

bounties only if performance levels are met, with the failure to earn a bounty being a sufficient penalty for not meeting designated performance levels. Explain.

45. (KIUC only) State the standards which should be used to determine whether an expenditure should be capitalized or expensed.

46. (KIUC only) On page 9 of its response to the Commission's Order of July 24, 1992, KIUC stated that the Commission should develop mechanisms that place more reliance on free and open markets and the force of competition.

a. Describe how and to what extent the Commission should rely on markets and competition.

b. Explain how the Commission can rely on the forces of competition if each electric utility has an exclusive certified service territory.

47. (KIUC only) On page 3 of its response to the Commission's Order of July 24, 1992, KIUC states: "In order to keep the playing field as level as possible. . .there should be no special treatment of DSM program costs." State whether demand-side and supply-side resource options are currently on a level playing field. Explain.

48. (KIUC only) On page 6 of its responses to the Commission's Order of July 24, 1992, KIUC states: "If new capacity resources were needed, perhaps this strategy [special DSM ratemaking treatment] might make sense. However, that is currently not the case." The IRPs submitted in 1991 indicate that 2,900 MW of new generating capacity will be required during the period of

1994-2005. State whether this future need requires utility consideration of cost-effective DSM programs and removal of any barriers that might prevent the development of utility DSM programs in Kentucky. Explain.

Done at Frankfort, Kentucky, this 7th day of January, 1993.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Don Mills

Executive Director