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

ORDER

On July 19, 2007, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") filed their proposed Energy Efficiency Program Plan and their proposed Demand Side Management ("DSM") cost recovery tariffs for a 7-year period. The Attorney General, through his Office of Rate Intervention ("AG"), the Community Action Council for Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc. ("CAC"), the Kentucky Association for Community Action, Inc. ("KACA") and the Kentucky Industrial Utility Customers, Inc. ("KIUC") were granted intervention in this proceeding.

KACA and CAC requested a formal hearing solely on the issue of the administration of LG&E and KU's proposed Residential Low Income Weatherization ("WeCare") program. A hearing was scheduled to occur on January 17, 2008; however, the parties were able to arrive at a settlement on the issue of the administration of the WeCare program. The Settlement Agreement is attached as Appendix A. At the request of KACA and CAC, the hearing was cancelled and an informal conference was convened on January 17, 2008 in order for the parties to present the terms of the agreement to Staff. Although KIUC was a signatory to the settlement agreement, it did not file testimony or comments and did not participate in the hearing or informal conference held in this case.

LG&E and KU state in their application that the National Action Plan for Energy Efficiency ("Action Plan") found energy conservation measures to be one of the most constructive and cost-effective ways to address the increasing demand for energy. That same Action Plan also found that conservation methods are critically underutilized in some regions of the country. The Action Plan's supplement, "The State Energy Efficiency Scorecard for 2006," places Kentucky 35th overall on utility spending for energy efficiency, indicating that Kentucky is one of the regions which is not significantly utilizing energy conservation methods. In response to this situation, E.ON U.S. LLC, the parent company of LG&E and KU, retained ICF International in early 2007 to assist in a broad review of its existing and proposed DSM programs, industry best practices, and strategic planning for energy efficiency. LG&E and KU hope to offer programs that aid customers to make better use of energy and that will delay the need to build power plants or purchase additional energy in the wholesale market.

LG&E and KU currently have four existing DSM programs. The companies propose to enhance these programs and add seven new programs. Most of the proposed programs were part of a comprehensive evaluation of DSM alternatives performed in LG&E and KU's Integrated Resource Plan filed in April 2005.[1] In developing the modifications and new programs, LG&E and KU solicited feedback from members of their Energy Efficiency Advisory Group, the Action Plan, and ICF

[1] Case No. 2005-00162, The 2005 Joint Integrated Resource Plan of Louisville Gas and Electric Company and Kentucky Utilities Company (Order dated February 24, 2006

International. LG&E and KU's estimated budget for all of the programs is $25.8 million for 2008 and is expected to average $26.0 million per year for the 7-year period 2008-2014. The budgeted amounts include such costs as additional employees, increases in the number of customers served each year and advertising. LG&E and KU estimate the savings generated by these programs to be 14,725 MWh in energy and 6,070 kW in demand for their combined electric customers and 720,955 Ccf for LG&E's gas customers. The cost recovery mechanisms and accounting will be separate for each company, although the programs will be operated as one group available to customers of both LG&E and KU. The existing programs expired on December 31, 2007. Because the case could not be completed by that date, the Commission issued an Order to continue the current mechanism until an Order could be entered in this matter.

The current DSM Cost Recovery Mechanism allows LG&E and KU to recover the cost of the programs, revenue from lost sales, an incentive and a balancing adjustment. LG&E and KU propose one modification to the mechanism: the incentive calculation for some of the programs. Under the current mechanism, LG&E and KU calculate the incentive in two different ways, depending on the program. The current tariff states that for all energy impact programs, except the Education and Load Control programs, the incentive is 15 percent of the annual net resource savings expected for installed measures during the upcoming 12-month period, not to exceed 5 percent of the program expenditures. For the Education and Load Control programs, the incentive is calculated as 5 percent of the annual cost for approved installations for the upcoming 12-month period. LG&E and KU propose to use the Education and Load Control incentive calculation for all of the programs in order to simplify the calculation and to apply a consistent methodology for all programs.

THE ATTORNEY GENERAL

General Comments and Criticisms

The AG voiced several concerns with LG&E and KU's proposal, both with the recovery mechanism itself, with individual programs and with the overall increase in cost. Under LG&E and KU's proposal, the cost of the program will increase 168 percent, from $9.7 million per year to about $26 million per year. He calculates that the cost of the proposals is approximately $219 per customer over the seven years of the program, which he considers a significant increase to the individual ratepayers. He also notes that ratepayers will spend approximately $0.84 for every dollar saved under the program.[2] Within the total cost of the program, the AG questioned the $40 million that LG&E and KU have earmarked for advertising. While the AG supports education on energy efficiency, he considers this level of advertising cost excessive. Beside the fact that he believes that LG&E and KU receive some benefit from the advertising, the AG argues that the existing programs have been in existence for nearly a decade and consumers should be aware of their existence at this point.[3] The AG therefore believes that either the level of cost should be lower or there should be some sharing of the costs between ratepayers and shareholders.

In reviewing the modification proposed by the companies in the mechanism, the AG expressed concern over the proposed change in the incentive calculation. The AG

[2] AG's Amended Comments filed November 16, 2007, at 29.

[3] Id. at 31.

notes that while changing the incentive calculation does not change the incentive earned for most of the programs, it does increase the incentive collected under the Responsive Pricing Pilot Program, the Residential HVAC Diagnostics & Tune-up Program and the Program Development and Administration ("PDA").[4] The AG believes that an incentive is inappropriate for the Responsive Pricing Pilot Program and Program Development and Administration. He also notes that an incentive was not included as part of the budget approved in Case No. 2007-00117,[5] in which the Commission approved the Responsive Pricing Pilot. As for the Program Development and Administration incentive, the main purpose of the program is to capture costs associated with development and administration of Energy Efficiency programs that are difficult to assign to an individual program. Because some of the costs included in this category are too remote to provide any direct benefit to ratepayers and in some cases benefit the companies rather than the ratepayers, the AG believes that the costs but not the incentive should be recovered from ratepayers.[6]

The AG takes issue with another component of the mechanism, the recovery of revenue from lost sales. The AG argues against this component although LG&E and KU have not proposed any change to it and the lost sales component is authorized by statute. The AG believes it is debatable whether these DSM programs actually reduce

[4] Response of LG&E and KU to the Second Data Request of Commission Staff dated September 21, 2007.

[5] Case No. 2007-00117, Application of Louisville Gas and Electric Company for an Order Approving a Responsive Pricing and Smart Metering Pilot Program (Order dated July 12, 2007).

[6] AG's Amended Comments, filed November 16, 2007, at 33.

sales. The AG notes that while this component was originally designed to compensate for the lowering of overall demand and load and the resulting lost sales, an examination of the projections provided by LG&E and KU show that overall demand and load are increasing, rather than decreasing. The AG argues from this information that both companies expect their sales to increase and that while DSM programs may slow the increase in customer demand, there are no lost sales and LG&E and KU should not be allowed to recover this cost in its DSM cost recovery mechanism.[7] The AG also notes that any reduction in customer sales is offset by sales of excess capacity into the wholesale energy markets which recoups the costs of generation, resulting in no lost sales.

On November 26, 2007, LG&E and KU filed responsive comments to the AG's general comments. LG&E and KU argue against the criticisms raised against its proposal, stating that the programs show benefits using the Commission approved and industry accepted benefit-cost tests, found in the California Standard Practice Manual. LG&E and KU also objected to the AG's assertion that the proposed programs do not result in lost revenues. The companies point out that KRS 278.285 specifically allows for the recovery of lost sales. LG&E and KU argue that overall sales can still increase while the increase is reduced by the lost sales from the DSM programs. In addition, LG&E and KU point out that they have requested recovery of lost sales for only 36 months, rather than the full 7-year period. As for the AG's argument against an incentive for some of the programs, LG&E and KU believe that the incentive is supported by Commission precedent and the legislation that allows the DSM incentive in order to encourage companies to operate against their own interest.

[7] AG's Amended Comments, filed November 16, 2007, at 35.

LG&E and KU believe that the AG has misconstrued the purpose of the program designed to reduce the load on the system. The companies argue that any load reduction will remain in the system despite any new generation or future demand it may experience. In response to the AG's statements regarding the level of education and advertising activity and expense, LG&E and KU argue that these are especially needed in Kentucky because of the low energy costs and the significant potential for energy efficiency. Finally, LG&E and KU address the modifications proposed by the AG in various specific programs. The companies believe that the AG's proposals would create barriers to participation or reduce the programs' effectiveness. LG&E and KU urge the Commission to approve the programs as proposed. In defending the companies' DSM proposal, LG&E and KU discuss House Bill 1, the legislation recently enacted by the General Assembly of Kentucky to deal with energy policy.[8] The thrust of that legislation is to avoid building new generation by using cost-effective DSM programs to reduce increasing demand and energy usage. The companies argue that their proposal projects a reduction in demand that addresses the issues raised in House Bill 1.

Concerning lost sales, LG&E and KU have correctly noted that KRS 278.285 specifically allows for recovery of lost sales. The AG bases his argument that LG&E and KU are not experiencing lost sales by referencing the increase in overall sales. He also notes that the companies will experience an increase in generation in the future. This argument does not recognize the fact that when a customer employs a DSM program to reduce usage, then LG&E and KU have lost the difference between the

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[8] *http://www.lrc.ky.gov/record/07S2/HB1.htm.*

revenue that would have been charged on the full usage and the revenue they collected on the lower usage. Increases will occur on LG&E and KU's systems, for example as customers are added to the system, regardless of the implementation of DSM programs. The Commission agrees with the companies that they are experiencing lost sales through the DSM programs and that the recovery should continue in the mechanism as the statute allows.

Concerning the proposed change in calculating incentives, LG&E and KU propose to use the calculation for the Load and Education programs, programs which do not show any measurable savings for the customer, and therefore the proposed change is calculated by 5 percent of the cost of the program. The proposed change allows LG&E and KU to recover $155,205 more per year than it does under the current incentive system.[9] The AG argues that it is inappropriate to have an incentive under three of the four programs which show an increase under the proposal. On this issue the Commission does not find LG&E and KU's arguments persuasive and therefore agrees with the AG and finds that the incentive mechanism should continue in its current form.

Concerning the increased costs of the DSM program, the Commission believes LG&E and KU have offered an appropriate response to the increased emphasis on DSM. KRS 278.285 requires that the recovery of the full costs of DSM programs, including lost revenues and incentives, are to be borne by ratepayers. While ratepayers will be bearing a larger cost due to the expansion and addition of programs, they will

[9] Response of LG&E and KU to Second Data Request of Commission Staff dated September 21, 2007.

benefit in that LG&E and KU will be able to delay the addition of new generating resources.

SPECIFIC PROGRAM COMMENTS AND CRITICISMS

The AG addresses each program individually in his amended comments, arguing against many of them based on the cost structure or the lack of benefit to the ratepayers and suggesting modifications of other programs. He does, however, recommend that the Commission approve the application but order the companies to incorporate the suggestions and modifications he has proposed for each program.

Each program is discussed individually below along with the AG's comments, LG&E and KU's response and the Commission's findings. KIUC, KACA and CAC have no positions on the programs, other than that discussed in the settlement agreement on the WeCare program.

Existing Programs

Residential Conservation. Currently, this program offers a residential customer a visit from a qualified energy audit professional for a payment of $15. The inspector then produces a report for the homeowner with a set of energy efficiency recommendations. LG&E and KU propose to modify the program by adding a free audit option that customers can access on-line or via telephone and by increasing the cost of the in-home audit to $25.

The AG believes that the on-line audits are a cost effective tool but is concerned that the proposed $25 fee for the in-home audit is too low. The AG notes that the increase in the fee still does not recoup much of the $200 it costs LG&E and KU to perform the in-home audit. Analysis of the program from past years shows that while customer participation rates were high, there was little implementation of the recommendations by customers, especially if it required extra effort and/or capital. The low implementation rate produces little in savings to offset the cost of the audit. The AG also objects to several items included in the budget for this program. The AG questions the $7,000 budgeted for office supplies and expenses. He suggests that it should be disallowed since LG&E and KU already include $49,000 for office supplies and equipment in the PDA. The AG argues that the $656,922 allocated for program advertising should be reduced since the program has been offered since 1998 and customers should already be aware of it.

LG&E and KU, in their responsive comments, state that they are not strongly opposed to increasing the charge but note that the program is cost effective even with a charge of $25 per audit. The companies are attempting to keep the cost low in order to encourage a broad array of customers to participate. In response to the AG's recommendations regarding the $7,000 in office supply costs, LG&E and KU respond that the costs are the supplies needed for the program over the 7-year period. The supplies included in the PDA are for costs associated with the implementation of the entire portfolio of programs. The companies also argue against reducing the advertising budget since promotion is still needed even though the program is not new. They point out that program details change and customers change within the customer base.

The Commission is not persuaded by the AG's arguments concerning the cost of the in-home audit. While he argues that the proposed $25 charge is too low, he does not provide any evidence concerning what the optimal charge should be or the impact on the program if the audit cost were higher. The Commission believes the proposed charge of $25 is reasonable.

The Commission is persuaded by LG&E and KU's arguments that the office supply costs are different within the budgets of the program and the PDA. The PDA costs are not easily identified with one program or are common to all programs and should be budgeted for differently than for the individual programs. As for the advertising budget, continued advertising is needed to remind customers that a program still exists. In addition, explaining the details of the program as well as educating new customers are valid reasons to continue to advertise.

Residential and Commercial Load Management. This program is designed to reduce peak demand and energy usage by installing load control devices on residential and commercial customer equipment. Commonly targeted equipment includes air conditioners, heat pumps, electric water heaters and pool pumps. Load is reduced during periods of high usage by cycling the equipment on and off. Currently, LG&E and KU report that summer peak demand has been reduced in excess of 107 MW. Historically, LG&E and KU have controlled load in this manner on average 11 days per year. Customers are compensated in one of two ways. Customers can elect to receive: (1) a bill credit during the summer months or (2) a programmable thermostat with no bill credit. Although LG&E and KU will see a reduction in peak demand on days when the equipment cycles, any energy savings experienced are later given back when individual units must run longer in order to bring the temperature back to the desired level. This program targets one of the main drivers of summer peak, which is air conditioning, and helps delay the need for future generation capacity. It also provides the companies with an additional tool in emergency situations by allowing them to rapidly shed load.

The AG argues that while the program has some benefit to the companies, it offers no benefits to the customer, referring to the companies' statement that any energy savings experienced under this program are given back later. He further states that LG&E and KU supplied data that shows that overall demand and load projected is forecasted to increase each year, rather than decreasing as the program should do. Finally, he states that if the program were truly needed by the companies, they would utilize it more than an average of 11 times a year. The AG states that while the program may have an effect on capacity, the impact would merely shift the required increase in generation capacity to a later date and would not eliminate demand increases. He points to five combustion turbine units that are planned for and additional 740 MW set to be installed between 2015 and 2018 and another 750 MW coal unit planned for 2019 in support of his argument. As a final concern, the AG notes LG&E and KU's reserve capacity, which any savings would increase and allow the companies to generate more off-system sales. Finally, the AG is concerned about the program cost which he believes is not cost effective from a ratepayer standpoint. According to the AG's calculations, the program consumes around 40 percent of the DSM budget while generating only 3.7 percent of the savings. The AG's recommendation is that the program be discontinued as expeditiously as possible.

LG&E and KU responded to the AG's critique of this program by stating that his comments demonstrate a clear lack of understanding of capacity savings and related benefits and of the misunderstanding of the proper benefit-cost analysis of DSM programs. The companies state that the proper analysis is the four traditional, industry standard, and Commission utilized cost-benefit tests, also known as the California Tests. Of all the programs, these tests are most favorable for this program. LG&E and KU note that this program provides permanent demand reductions as long as the program is in effect and can be done with the flip of a switch. This program gives the companies a degree of control over a known quantity of demand which ensures that they do not have to build or acquire capacity to serve incremental load.

The Commission finds that the California Tests show that these programs are cost effective and do provide load reduction and reduce the need for adding additional capacity for time of peak load and should continue as proposed.

WeCare. This program provides free home energy audits and weatherization to qualified low income customers. Eligible households are those at or below the Low Income Home Energy Assistance Program ("LIHEAP") federal poverty guidelines. KACA and CAC disagreed with LG&E and KU over certain administrative issues related to WeCare.

The parties were able to reach a settlement on the WeCare program. Pursuant to the Settlement Agreement, among other things, LG&E and KU will contract with KACA to perform intake for the WeCare program at a reasonable price reflecting the economies of scale and scope available to KACA due to its operation of the U.S. Department of Energy Weatherization Assistance Program and the federal LIHEAP. LG&E and KU also agreed to contract with KACA to perform audits necessary for the WeCare program at a reasonable price. With respect to the weatherization work, the parties agreed that LG&E and KU will conduct a reasonable Request For Proposal process to ensure that they prudently choose the best WeCare program weatherization vendor looking at factors such as quality, experience, certification of staff, ability to coordinate with existing programs, and cost. All parties also agreed that the use of engineered savings with a billing analysis component is a reasonable and appropriate means of evaluating the efficacy of energy efficiency measures implemented by the WeCare program.

The Commission finds the settlement agreement reasonable and that it should be accepted.

Commercial Conservation. This program offers free energy audits to commercial customers and attempts to increase implementation rates by offering an energy efficient new technology equipment incentive for replacement of aging, less efficient equipment. The program offers rebates upon verification and proof of purchase and installation of the new measures. LG&E and KU propose to modify the program by expanding the levels of audits from three to five. Walk through and light commercial audits will be added for small commercial customers. The focus will be prescriptive measures such as lighting, water heating, air conditioning, HVAC tune-up and other measures that are cost effective, easily identified and analyzed. LG&E and KU will further modify the program to include additional contractor participation. The program will establish a dealer referral network which will assist participants of all energy efficiency programs in selecting qualified energy service companies who can implement the recommended measures. The program is designed to reduce demand and energy usage. The program will add a rebate component to increase implementation rates.

The AG believes that this program is a reasonable use of ratepayer funds but believes that the participants should be required to pay a fee similar to that paid in the residential conservation program. He suggests that the fees collected could help offset and lower the overall cost to ratepayers. He recommends approval of the program with the above-mentioned modification.

LG&E and KU oppose charging a fee for this service. The companies believe that such a fee would create a barrier to participation in the program since the audit takes place during business hours, thereby interrupting the customer's business. They believe that this inconvenience will prevent frivolous use of this program.

The Commission is persuaded by LG&E and KU's concerns regarding how a fee might hamper getting companies to participate and find that the program should be approved as proposed.

New Programs

Responsive Pricing and Smart Metering Pilot. This program was approved as a pilot program by the Commission in Case No. 2007-00117. The goal of the program is to determine customers' ability and willingness to shift usage from higher demand and higher cost time periods to lower demand and lower cost time periods. The program will test various combinations of equipment and variable rate structures to encourage shifting. Various combinations of equipment without the rate incentive will also be tested. The program will use smart metering, information displays, programmable thermostats, load control switches, and a variable rate structure, which includes time-of-day use and real-time critical peak price components. Although previously approved by the Commission, LG&E and KU included this program to provide a full and complete picture of all their DSM programs.

Residential High Efficiency Lighting. The objective of this program is to encourage customers to switch from purchasing incandescent light bulbs to compact fluorescent light bulbs ("CFL"). The companies plan to increase customer awareness of environmental and financial benefits of CFLs, thereby increasing societal acceptance and market penetration. LG&E and KU will partner with retail outlets to provide incentives to place 5.8 million Energy Star rated CFLs over the next 7 years. LG&E and KU will provide coupons good for a $1 discount on standard CFL bulb replacements and a $2 discount for CFL flood replacements. The companies will mail the coupons to customers along with educational materials several times a year. The coupons will be good at certain retailers who will capture sales information and report it to the companies. Educational materials will also be available from the retailers participating in the program.

The AG is concerned that the promotional costs begin at around 50 percent of the yearly budget and increase over the life of the program to 70 percent of the program budget. The amount for consumer rebates, on the other hand, decreases from 30 percent of the budget to 24 percent. LG&E and KU have stated that this is because only the promotional expense has been adjusted for inflation over the 7-year period of the program. The AG states that it is unclear how spending more on advertising than on the rebate will accomplish the goal of the program. During discovery, the AG had questioned whether it would cost less to just mail each customer a CFL. LG&E and KU agreed that it would cost less to do this, but the companies could not be assured that the customer would actually use the bulb. The AG recommends approving the program but also recommends that the Commission require LG&E and KU to evaluate direct mailing of the bulbs as a more cost effective use of ratepayer dollars.

LG&E and KU accept the AG's recommendation and upon Commission approval will evaluate the cost effectiveness of mailing each residential customer a CFL instead of a coupon and promotional expenses. As for the AG's objections to the budgeted amount for advertising, the companies expect a drop in the customer response rate as the market becomes more saturated with CFLs. The promotional expenses stay flat because of the plan to mail a $1 or $2 coupon to each customer four times a year. They expect the use rate of the coupons to fall each year producing the change in the relationship between the budgeted amounts noted by the AG.

The Commission finds that LG&E and KU should further evaluate the cost effectiveness of mailing the bulbs rather than coupons. The Commission further finds that LG&E and KU should notify the Commission of the results of its evaluation and employ that result in its implementation of this program.

Residential New Construction. The goal of this program is to reduce residential energy usage through creating a shift in builders' new home energy efficient construction practices. Energy Star statistics indicate that builder penetration and customer participation in the Energy Star program is low in Kentucky. The companies plan to educate builders, contractors and customers on the environmental and financial benefits of whole-house energy efficient building practices. LG&E and KU will partner with homebuilders associations in Kentucky to adopt and implement the Department of Energy's Energy Star new homes energy efficiency program. Selected National

Association of Home Builders' approved green building methods may also be included to further impact the environment and reduce carbon dioxide emissions. The companies hope to increase the participants in this program, since some of the opportunities to save energy are lost once the home is built.

The AG recommends that the program be designed to encourage and assist homebuyers in the purchase of energy efficient homes rather than have the companies encourage the building of these houses and to provide support, training and infrastructure to develop the necessary number of Energy Star inspectors. He further states that it is hoped over time that the public will want Energy Star homes and that the companies will no longer need to provide incentives.

LG&E and KU note that this program passed the Participant, Utility Cost and Total Resource Cost tests. The companies agree to evaluate the AG's recommendation to provide incentives to homebuyers to purchase Energy Star compliant homes but believe, however, that the issue is more one of supply rather than demand. They note that encouraging the building of these homes by ensuring a sufficient supply of inspectors is necessary to make sure that there is both a supply and demand for these types of homes. The Commission finds LG&E and KU's arguments persuasive and finds that the program should be approved as proposed.

Residential and Commercial HVAC Diagnostics and Tune Up. The program is designed to reduce peak demand and energy use by conducting a diagnostic performance check on residential and small commercial air conditioning and heat pump units, air restricted indoor and outdoor coils, and over- and under-refrigerant charge. Units with any of these problems will be eligible for corrective action through an

Authorized Dealer Network. Not every customer will be targeted in this program, only those with probable HVAC system performance issues. Customers can seek help individually or they may be referred through other LG&E and KU DSM programs which identify an underperforming unit. Correcting these problems is expected to decrease run times, reduce excess energy consumption, and demand and increase unit life. Customers will be charged the following fees for the service:

	Fee	Full Cost to Utility
Diagnosis		
Residential	$35	$125
Commercial	$50	$200
Repairs		
Residential	$50	$200
Commercial	$100	$300

The program will subsidize the unpaid portion of diagnostic and tune-up costs. The contractor who diagnoses the problem will not be the same contractor who repairs the problem.

The AG argues that the customer should be held accountable for more of the true cost of the service. He believes that the companies could still offer a discount, which would benefit the customer, yet would create a more cost effective program. He therefore recommends approval of the program, but suggests that participants be given a discount of 25 to 33 percent rather than only paying 25 to 33 percent of the true cost.

LG&E and KU responded that its proposal discounts those services that will induce customers to actually use the services offered. The companies will monitor the level of participation associated with these discounted services. If it appears that the participation levels will continue as a lower discount, the companies will adjust the discount.

The Commission agrees with LG&E and KU that the discount is needed to entice customers to use the services and therefore finds that that the program should be approved as proposed.

Customer Education and Public Information. The objective of this program is to increase public awareness and understanding of the need for more efficient use of energy as well as the environmental and financial impacts from climate change issues. LG&E and KU also aim to increase customers' awareness of energy efficiency products and services. The program includes an educational component for elementary and middle school students. No incentives will be paid under this program. The educational materials will be disseminated through schools, printed information, and mass media advertisements. There are no discernable energy savings associated with this program.

The AG agrees that it is important to educate the public on energy and climate issues but questions the reasonableness of using a dedicated employee specifically for the purpose of school outreach, as LG&E and KU have proposed. He questions the effectiveness of a child's influence over parents' energy decisions. The AG also questions whether the advertising also benefits the shareholders since the advertising creates goodwill for the companies as well as educating the public. The AG recommends reducing the advertising budget of these programs but does not suggest by how much. He also recommends having the shareholders share in the costs of the proposed advertising.

LG&E and KU argue that the proposed educational costs are needed for the success of the whole portfolio of the proposed DSM programs. The companies note that this program is cost effective when these costs are factored into the cost of the entire portfolio of programs, rather than separately.

The Commission finds that education is necessary to ensure the success of the entire proposal and finds that the program should be approved as proposed.

Dealer Referral Network. LG&E and KU plan to establish and maintain a Web-based Dealer Referral Network ("Network") to deliver services to program constituents. It will assist customers in finding qualified and reliable personnel to install energy efficiency improvements recommended by other energy efficiency programs, identify energy-related subcontractors for contractors seeking to build energy efficient homes or improve energy efficiency of existing homes and fulfill incentives and rebates. LG&E and KU hope to improve the implementation rate for its programs with this program by helping customers find qualified personnel and by making the payment of incentives simple and timely. There are no customer incentives with this particular program. The Network will be maintained by a contractor who will establish the database sorted by the type of work they perform.

The AG supports the program and recommends approval, but strongly suggests that the Commission require LG&E and KU to vigilantly maintain the proposed oversight procedures to ensure that any contractors failing to meet licensing or other requirements are removed in a timely fashion. The AG further believes that the Commission should require LG&E and KU to notify customers using the Website that they are not endorsing or recommending any of the firms listed on the site and they are not guaranteeing the quality of the work or accepting liability for the work.

LG&E and KU agree with the AG's recommendation and will take steps to ensure that the dealer referral Website prominently displays the appropriate disclaimers.

The Commission finds that the program should be approved with the AG's recommendations incorporated into the program.

Program Development and Administration. This is a support program that captures development costs, administrative costs and functions that are common to all energy efficiency programs. This category was developed due to the difficulty in determining an exact allocation to individual programs or rate classes; therefore, these costs will be allocated to each rate class. Typical costs included in this category are:

- Consultant cost for new program concept and initial design
- Market research related to new programming
- Research and technical evaluation of new technologies and programs
- Overall program tracking and management
- Attendance at Energy Efficiency/DSM conferences and workshops
- Development of key personnel
- Membership in associated trade organizations
- Subscriptions to educational and trade publications
- Office supplies and equipment related to general management of the organization

Program development costs will be accrued into this program's administrative budget until they are incorporated into pilot or full scale program offerings submitted in subsequent filings.

The AG argues that some of the costs in this program, such as consultant costs for new program concept and initial design, research and technical evaluation, are too remote to provide any direct benefit to ratepayers and therefore the costs associated with these activities should be disallowed. He further argues that some of the other proposed activities benefit the companies rather than the customers. Personnel development, workshop and conference attendance, and membership in trade organizations and subscriptions primarily benefit the companies and therefore should also be disallowed. He also fears that costs included in this program, such as market research and office supplies, are already included in the other programs' budgets and therefore these costs may be duplicative. He urges the disallowance of these costs unless the companies can provide justification for their inclusion.

LG&E and KU note that the costs in this program have always existed and they disagree that most of the costs should be disallowed. They argue that these costs are needed to grow and manage existing DSM programs and to develop new ones. Costs already recovered in the current program, such as management costs, will be included in this category and will help sustain the full DSM portfolio. LG&E and KU disagree with the AG's characterization of the costs as "remote," since they are key to the development of new energy efficiency technologies and future DSM programs that will benefit customers. Other costs objected to by the AG, such as personnel development, memberships in trade associations, and subscriptions to trade publications, are necessary to the ongoing development of new programs. LG&E and KU addressed the costs that the AG feared were recovered both in other programs and in this one, such as market research and office supplies, by noting that the costs in specific programs are related to tasks and supplies for that program, while the similarly named costs in this program will apply to future programs or are common to all programs. Therefore, the costs are not duplicative.

The Commission finds LG&E and KU's arguments persuasive and finds that the program should be approved as proposed.

IT IS THEREFORE ORDERED that:

1. The proposed modification of the incentive mechanism is denied. The incentive mechanism shall continue in its current form.

2. With the exception of the incentive addressed above, LG&E and KU's revised DSM Tariff and the revised DSM surcharge factors are approved effective as of the date of this Order.

3. The settlement agreement in the Residential Low Income Weatherization is approved.

4. In the Residential High Efficiency Lighting program, LG&E and KU shall evaluate the cost effectiveness of mailing the light bulbs rather than mailing a coupon, implement the most cost effective method, and notify the Commission as to the results of the evaluation.

5. The Dealer Referral Network program, incorporating the AG's modifications, is approved.

6. All of the other DSM programs are approved as proposed.

7. Within 20 days from the date of this Order, LG&E and KU shall file a revised DSM Tariff showing the date of issue and that it was issued by authority of this Order.

Done at Frankfort, Kentucky, this 31st day of March, 2008.

By the Commission

Commissioner Clark Abstains.

ATTEST:

Stephanie Stumbo

Executive Director

Case No. 2007-00319

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2007-00319 DATED MARCH 31, 2008

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 17th day of January 2008, by and between the Office of the Attorney General of Kentucky by the Office of Rate Intervention ("Attorney General"); Kentucky Utilities Company ("KU"); Louisville Gas and Electric Company ("LG&E") (collectively, KU and LG&E are the "Companies"); the Community Action Council for Lexington-Fayette, Bourbon, Harrison, and Nicholas Counties, Inc. ("CAC"); the Kentucky Association for Community Action, Inc. ("KACA"); and the Kentucky Industrial Utilities Customers, Inc. ("KIUC").

W I T N E S S E T H:

WHEREAS the Attorney General, the Companies, CAC, KACA, and KIUC (collectively, "Parties") are parties to a proceeding before the Kentucky Public Service Commission ("Commission"), Case No. 2007-00319, regarding the Companies' application for approval of a portfolio of energy efficiency and demand-side management programs, including a low-income weatherization program commonly known as "WeCare";

WHEREAS, on December 19, 2007, the Commission issued an order in which it "encourage[d] the parties to see if the matter can be settled before the hearing date";

WHEREAS the Companies, CAC, KACA, and KIUC desire that the Commission approve the WeCare program as-filed, subject to the following agreements and conditions; and

WHEREAS the Attorney General does not wish to prejudice his stated position that the WeCare program should not be approved; however, if the Commission determines to approve such a program, the Attorney General desires that the following agreements and conditions should apply to ensure the efficient and effective administration of the program.

NOW, THEREFORE, for and in consideration of the agreements and conditions set forth herein, the parties hereby agree as follows:

Article 1 **Intake of Customers into the WeCare Program**

1.01 KACA, as operator of the U.S. Department of Energy Weatherization Assistance Program ("WAP") and the federal Low-Income Home Energy Assistance Program ("LIHEAP"), has access to certain information concerning applicants for the WeCare program not in the Companies' possession. Because KACA must perform intake processes for the WAP and LIHEAP programs, and to achieve efficiencies and to avoid duplication, the Companies will contract with KACA to perform intake for the WeCare program at a reasonable price reflecting the economies of scale and scope available to KACA due to its operation of the WAP and LIHEAP programs.

Article 2 **Home Energy Efficiency Audits**

2.01 KACA, a network of community action agencies, and one unit of local government, as operators of the WAP program, currently perform home energy efficiency audits using an industry-recognized and -approved tool, the National Energy Audit Tool. The WeCare program, as it currently is being implemented, also performs such audits. Without coordination between the two programs a single home can receive more than one audit in a relatively short period of time, causing wasteful duplication and inefficiency. To eliminate redundant audits and to avoid wasteful duplication and associated inefficiency that would result if the WAP and WeCare programs continued to perform separate audits, the Companies will contract with KACA to perform the audits necessary for the WeCare program at a reasonable price. The Companies and KACA agree that the cost to WeCare of audits performed will be fairly and reasonably allocated between the WeCare and WAP programs.

2.02 The energy education component of the WeCare program, conducted during energy efficiency audits, shall be conducted by KACA and its agents or subcontractors, including community action agencies and branches of local government. The cost of such energy education performed during audits shall be fairly and reasonably allocated between the WeCare and WAP programs.

Article 3 **Conducting Weatherization Work**

3.01 The Companies will conduct a reasonable Request for Proposals ("RFP") process to ensure that they prudently choose the best WeCare program weatherization vendor looking at several factors such as quality, experience, certification of staff, ability to coordinate with existing programs, and cost.

3.02 The Companies will include in the RFP a requirement that the successful bidder will have all work performed by certified weatherization measure installers, or that the provider will ensure that its installers will obtain certification within a reasonable period of time after the provider receives the WeCare weatherization work contract. For purposes of the RFP, evidence of certification may be provided by (1) Kentucky Cabinet for Health and Family Services, (2) a program the Kentucky Cabinet for Health and Family Services agrees is an equivalent, or

(3) by another state's certification program to perform weatherization services under the Federal Weatherization Assistance Program.

3.03 The RFP will include a requirement that the successful bidder will coordinate and share information with KACA and other responsible community action agencies to ensure the greatest reasonable degree of coordination between, and therefore effectiveness of, the WeCare and WAP programs.

Article 4 **<u>Evaluation of the WeCare Program</u>**

4.01 All Parties agree that use 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 implemented by the WeCare program.

4.02 Concerning dwellings in which energy efficiency measures are installed with funding from both the WeCare and WAP programs, the energy savings created by such measures will be fairly and reasonably allocated between the programs.

Article 5 **<u>Additional Requirements of the WeCare Program</u>**

5.01 Insofar as it performs intake or audit work for the WeCare program, KACA agrees to all of the following conditions:

- Work must meet energy efficiency, budgetary, and cost effectiveness goals set out in the Companies' application in this proceeding;
- Work may be coordinated with, but must be operated and accounted for separately from, other weatherization assistance programs;

- Work may serve LG&E and KU residential customers only;
- KACA must meet all reporting requirements of the Companies;
- KACA must be subject to Company-initiated audits to ensure appropriate utilization of and accounting for funds, including audits to ensure appropriate cost allocations between the WeCare and WAP programs; and
- Insofar as it is applicable, KACA must be subject to independent program evaluation initiated by the Companies.

Article 6 **<u>Attorney General's Position in this Case</u>**

6.01 The Attorney General is a signatory to this Settlement Agreement without prejudice his stated position that the WeCare program should not be approved; however, if the Commission determines to approve such a program, the Attorney General desires that the agreements and conditions contained herein apply to ensure the efficient and effective administration of the program and to avoid wasteful duplication.

Article 7 **<u>Hearing Request Withdrawal</u>**

7.01 CAC and KACA will withdraw their request for a hearing and agree to submit this Settlement Agreement as a full and complete settlement of the issues raised in this proceeding.

7.02 In accord with its previous statements, the Attorney General states that if the Commission approves this Settlement Agreement, there will be no need for a hearing and all remaining issues may be submitted for decision based on the record already developed in this proceeding. The Attorney General states also that this Settlement Agreement is not a complete resolution of all issues outstanding in this proceeding; rather, it is meant only to resolve the issues addressed herein, consistent with the Attorney General's position stated in Paragraph 6.01 above.

Article 8 Position of the KIUC

8.01 KIUC states that it has no objection to the merits of the Settlement Agreement, and otherwise takes no position on the Companies' application or the positions of record by the Parties.

Article 9 Additional Provisions

9.01 This Settlement Agreement shall in no way be deemed to divest the Commission of any jurisdiction under, or to supersede in any way, Chapter 278 of the Kentucky Revised Statutes.

9.02 This Settlement Agreement shall inure to the benefit of and be binding upon the parties hereto, their heirs, successors, and assigns.

9.03 The signatories hereto warrant that they have informed, advised, and consulted with the respective parties hereto in regard to the contents and significance of this agreement, and based upon the foregoing are authorized to execute this Settlement Agreement on behalf of the parties hereto.

9.04 This Settlement Agreement is a product of negotiation among all the parties, and no provision of this Settlement Agreement shall be construed in favor of or against any party. The signatories hereto agree that making this Settlement Agreement shall not be deemed in any respect to constitute an admission by any party hereto.

9.05 The signatories hereto agree that this Settlement Agreement constitutes the complete agreement and understanding among the parties hereto, and any and all oral statements, representations or agreements made prior hereto or contained contemporaneously herewith shall be null and void and shall be deemed to have been merged into this Settlement Agreement.

9.06 The signatories hereto agree that neither the Settlement Agreement nor any of its terms shall be admissible in any court or commission except insofar as such court or commission is addressing litigation arising out of the implementation of the terms herein or the approval of this Settlement Agreement. This Settlement Agreement shall not have any precedential value in this or any other jurisdiction.

9.07 All signatories hereto agree and affirm that the complete and total consideration for this Settlement Agreement is contained herein, and further attest that there has been no collusion in the negotiating or drafting of this Settlement Agreement.

***IN WITNESS WHEREOF*, the parties hereto have hereunto affixed their signatures.**

Office of the Attorney General of Kentucky by the Office of Rate Intervention

BY: ______________________
Dennis G. Howard II, Counsel

Kentucky Utilities Company and Louisville Gas and Electric Company

BY: ______________________
Kendrick R. Riggs, Counsel

Community Action Council for Lexington-Fayette, Bourbon, Harrison, and Nicholas Counties, Inc.

BY: ______________________
Joe F. Childers, Counsel

Kentucky Association for Community Action, Inc.

BY: ______________________
Joe F. Childers, Counsel

Kentucky Industrial Utilities Customers, Inc.

BY: Michael L. Kurtz / with permission Kendrick R. Riggs
Michael L. Kurtz, Counsel

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