STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF DUKE ENERGY INDIANA, INC. REQUESTING THE INDIANA UTILITY REGULATORY COMMISSION TO APPROVE AN ALTERNATIVE REGULATORY PLAN PURSUANT TO IND. CODE § 8-1-2.5-1, ET SEQ., FOR THE OFFERING OF ENERGY EFFICIENCY CONSERVATION, DEMAND RESPONSE, AND DEMAND-SIDE MANAGEMENT PROGRAMS AND ASSOCIATED RATE TREATMENT INCLUDING INCENTIVES PURSUANT TO A REVISED STANDARD CONTRACT RIDER NO. 66 IN ACCORDANCE WITH IND. CODE §§ 8-1-2.5-1 ET SEQ. AND 8-1-2-42 (a); AUTHORITY TO DEFER PROGRAM COSTS ASSOCIATED WITH ITS ENERGY EFFICIENCY PORTFOLIO OF PROGRAMS; AUTHORITY TO IMPLEMENT NEW AND ENHANCED ENERGY EFFICIENCY PROGRAMS, INCLUDING THE POWERSHARE® PROGRAM IN ITS ENERGY EFFICIENCY PORTFOLIO OF PROGRAMS; AND APPROVAL OF A MODIFICATION OF THE FUEL ADJUSTMENT CLAUSE EARNINGS AND EXPENSE TESTS	)	CAUSE NO. 43374

ADDITIONAL SUPPLEMENTAL DIRECT TESTIMONY AND EXHIBITS OF

J. RICHARD HORNBY

ON BEHALF OF

CITIZENS ACTION COALITION OF INDIANA. INC

JUNE 10, 2010

I. INTRODUCTION AND SUMMARY

Q. Please state your name, employer, and present position.

A. My name is J. Richard Hornby. I am a senior consultant at synapse energy economics, Inc., 22 Pearl Street, Cambridge, MA 02139.

Q. On whose behalf are you testifying in this case?

A. I am testifying on behalf of the Citizens Action Coalition of Indiana, Inc. ("CAC").

Q. Are you the same J. Richard Hornby who submitted direct and supplemental testimony in this proceeding?

A. Yes.

Q. What is the purpose of your additional supplemental direct testimony?

A. On April 15, 2010 Duke Energy Indiana, Inc. ("Duke Energy Indiana" or the "Company") submitted supplemental testimony of Theodore Schultz, Michael Goldberg and Stephen farmer in response to the march 26, 2010 order of the Indiana Utility Regulatory Commission ("Commission") granting petitions for rehearing. Their testimonies explain the effects of the commission order of February 10, 2010 in this cause and the Commission order of December 9, 2009 in cause 42693 ("Phase II order") on the August 15, 2008 settlement agreement between the Indiana Office of Utility Consumer Counselor ("OUCC") and Duke Energy Indiana ("OUCC Agreement"). They also compare the OUCC agreement to the save-a-watt proposals that have been approved in North Carolina, South Carolina and Ohio. The purpose of my testimony is to report on my review of the supplemental testimony of those three witnesses and present my conclusions based upon that review.

Q. Are you presenting any exhibits to support your Supplemental Direct Testimony?

A. Yes. I have prepared four exhibits to support my additional supplemental direct testimony:

Exhibit JRH-14	Comparison of 2013 Cumulative Electricity Reduction Targets as % of average 2007-2009 Weather Normalized Sales
Exhibit JRH-15	Duke Energy Indiana Pre-tax Performance Incentive under OUCC agreement vs Illustrative Vectren Electric per Phase II Order.
Exhibit JRH-16	Duke Energy Indiana Pre-tax Performance Incentive under OUCC agreement vs Duke Energy Carolinas.
Exhibit JRH-17	Duke Energy Indiana Pre-tax Performance Incentive under OUCC agreement vs Duke Energy Carolinas and vs Illustrative Vectren Electric per Phase II Order.

Q. What data sources did you rely upon to prepare your Supplemental Direct Testimony and exhibits?

A. In addition to the testimony and exhibits filed in the earlier phases of this proceeding I relied upon the Commission Orders of February 10, 2010 in this Cause, the Commission Order of December 9, 2009 in Cause 42693 (“Phase II Order”) and the Commission Order of December 16, 2009 in Cause 43427 (“Vectren DSM Order”). I also relied upon the Supplemental Testimony and exhibits of the Company witnesses filed on April 15, 2010 and their responses to data requests on that testimony. Finally, I relied upon the settlement agreements accepted by Duke Energy Carolinas and approved by the public utility commissions in its save-a-watt proceedings in North Carolina and South Carolina.

Q. Please summarize your conclusion regarding the OUCC Agreement based upon your review of those materials.

A. My conclusion is that key provisions of the OUCC Agreement are substantially inconsistent with the Phase II Order and the Vectren DSM order. This conclusion is based upon the following three points:

- Under the OUCC Agreement Duke Energy Indiana is proposing to achieve a cumulative level of electricity reductions that is approximately one-third the target the Commission established in the Phase II Order;
- Under the OUCC Agreement Duke Energy Indiana has the opportunity to earn shareholder incentives approximately twice as high as those the Commission approved in the Vectren DSM Order; and
- Under the OUCC Agreement the total amount the Company can collect to fund both its programs and its shareholder incentives is capped at $260 million. This cap is based on the levels of electricity reductions proposed under that Agreement and the estimated value of those reductions. The Company may have to request an increase in that cap in order to fund an expansion of programs to achieve the additional reductions needed to achieve its Phase II Order targets.

Q. Please summarize your recommendation regarding the OUCC Agreement based upon those conclusions.

A. I recommend that the Commission not approve the OUCC Agreement and that it direct he Company to file a new application to develop, implement and manage energy efficiency programs that will meet the Phase II Order target savings under a ratemaking framework that would, subject to Commission review, set revenue requirements enabling it to recover its actual incurred DSM program costs, address verified revenue erosion or lost revenues, and provide a shareholder incentive that is consistent with the target level of reductions in the Phase II Order and the incentive levels in the Vectren DSM Order.

II. COMPANY PERFORMANCE TARGETS AND COMPENSATION

Q. Please summarize the OUCC agreement.

A. Duke Energy Indiana entered the OUCC Agreement in August 2008. That Agreement established target levels of annual electricity reductions for a four year period as well as the manner in which the Company would be compensated for those programs. The compensation arrangement covered funding for program costs, a shareholder incentive and a limited decoupling mechanism, i.e., limited to recovery of revenues lost due to Company programs.

Q. Has Commission policy regarding energy efficiency evolved since Duke Energy Indiana entered the OUCC Agreement?

A. Yes. In December 2009 the Commission issued two Orders of particular relevance to the OUCC Agreement, the Phase II Order and the Vectren DSM order.

The Phase II Order, applicable to all jurisdictional electric and gas utilities in Indiana, establishes several specific policies regarding demand side management ("DSM"). In particular it establishes explicit annual electricity savings targets and it transfers responsibility for certain DSM programs, referred to as Core Programs, from individual utilities to an Independent Third Party Administrator ("TPA"). Individual utilities are left with the responsibility for all remaining DSM programs, which the Company refers to as Core Plus programs.

The Vectren DSM order, applicable to Vectren Energy Delivery of Indiana, approves specific DSM programs proposed by Vectren as well as compensation for those programs. In particular, the Vectren DSM order approves funding for program costs and a shareholder incentive for Core Plus Programs. That Order rejects Vectren's request for full decoupling but indicates the Commission's willingness to consider a request for a limited decoupling mechanism.

Q. Is the OUCC Agreement, as amended by the supplemental testimony of the company witnesses, consistent with the Phase II Order and the Vectren DSM Order?

A. No. The Company witnesses have proposed changes to the OUCC Agreement to reflect the assignment of Core programs to a TPA and to report income from shareholder incentives in their earnings reports. However, the key provisions of the OUCC Agreement relating to reduction targets as well as to compensation for program costs and shareholder incentives are not consistent with the Phase II and Vectren DSM orders.

(A) TARGET REDUCTIONS

Q. Please explain why the electricity reduction targets in the OUCC Agreement are not consistent with those in the Phase II Order.

A. The levels of electricity reductions that Duke Energy Indiana proposes to achieve under the OUCC Agreement, as amended by the February 10, 2010 Order, are approximately one-third of those established in the Phase II Order and thus not consistent with that Order.

The Company estimates that it would have to achieve a cumulative reduction of 697,137 MWh by 2013 to meet the target reductions set in the Phase II Order (Response NUCOR 4.1). That cumulative reduction is equivalent to 2.3% of the average of its 2007 to 2009 weather normalized annual sales of 30,382,452 (Response CAC 8.8). (The Phase II Order uses a baseline equal to a three year average, but for the purposes of comparing various targets in my testimony I will refer to annual sales in 2009). In contrast, the cumulative electricity reductions that Duke Energy Indiana proposes to achieve under the OUCC Agreement as amended by the February 10, 2010 Order is 247,181 MWh.[1] That

[1] The cumulative reduction of 210,104 MWh at a performance level of 85% presented in Response CAC 8.8 equates to 247,181 MWh at a performance level of 100%.

level of reduction is 0.8%, or 35 percent of the cumulative target established in the Phase II Order.

Those reductions reflect savings from Core programs in 2010, after which those programs will be transferred to a TPA, and from CorePlus programs in 2010 through 2013. Even if responsibility for Core programs had not been shifted to a TPA, the cumulative electricity reductions that Duke Energy Indiana had proposed to achieve under the original OUCC Agreement would have been 1.0%, or approximately 43 percent of the cumulative target the Commission established in the Phase II Order. While the Company does not know the reductions the TPA will achieve from Core programs in its service territory from 2011 through 2013 it is reasonable to assume that the Company will have to expand its CorePlus programs dramatically to achieve the Phase II Order targets.

It is also relevant to note that the Company's sister utilities have agreed to cumulative target reductions close to those in the Phase II Order. In response to CAC 8.1 the Company indicates that Duke Energy Carolinas agreed to a settlement under which its cumulative target reductions over four years are approximately 1.8% of its 2009 Baseline sales. This cumulative percentage reduction is comparable to 75% of the cumulative target established in the Phase II Order. Duke Energy Ohio agreed to a settlement under which its cumulative target reductions over three years are approximately 1.5% of its 2009 baseline sales, a cumulative reduction approximately equal to the three year cumulative target established in the Phase II Order.

Figure 1 below, which is drawn from Exhibit JRH-14, illustrates the relative levels of cumulative electricity reduction targets under the amended OUCC Agreement, the original OUCC Agreements, the save-a-watt settlement approved in North Carolina and South Carolina and the Phase II Order.

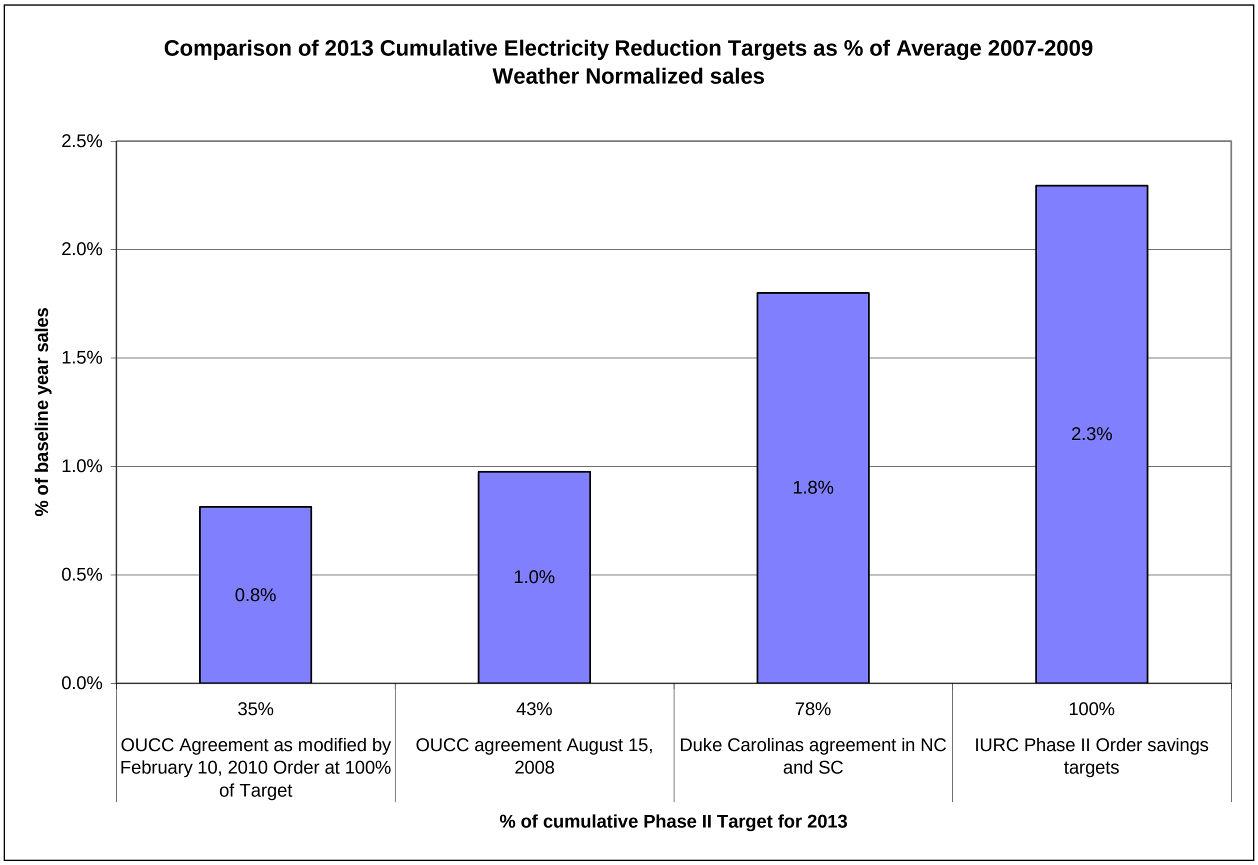

Figure 1

(B) PERFORMANCE INCENTIVES

Q. Please explain why the shareholder incentive provisions in the OUCC Agreement are not consistent with the Phase II and Vectren DSM Orders.

A. Under the OUCC Agreement Duke Energy Indiana has the opportunity to earn a shareholder incentive, also referred to as a management or a performance incentive. The incentive is an amount that it can earn on an after-tax basis. The incentive, expressed as a percentage of its DSM program costs, varies according to the reductions the Company actually achieves expressed as a percentage of a target level of reduction. The target level of reduction, which is expressed as the estimated dollar value of its electric energy and demand reductions over four years, is $260 million. The minimum incentive it can earn is an after-tax amount equivalent to 5 percent of program costs for actual reductions, or performance, between zero and sixty percent of that target reduction. The maximum incentive it can earn is an after-tax amount equivalent to 15 percent of program costs for actual reductions over ninety percent of its target reduction.

The shareholder incentive is inconsistent with the Phase II and Vectren DSM orders in several respects. First, the target level of reduction is expressed as a dollar value rather than as a physical reduction in MWh as in the Vectren DSM Order. Second, the physical reductions that the Company has projected are only approximately 35 per cent of the Phase II reduction target, as noted earlier. Third, the incentives that the Company can earn are much higher than those that Vectren could earn under the Vectren DSM Order, particularly if the target reduction level is set at the Phase II savings target.

The incentives that the Company can earn are much higher than those that Vectren could earn under the Vectren DSM Order because they are expressed as after-tax amounts rather than pre-tax amounts, and because the incentive tiers start and finish at higher percentages than those in the Vectren DSM Order. The levels of incentives under each approach are compared in the table below. For illustration purposes I have estimated the pre-tax value of the incentive under the OPUCC agreement assuming 100% equity and a 40 per cent tax rate, such that the pre-tax percentage equals the after-tax percentage divided by the equity portion multiplied by one minus the tax rate.

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Incentive Levels under OUCC Agreement versus Vectren DSM Order			
Performance Level (Actual Reductions as % of Target Reduction)	**OUCC Agreement Shareholder Incentive % of Program Costs received after-tax**	**OUCC Agreement Shareholder Incentive % of Program Costs received pre-tax (100% equity, 40% tax rate)**	**Vectren DSM Order Shareholder Incentive expressed as a % of Program Costs received pre-tax**
0-49	5	8	- 4
50-60	5	8	0
61 – 64	9	15	0
65 – 74	9	15	2
75 – 79	9	15	4
80 -89	12	20	4
90 – 99	15	25	8
100 – 120	15	25	12

Q. Please illustrate the implications of these inconsistencies.

A. The implication of these inconsistencies is that, under the OUCC Agreement, Duke Energy Indiana has the opportunity to earn higher levels of incentives at lower levels of electricity savings than a utility whose target is set at the level in the Phase II Order and whose incentive tiers are set at those approved in the Vectren DSM order. This inconsistency is illustrated by the two lines in Figure 2 below, which is drawn from Exhibit JRH-15.

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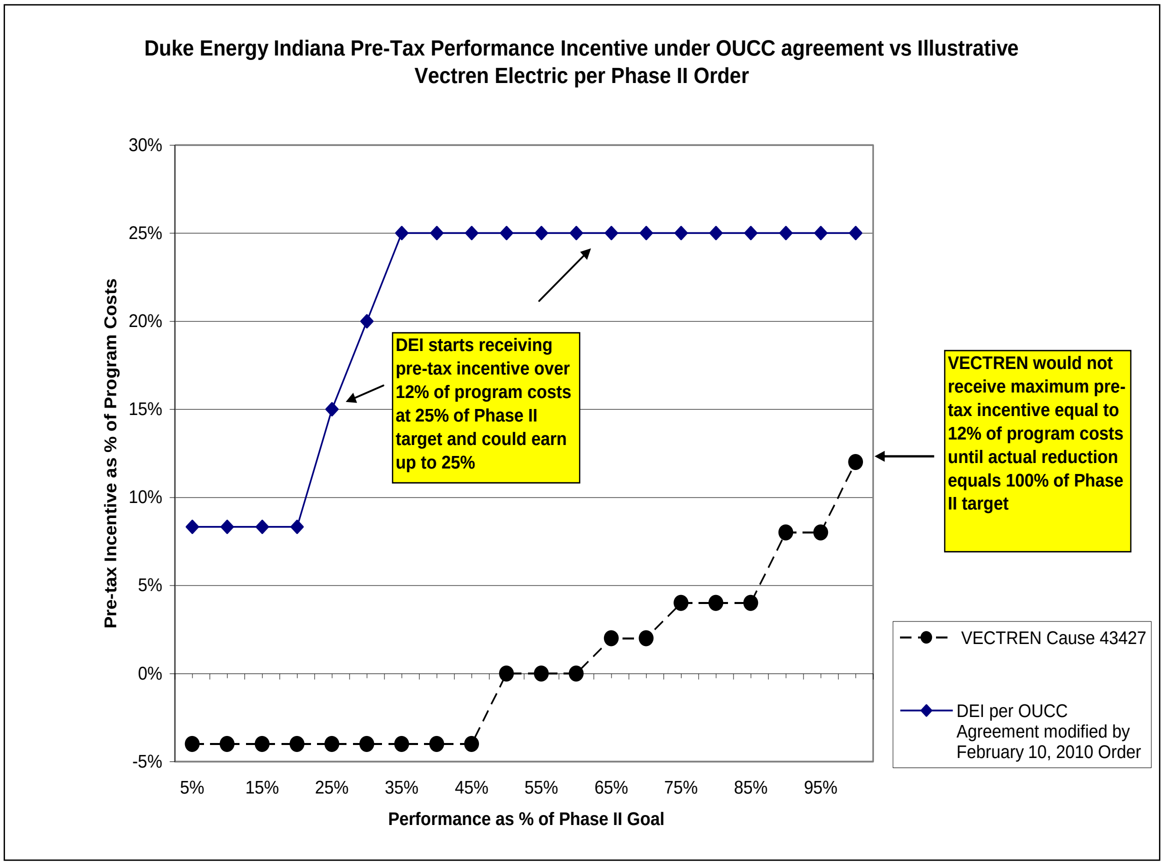


Figure 2

The top line, marked with diamonds, shows the levels of shareholder incentive that Duke Energy Indiana would earn at various levels of actual reductions expressed as a percentage of the Phase II target. The bottom line, marked with circles, shows the levels of shareholder incentive that a utility would earn according to the Vectren DSM Order tiers. This figure illustrates that the Company would not incur a penalty for failing to achieve any level of reductions. It would start earning a pre-tax performance incentive greater than 12% of program costs at reductions equal to approximately 25% of the Phase II target, and could earn a pre-tax incentive of 25% of program costs. In contrast, a utility operating under the Vectren DSM Order incentives and a Phase II savings target would incur a penalty at low levels of performance and would not earn its maximum pre-tax incentive of 12% of programs costs until achieving reductions equal to 100% of its Phase II Order target.

Q. Is the shareholder incentive provision in the OUCC Agreement consistent with the shareholder incentive provision in save-a-watt settlements approved in North and South Carolina?

A. No. The OUCC Agreement shareholder incentive structure has the same set of tiers as the settlement agreements in North Carolina and South Carolina. However, the OUCC Agreement shareholder incentive has a target level of reduction that is less than half of the reduction targets set in the save a watt proceedings in those two states. As a result, under the OUCC Agreement Duke Energy Indiana has the opportunity to earn higher levels of incentives at lower levels of electricity savings than Duke Energy Carolinas.

The difference between the two sets of incentive structures is illustrated by the two lines in Figure 3 below, drawn from Exhibit JRH-16.

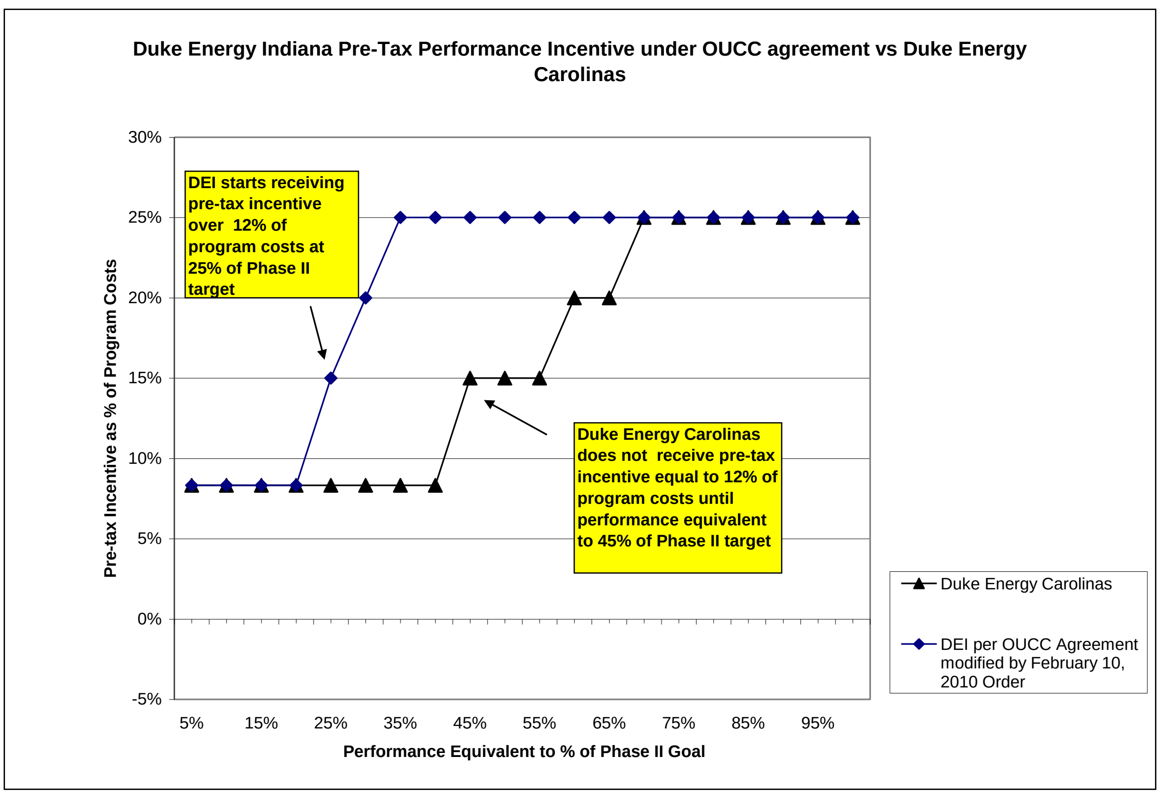


Figure 3

The top line, marked with diamonds, shows the levels of shareholder incentive that Duke Energy Indiana would earn at various levels of performance expressed as actual reductions as a percentage of the Phase II target. The bottom line, marked with triangles, shows the levels of shareholder incentive that Duke Energy Carolinas would earn.

This figure illustrates that the Company would start earning a performance incentive of 15% of program costs at reductions equal to approximately 25% of the Phase II target. In contrast, Duke Energy Carolinas would not start earning that level of incentive until achieving reductions equivalent to 45% of the Phase II Order target.

Q. Please illustrate the potential net result of these inconsistencies with Indiana orders and save-a-watt orders in the Carolinas.

A. The net result of these inconsistencies is shown in Figure 4 below, drawn from Exhibit JRH-17.

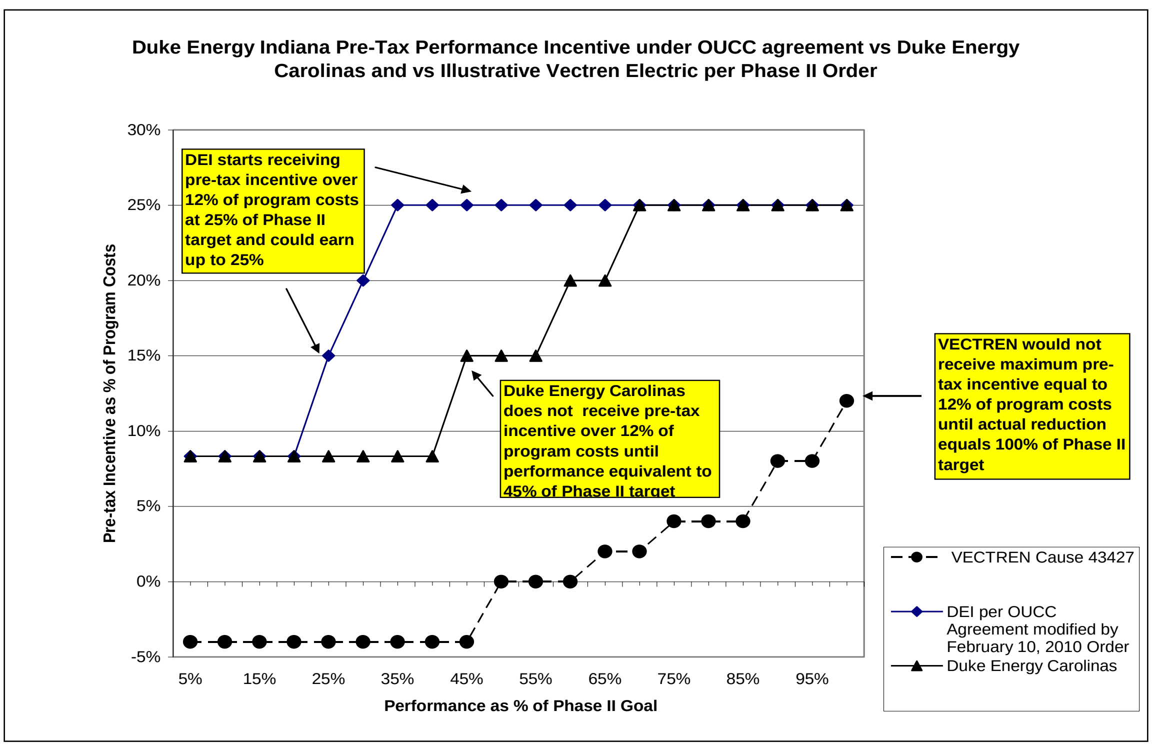


Figure 4

The top line, marked with diamonds, shows the levels of shareholder incentive that Duke Energy Indiana would earn at various levels of performance expressed as actual reductions as a percentage of the Phase II target. The middle line, marked with triangles, shows the levels of shareholder incentive that Duke Energy Carolinas would earn. The bottom line, marked with circles, shows the levels of shareholder incentive that a utility would earn according to the Vectren DSM Order tiers and the Phase II Order savings target.

Q. Did you identify the performance incentives under the OUCC Agreement as being high relative to the target levels of reductions in your supplemental testimony?

A. Yes**.** In my supplemental testimony I stated that the shareholder incentive was high relative to the low level of energy reduction.

(C) DSM PROGRAM FUNDING

Q. Please explain why the program funding provisions in the OUCC Agreement may not be consistent with the Phase II Order.

A. The OUCC Agreement caps the total amount that the Company can collect to fund both its DSM programs and its shareholder incentives over four years at $260 million. This cap is based on the levels of program activity and corresponding electricity reductions proposed under that Agreement. The Company has not proposed either reducing that cap, to reflect the transfer of Core Programs and their associated program costs to a TPA, or increasing the cap to cover the costs of expanding CorePlus programs to meet the Phase II Order targets. However, Mr. Farmer states that this cap "…may need to be revisited" if it impedes the Company's ability to comply with the Phase II Order. (Farmer Supplemental, page 6). Thus, it is possible that the cap of $260 million will prove to be inadequate to fund the level of program costs the Company requires to achieve the much higher levels of electricity reduction targets established in the Phase II Order.

Q. Did you identify the $260 million value based cap as a potential problem in your supplemental testimony?

A. Yes**.** In my supplemental testimony I stated that the cap, which is a value-of-service based compensation structure, may limit the Company's ability to respond easily to unexpected changes in market conditions such as the potential for greater levels of energy reductions.

III. CONCLUSIONS AND RECOMMENDATIONS

Q. What are your conclusions and recommendations regarding the OUCC Agreement?

A. My conclusion is that key provisions of the OUCC Agreement are substantially inconsistent with the Phase II Order and the Vectren DSM order. I recommend that the Commission not approve the OUCC Agreement and that it direct he Company to file a new application to develop, implement and manage energy efficiency programs that will meet the Phase II Order target savings under a ratemaking framework that would, subject to Commission review, set revenue requirements enabling it to recover its actual incurred DSM program costs, address verified revenue erosion or lost revenues, and provide a shareholder incentive that is consistent with the target level of reductions in the Phase II Order and the incentive levels in the Vectren DSM Order.

Q. Does this complete your Additional Supplemental Direct Testimony?

A. Yes.

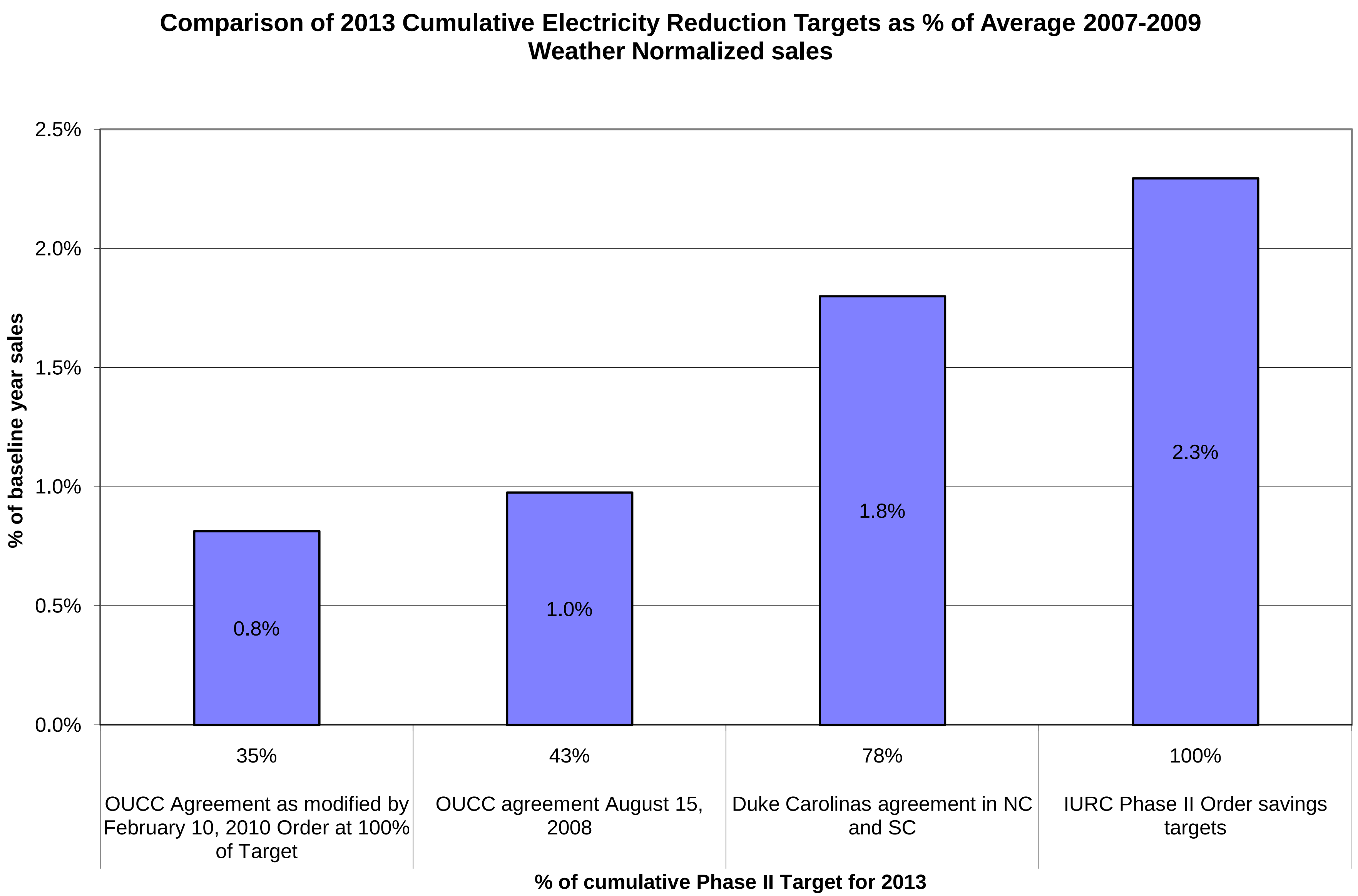
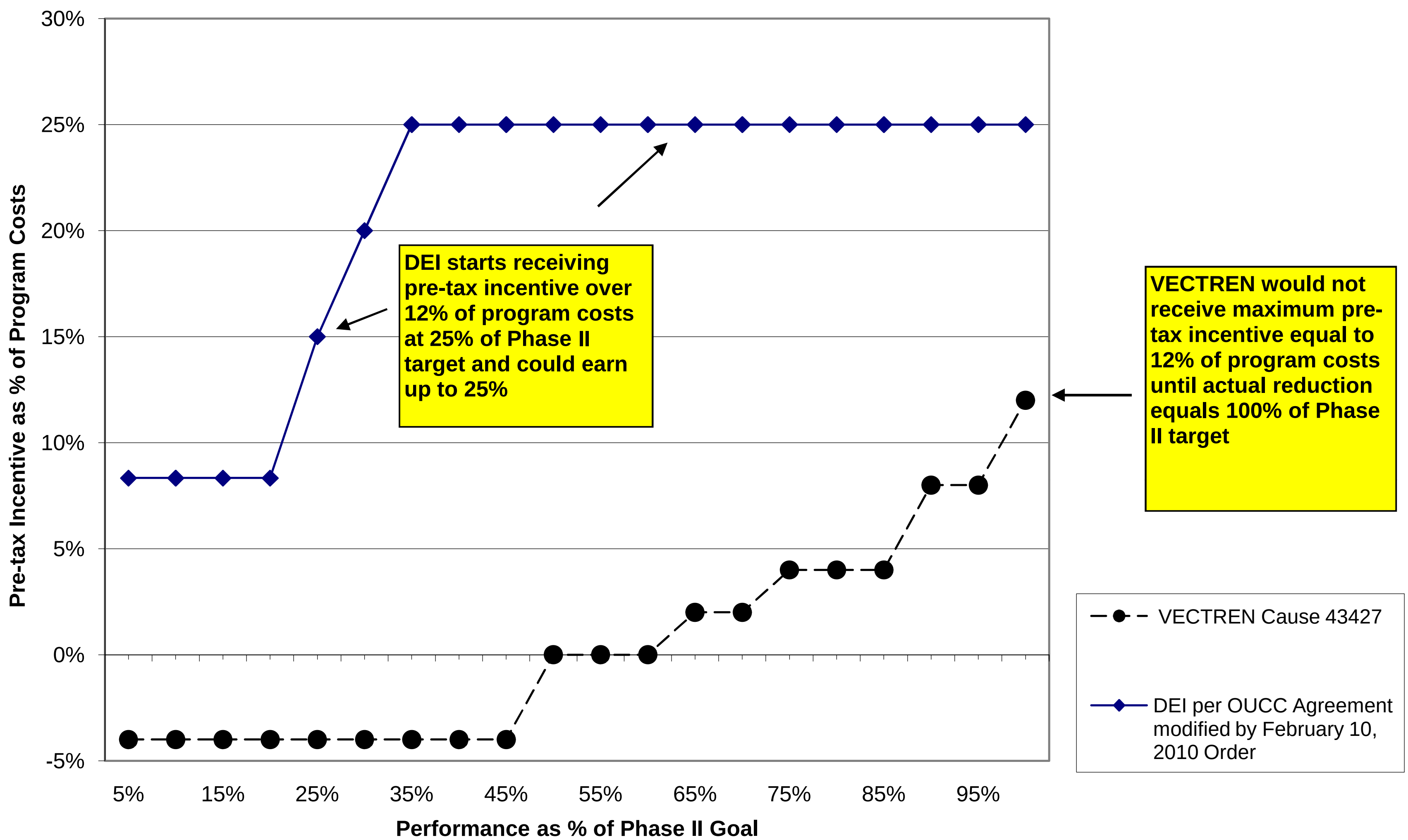
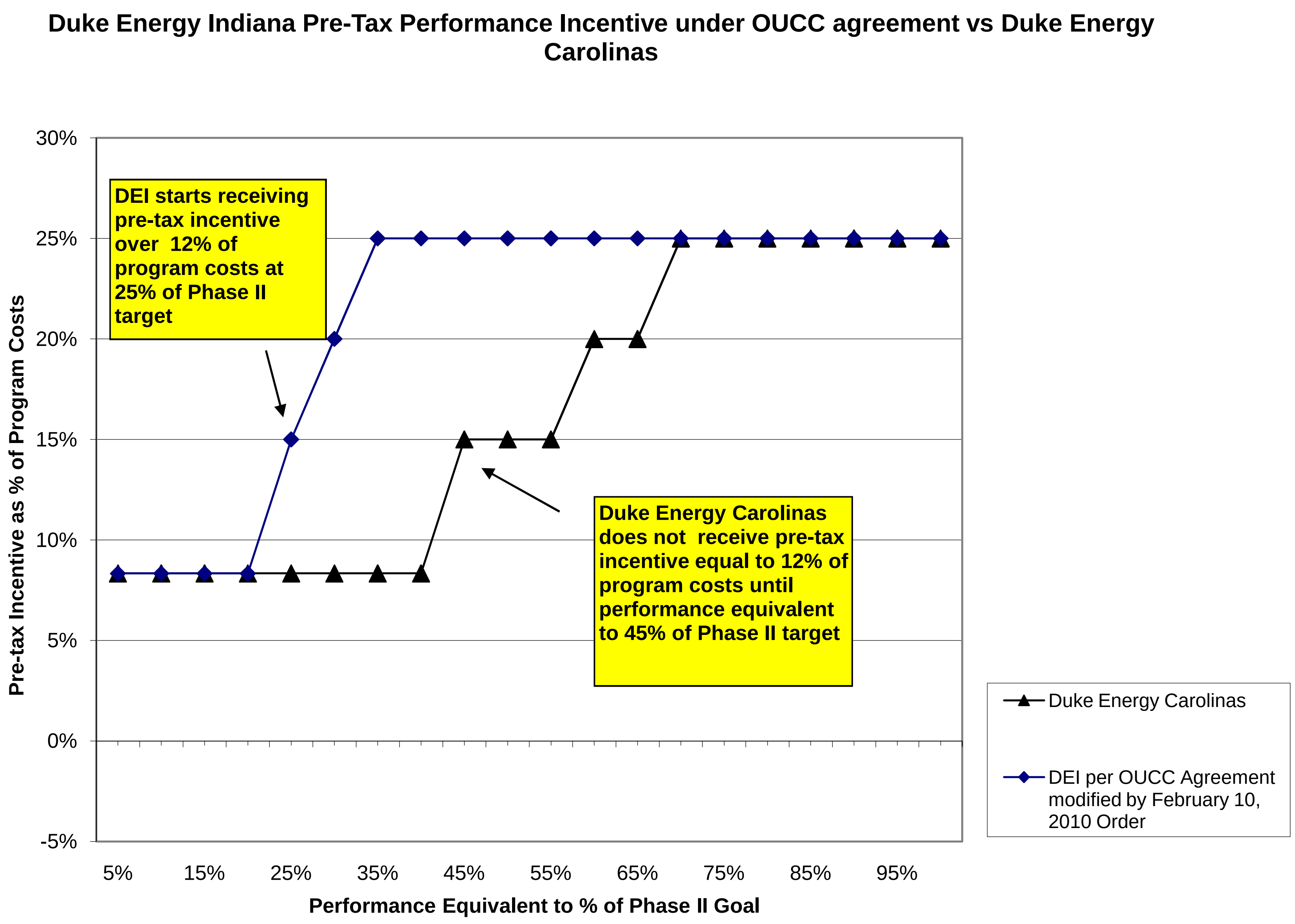

Comparison of 2013 Cumulative Electricity Reduction Targets as % of Average 2007-2009 Weather Normalized sales
% of baseline year sales
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
0.8%
1.0%
1.8%
2.3%
35%
43%
78%
100%
OUCC Agreement as modified by February 10, 2010 Order at 100% of Target
OUCC agreement August 15, 2008
Duke Carolinas agreement in NC and SC
IURC Phase II Order savings targets
% of cumulative Phase II Target for 2013

Exhibit JRH-15

Duke Energy Indiana Pre-Tax Performance Incentive under OUCC agreement vs Illustrative Vectren Electric per Phase II Order




Duke Energy Indiana Pre-Tax Performance Incentive under OUCC agreement vs Duke Energy Carolinas
Pre-tax Incentive as % of Program Costs
30%
25%
20%
15%
10%
5%
0%
-5%
5%
15%
25%
35%
45%
55%
65%
75%
85%
95%
Performance Equivalent to % of Phase II Goal
DEI starts receiving pre-tax incentive over 12% of program costs at 25% of Phase II target
Duke Energy Carolinas does not receive pre-tax incentive equal to 12% of program costs until performance equivalent to 45% of Phase II target
Duke Energy Carolinas
DEI per OUCC Agreement modified by February 10, 2010 Order

Duke Energy Indiana Pre-Tax Performance Incentive under OUCC agreement vs Duke Energy Carolinas and vs Illustrative Vectren Electric per Phase II Order