G-001/M-92-517 ORDER APPROVING DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE PROGRAM WITH MODIFICATIONS AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Proposal of Interstate Power Company Gas Utility for a Demand-Side Management Incentive Mechanism

ISSUE DATE: December 9, 1992

DOCKET NO. G-001/M-92-517

ORDER APPROVING DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE PROGRAM WITH MODIFICATIONS AND REQUIRING FURTHER FILINGS

PROCEDURAL HISTORY

On April 10, 1991, the Commission issued its ORDER SOLICITING COMMENTS in Docket No. G-999/CI-91-188, In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Gas Utilities. In that Order the Commission initiated an investigation into financial incentives for encouraging demand-side resource options for gas utilities.

On October 18, 1991, the Commission issued its ORDER REQUIRING GAS UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS in the aforementioned docket. In that Order the Commission required all Minnesota gas utilities (except Midwest Gas, which was already implementing a financial incentive pilot program) to file demand-side management (DSM) programs on or before June 1, 1992.

On June 1, 1992, Interstate Power Company Gas Utility (Interstate) filed its proposal for a DSM financial incentive program.

On August 31, 1992, the Department of Public Service (the Department) and the Residential Utilities Division of the Office of Attorney General (RUD-OAG) filed comments regarding Interstate's DSM proposal.

The matter came before the Commission on November 12, 1992.

FINDINGS AND CONCLUSIONS

I. Interstate's DSM Proposal

In its DSM proposal, Interstate recognized that more and better DSM and conservation programs will bring about significant reductions in gas sales. Lower gas sales mean a lower recovery of fixed cost, which is a temporary disincentive against the DSM option. The Company explained that the disincentive is temporary because the filing of a general rate case will cause fixed cost to be spread over the new, test year level of gas sales.

To address these issues, Interstate proposed applying a Lost Margin Factor to estimated monthly Therms (units of gas sold) which are conserved since the last rate case test year. The amount would be calculated by customer class and would be deferred for recovery for the calendar year. Interstate would use annual consumption data from the previous year to arrive at the Lost Margin Factor to be applied on a monthly basis in the current year.

Under Interstate's proposal, the Company would seek recovery of deferred lost margins by means of a miscellaneous rate filing. If the Company obtained Commission approval of the rate filing, Interstate would increase the Therm charge in the currently approved tariff by an amount sufficient to recover the deferred amount over a 12-month period. Over- or under-recovery would be trued up in future filings.

II. Comments of the Parties

The Department

In its comments, the Department discussed its general criteria for assessing proposals on DSM financial incentives. Those criteria included lack of conflict with Minnesota statutes or rules, contribution to diversity in incentive mechanisms, a performance basis for recovery, and administrative practicality.

After applying its criteria to Interstate's DSM proposal, the Department stated that the proposal provides a good start for developing a reasonable financial incentive. The Department suggested three modifications to the basic proposal which it believed would make the incentive plan more effective. According to the Department, Interstate should not be allowed to recover lost margins through rate adjustments between rate cases, there should be a performance component built into the proposal, and lost margins should be calculated by engineering estimates of the savings per participant.

The Department's first modification, the elimination of yearly adjustments for recovery of lost margins, stemmed from the Department's reading of Minnesota statutes and rules. The Department argued that the yearly miscellaneous rate filings would not be permissible under current law. The Department stated that only two types of rate changes are allowed between rate cases: changes reflecting fluctuations in gas costs; and in some instances, rate changes reflecting taxes, fees and permits. Since the adjustments to recover lost margins did not fall in these categories, the Department reasoned that they could not take place. Such adjustments between rate cases would amount to single-issue ratemaking, according to the Department. Further, the Department felt that highlighting rate increases due to conservation expenditures, without emphasizing the benefits, might turn the public against the idea of DSM projects and conservation in general.

The Department recommended that Interstate's DSM proposal be modified by the addition of a performance component. Under the Department's plan, Interstate's recovery of lost margins would range from 110 percent for exceeding its participation goals, to 0 percent for failing to meet at least 35 percent of its participation goals.

As a third modification to Interstate's plan, the Department recommended that Interstate calculate lost margins by engineering estimates of the savings per participant, applied to the number of participants in the project.

<u>The RUD-OAG</u>

The RUD-OAG agreed with the general principle of recovery of lost margins as a conservation incentive. The RUD-OAG stated, however, that lost margins can arise from circumstances such as weather fluctuations or reduction in customer base, as well as from conservation practices. For this reason, the RUD-OAG recommended that Interstate be required to include a weather normalization adjustment in its lost margin calculation.

The RUD-OAG also recommended that there be a performance basis for Interstate's DSM option. The RUD-OAG suggested that Interstate only be allowed to recover lost margins if it achieved at least 50% of its DSM goals.

The RUD-OAG agreed with the Department that Interstate's proposed recovery of deferred lost margins by means of annual miscellaneous rate filings is not permissible under Minnesota law.

<u>III. Commission Analysis</u>

<u>Full Recovery of Lost Margins</u>

The Commission is required by statute to emphasize and promote DSM and other conservation programs. Minn. Stat. § 216B.03 (1992) directs the Commission to set rates to encourage energy conservation and renewable energy use to the maximum reasonable extent. Minn. Stat. § 216B.241, subd. 1a (Supp. 1991) requires utilities to expend money in the promotion of conservation practices. The legislature has clearly expressed its commitment to the promotion of conservation and DSM.

In its previous decisions in other dockets, the Commission has supported the concept of recovery of lost margins as a DSM financial incentive. The Commission has found that allowing recovery of lost margins reduces the obstacle of regulatory lag and thus encourages conservation. Recovery of lost margins can lessen the need of utilities to file frequent general rate cases.

After examining Interstate's filing, the Commission finds that Interstate's proposal to recover 100% of margins lost due to DSM programs is reasonable and acceptable.

Interstate's Proposed Recovery Mechanism

Parties to this proceeding have proposed different methods of lost margin recovery. Interstate proposed recovery through miscellaneous rate filings; the Department and the RUD-OAG argued that Interstate should not be allowed to adjust rates between general rate cases. These issues raise such questions as rate design versus rate change, and the effect of annual rate adjustments for DSM costs on public perception of conservation.

The Commission will be approving Interstate's DSM proposal on a two year pilot basis. For this pilot program, the Commission finds that it is in the public interest to coordinate its consideration of Interstate's DSM lost margins with the Commission's consideration of the Company's CIP costs. Interstate will thus be required to track its lost margins and to submit the tracker amount along with the CIP tracker balance for annual Commission review and approval. The lost margins due to DSM will continue to be tracked until Interstate's next general rate case, when the Company will submit the balance for analysis, review and potential recovery, along with appropriate carrying charges, in the rate case. Tracking the DSM lost margins and filing them along with CIP costs is consistent with prior Commission decisions, administratively sound, and a satisfactory means of protecting both ratepayers and shareholders.

At some time in the future, the Commission plans to address the issues of policy and statutory power raised by Interstate's DSM proposal. The Commission will continue to consider proposed methods of lost margin recovery. For the purposes of this pilot program, however, tracking and coordination with CIP costs remain the best means of recovery.

The Performance Component

The Department and the RUD-OAG urged the Commission to require a performance component in Interstate's DSM program. According to the Department, using a sliding scale of "carrot" and "stick" lost margin recovery would encourage Interstate to meet its conservation goals more effectively.

The Commission has previously addressed the issue of a performance basis for DSM lost margin recovery. In its Order approving Minnesota Power's DSM proposal[1], the Commission stated:

---

[1] In the Matter of the Proposal of Minnesota Power for a Demand-Side Management Financial Incentive, Docket No. E-015/M-91-458, ORDER ESTABLISHING DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS, March 12, 1992.

> The Department urged the Commission to tie Minnesota Power's recovery of lost margins to achievement of its CIP goals. The Department is rightly concerned with performance; ***** The Commission believes, however, that for purposes of this pilot project, limiting recovery to margins actually lost due to conservation adequately ties recovery to performance. Only when energy has been saved will the Company recover lost margins.

The Commission applies the same reasoning to Interstate's DSM proposal. The Commission finds that achievement of performance goals is intrinsic to Interstate's proposal: if margins are not lost due to lower sales, which are in turn due to DSM expenditures, there is no basis for recovery. Interstate is only proposing a return to the financial position it would have been in if DSM had not been pursued; it is not seeking any recovery beyond that. It would be unduly harsh to deny Interstate its margin recovery, or a portion of it, if it fails to meet certain conservation goals. For these reasons, the Commission will not impose a performance requirement onto Interstate's DSM proposal.

Calculation of Lost Margins

The Department recommended that Interstate calculate lost margins by engineering estimates of the savings per participant, then applying the estimated savings to the number of participants in the project. The Commission finds that this method is straightforward, reasonably accurate and administratively sound. The Commission will require Interstate to adopt this method of lost margin calculation for its DSM proposal.

ORDER

1. Interstate's DSM financial incentives proposal, as modified in this Order, is approved as a two year pilot program.

2. Within 45 days of the date of this Order, the Company shall file a plan for evaluating the DSM financial incentives pilot project.

3. The Company shall file its calculations of lost margins annually on April 1.

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)