

E-017/M-91-457 ORDER EXTENDING PILOT PROJECT, REQUIRING FURTHER
FILINGS, AND AUTHORIZING WORKING GROUP

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
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Commissioner

In the Matter of the Proposal of
Otter Tail Power Company for a
Demand-Side Management Financial
Incentive

ISSUE DATE: January 31, 1994

DOCKET NO. E-017/M-91-457

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PROCEDURAL HISTORY

I. Proceedings to Date

On March 12, 1992 the Commission issued an Order in the above-entitled matter establishing a two-year pilot project of demand side management financial incentives for Otter Tail Power Company. The incentives package had three parts: a monthly carrying charge on the Company's Conservation Improvement Program (CIP) tracker account, recovery of margins lost due to conservation, and symmetrical bonuses and penalties per kWh saved for achieving or failing to achieve Company-specific CIP goals. The pilot project was scheduled to expire on December 31, 1993. The Company was required to file a project evaluation on April 1, 1994.

On November 8, 1993 the Company filed a request to extend the pilot project through calendar year 1994. The Company stated the project had resulted in significant demand side management gains and should not be discontinued until a new incentive program was in place.

The Department of Public Service (the Department) recommended approving the one-year extension. The Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) raised concerns about the formal evaluation the Company is to file on April 1. The agency asked the Commission to require the Company to file an updated proposal for preparing the evaluation, to allow public comment on the updated proposal, and to require the Company to include in its April 1 filing an analysis of the issue of "free riders" and its relevance in designing future incentive programs.

The matter came before the Commission on January 6, 1994.

FINDINGS AND CONCLUSIONS

II. Pilot Project Extended

The Commission agrees with the Company and the Department that the pilot project is producing results and should be continued through calendar year 1994. During 1994 the Commission will evaluate Otter Tail's financial incentive program and the performance of financial incentives in general. To avoid losing ground during this evaluation period, the Commission will extend the pilot project for another year.

III. Current Evaluation Proposal Sufficient

The Commission will not require the Company to file an updated proposal for evaluating the pilot project unless its evaluation plans have changed. The Commission approved the Company's original evaluation plan on August 21, 1992. Since then, the Company has modified the plan by adding procedures for evaluating demand side management projects approved after the August Order. The Commission will not re-examine the issue of how the Company should evaluate its pilot project in the absence of evidence that the existing plan is inadequate. If, however, the Company plans to deviate from the approved plan, it should include a detailed proposal and explanation in its annual April 1 project report.

IV. Free Ridership to be Addressed

The Company agrees with the RUD-OAG that the "free rider" issue should be addressed in evaluating the pilot project and designing any future financial incentive program. Briefly, the free rider issue is how to treat behavior that qualifies for a reward but would have occurred anyway. Rewarding free riders makes incentive programs more expensive than they need to be, but identifying and excluding free riders on clearly equitable terms can be difficult. The Commission will require the Company to examine and report on the free rider issue, and other misattributions of efficiency gains, on or before June 1. This examination should include a review of other utilities' work on free rider issues and the relevant literature.

V. Working Group Authorized

When the Commission approved Otter Tail's financial incentive pilot project, the Order made it clear that financial incentives were innovative regulatory tools the Commission might or might not continue to use in the future:

The role of demand side management financial incentives in Minnesota regulation is still evolving. Legislation enacted in 1991 allows the Commission to approve financial incentives; it does not require the Commission to do so. That legislation also requires substantial investments in demand side management by all Minnesota utilities. Minn. Stat. § 216B.241, subd. 1a and 1b (Supp. 1991). There is a certain anomaly in giving utilities financial incentives to comply with the law.

On the other hand, financial incentives may increase the quality and quantity of utilities' demand side efforts, producing the significant energy savings the Act aims to achieve. Requiring utilities to spend specified amounts of money on conservation is one thing; harnessing their creativity on behalf of conservation is another. The Commission believes that financial incentives may be an effective tool for encouraging utilities to do more than comply with statutory spending requirements, to focus their creative energies on conservation.

The Commission concludes that it is in the public interest to establish financial incentives for Otter Tail to invest in demand side management. By doing this, the Commission is not finding that financial incentives are in the public interest and should become a permanent part of electric utility ratemaking. It may turn out that financial incentives are useful primarily as devices to ease the transition from supply side management to a combination of supply side and demand side management. It may turn out that the role of financial incentives should be limited to encouraging utilities to find and implement the most cost effective conservation programs possible. For now, however, the Commission is convinced it is in the public interest to explore the potential of incentive programs designed by individual utilities to increase their individual use of demand side management.

ORDER ESTABLISHING DEMAND SIDE MANAGEMENT INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS, this docket, (March 12, 1992).

The task facing the Commission, then, is not just to evaluate Otter Tail's pilot project but to evaluate the continued usefulness of financial incentives for all Minnesota electric utilities. To be successful, the second evaluation requires resources and perspectives beyond those of Otter Tail and the Commission. The Commission will therefore authorize its staff to convene a working group of interested persons to make recommendations to the Commission on what information is necessary to conduct a proper evaluation, to render its own

evaluation of financial incentives' effect on utility behavior, and to make recommendations on the future of financial incentives in Minnesota.

In addition to Commission staff, the working group will include the four electric utilities operating financial incentive pilot projects, the Department, the RUD-OAG, and one or two stakeholders from the private or non-profit sectors.

ORDER

1. Otter Tail Power Company's demand side management financial incentives pilot project is extended through calendar year 1994.
2. On or before April 1, 1994 the Company shall file a detailed explanation of any changes it proposes to make to its approved plan for evaluating the pilot project.
3. On or before June 1, 1994 the Company shall file an examination of the free rider issue and an analysis of other misattributions of efficiency gains. This examination should include a review of other utilities' work on free rider issues and the relevant literature.
4. The Commission authorizes its staff to convene a working group to make recommendations to the Commission on what information is necessary to evaluate the two-year experiment with financial incentives, to render its own evaluation of financial incentives' effect on utility behavior, and to make recommendations on the future of financial incentives in Minnesota. The composition and charge of the working group shall be as described above.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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