ISSUE DATE: August 1, 1996

DOCKET NO. G-011/M-95-1372

ORDER APPROVING CALCULATION OF LOST MARGINS AND SHAREHOLDER INCENTIVES, AS MODIFIED

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs	Chair
Marshall Johnson	Commissioner
Dee Knaak	Commissioner
Don Storm	Commissioner

In the Matter of a Petition by Peoples Natural Gas Company, a Division of UtiliCorp United, Inc., for Recovery of Lost Margins and Shareholder Incentives

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PROCEDURAL HISTORY

On August 1, 1995, Peoples Natural Gas Company, a Division of UtiliCorp United, Inc., (Peoples or the Company) filed a petition seeking recovery of its lost margins and shareholder incentives. The matter was assigned to Docket No. G-011/M-95-794.

On September 29, 1995, the Minnesota Department of Public Service (the Department) filed its comments. The Department recommended that the Commission reject the Company's petition without prejudice.

On October 2, 1995, the Residential Utilities and Small Business Division of the Office of the Attorney General (RUD-OAG) filed its comments. The RUD-OAG recommended that the Commission modify Peoples' application before approving it.

On October 10, 1995, Peoples made a filing in which it indicated its desire to withdraw its petition.

On November 8, 1995, the Commission granted Peoples' request and issued its ORDER ALLOWING WITHDRAWAL OF PETITION WITHOUT PREJUDICE.

On December 13, 1995, Peoples refiled its petition seeking recovery of its lost margins and shareholder incentives. The matter was assigned to the current docket, Docket No, G-011/M-95-1372.

On February 12, 1996, the Department and the RUD-OAG filed comments on the petition.

On March 4, 1996, Peoples filed reply comments.

FINDINGS AND CONCLUSIONS

A. Peoples' Proposal

Based on its approved incentive plan,[1] Peoples sought authority to recover a total of $446,485 for lost margins and incentives for the Conservation Improvement Program (CIP) years 1992/93 and 1993/94 through its Resource Adjustment Charge (RAC).

Peoples proposed that the total amount be booked to its CIP tracker account, included in the calculation of its next annual RAC, and recovered over a 12-month period.

The Company's DSM financial incentive filing included:

- a summary of the approved framework for the incentive plan;
- a section identifying approved CIP data and achievement goals;
- a section showing the calculation of lost margins; and
- a section showing the calculation of shareholder incentives.

The basic structure of Peoples' lost margin and shareholder incentive calculations were initially developed in its 1992 general rate case, Docket No. G-011/GR-92-132. In the current filing, the Company proposed to calculate lost margins and shareholder incentives as follows:

Calculation of Lost Margins

Peoples indicated that the lost margins be calculated as the product of 1) the load impacts of the programs and 2) the applicable lost margin per unit of sales. Pursuant to this calculation, the 1992/93 programs saved 53,011 Mcf (weather normalized) and the 1993/94 programs saved 26,143 Mcf (weather normalized). At the approved lost margin per unit of sales during these periods ($1.1158/Mcf), this translated into $53,971 and $29,171, respectively, a total of $83,142 for both program years.

Calculation of Shareholder Incentives

Under its approved shareholder incentive plan, Peoples' shareholders are entitled to a 25 percent share of the **net benefits** of the CIP programs it has implemented. The Company proposed to calculate the net benefit using the following formula:

[1] In its FINDINGS OF FACT order issued February 12, 1993 in Peoples' last general rate case, the Commission approved Peoples' demand side management (DSM) financial incentive plan. The Commission also approved methodologies for calculating Peoples' lost margins and shareholder incentives.

Net Benefit = avoided capacity and energy savings (including externalities)
minus
Utility administration and other “non-incentive” costs
minus
Gross participant costs (i.e. participant costs prior to receiving a rebate)

Peoples calculated the amount of shareholder incentives separately for each program year. Using this formula, the Company initially calculated 1992/93 program year net benefits of \$1,099,972 (of which Peoples’ share was \$274,993) and 1993-94 program year net benefits of \$244,897 (of which Peoples’ share was \$61,224) for a total shareholder incentive for the two years of \$336,217.

In its reply comments, Peoples revised its figures for shareholder incentives as follows: 1992/93 = \$302,119; 1993/94 = \$61,224; 2-year total = \$363,343. The \$27,126 increase in the amount of shareholder incentives was due to the Company incorporating in its reply comments the correction of an error identified by the Department in its comments regarding the BENCOST factors for 1992/93.

B. The Department’s Comments

First, the Department noted that Peoples’ filing of its calculations of lost margins and shareholder incentives was not timely filed. The initial date for filing the annual calculations established in the Commission’s February 22, 1993 Order was November 1, 1994. The Company did not file its initial request until August 1, 1995.

Lost Margins

Regarding Peoples’ lost margin calculations for 1992/93, the Department disputed the Company’s figures because they were based on a total program approach in determining if savings goals have been met. The Department stated that the incentive plan in place during the 1992/93 CIP year required the use of a project-by-project basis for determining whether project goals have been met. Consistent with that approved plan, the Department argued, the Company should not use a total program approach in determining if savings goals have been met.

In addition, the Department noted that its Commissioner approves specific annual budgets and Peoples may not exceed the approved budget on any project by more than 10 percent without a formal modification. Consistent with that, the Department argued, Peoples should not be allowed to recover costs, lost margins, or receive a bonus where it has exceeded an annual project budget by more than 10 percent without having obtained a formal modification.

Shareholder Incentives

The Department disagreed with Peoples’ inclusion of externality costs in determining the net benefits upon which the shareholder bonus is based. The Department noted that in two earlier filings in which Peoples had been required to identify the factors it would use to determine net benefits and the shareholder incentive, the Company had not identified externalities as a factor for determining net benefits.

The Department argued that Peoples should not be permitted to include externalities in the current calculation of a shareholder incentive for three reasons:

- the resulting bonus is unreasonable and out of proportion with the budget, the energy savings, and other utilities' incentives;
- the incentive mechanism approved by the Commission in Docket No. G-011/GR-92-132 did not include externalities; and
- the financial incentive mechanism should not be used to reward parties for externalities that are currently considered non-financial benefits.

Based on its initial recommendations and the revised data made available by the Company, the Department recommended that the Commission approve $188,171 for lost margins and shareholder incentives for CIP program years 1992/93 and 1993/94.

C. Comments of the RUD-OAG

As a preliminary matter, the RUD-OAG noted that Peoples' August 1, 1995 filing of its actual calculations regarding lost margins and net benefits was late: nine months after the due date established by the Commission in the Company's last rate case. The RUD-OAG stated that this delay increased the magnitude of Peoples' request and therefore increased the impact on ratepayers.

The main focus of the RUD-OAG's comments was its objection to Peoples' inclusion of environmental damage costs as part of its avoided cost element in the net benefit formula:

1. The RUD-OAG clarified that in earlier Orders the Commission has approved Peoples' methodology in general terms, but has not determined the individual items making up the avoided cost.

2. The RUD-OAG noted that Peoples used the BENCOST cost-effectiveness analysis for gas CIPs which calculates avoided cost by taking into account energy savings, demand savings, variable operating and maintenance (O&M) savings and avoided environmental costs. The RUD-OAG argued that the BENCOST cost-effectiveness analysis used for gas CIPs may be appropriate for determining which CIP projects are cost effective for implementation in Minnesota, but it should not be used to determine shareholder incentives. The RUD-OAG explained that shareholders are already reimbursed for CIP costs, lost margins, and shareholder incentives. As such, adding avoided environmental damage costs to shareholder incentives would grant shareholders a windfall and unnecessarily inflate ratepayers' rates.

3. The RUD-OAG argued that the Commission's analysis of incentive plans for energy conservation improvements is guided by Minn. Stat. § 216B.16, subd. 6(C) which makes no

provision for providing a shareholder bonus by imputing avoided environmental costs and charging them to ratepayers.

4. The RUD-OAG also stated that the stipulation agreed to by all parties and approved by the Commission in Peoples' last rate case addressed the incentive program. The RUD-OAG argued that the stipulation indicated that if Peoples achieved 100 percent of its goals, the Company would receive an incentive of $50,000. This contrasts sharply with the Company's current request to recover $275,000 for achieving 100 percent of its goals for the 1992/93 CIP year.

In sum, the RUD-OAG recommended that the Commission remove the environmental damage costs from the calculation of Peoples' lost margins and shareholder incentives.

D. Commission Analysis and Action

1. Peoples' Untimely Filing

Peoples is correct that its late filing of the calculations for 1992/93 will not increase the total amount owed by ratepayers. However, the delay will increase the magnitude of the annual CIP adjustment. On the other hand, the Company explained the complexity and difficulty of obtaining relevant data and the difficulty completing the required analysis for the first time. The Commission will take no action regarding the delayed filing at this time, particularly in view of the Company's explanation and commitment to file its DSM financial incentive plan on an annual basis in the future.

2. Exclusion of Externalities From Calculation of "Net Benefits"

The tests used to determine if CIP programs are cost-effective for ratepayers are different from those used to determine an appropriate level of financial incentive for shareholders. The purpose of a bonus or shareholder incentive is to provide an effective inducement to encourage utilities to exceed goals and achieve cost-effective conservation that may not otherwise be pursued. The purpose of a "net benefits" approach to determining a bonus is to increase net benefits through a sharing of benefits between ratepayers and shareholders.

Based on a clarification of that distinction and the many reasons expressed by the Department and the RUD-OAG, the Commission will not allow Peoples to include net societal benefits such as avoided environmental damage costs in its calculation of "net benefits" and, ultimately, shareholder incentive.

3. Exceeding CIP Project Budgets

Under the Department's CIP approval process, utilities may not exceed the approved budget on any project by more than 10 percent without formal modification. In CIP year 1992/93, Peoples exceeded its approved budget for the Community Garden Program by 107 percent without securing a modification from the Department.

The Commission, which is mandated to pass through expenditures that have been approved by the Department, finds it appropriate to base lost margin and shareholder incentive recovery on the project budgets that have been established by the Department.

Accordingly, the Commission will limit Peoples' recovery of lost margins and shareholder incentives to costs associated with the Department's approved CIP budgets. The lost margin amount associated with the excess budget for the Community Garden Program, approximately $1,500, will be disallowed. The amount of shareholder incentive associated with that excess budget (about $9,000) will also be disallowed.

4. Project-By-Project Calculation

The Department recommended that Peoples' performance be measured on a project-by-project basis, as provided in the Company's currently approved DSM financial incentive,[2] rather than on its overall performance as proposed by the Company in this matter.

Peoples stated that the Work Group on DSM Financial Incentives for Gas Utilities has filed a report in which it opposed using a project-by-project method for determining lost margins and instead recommended recovery of margins based on the overall success of a company's program.

Peoples' unilateral incorporation of a work group recommendation into its plan to recover lost margins and its DSM bonus will be rejected. The work group recommendations were intended for prospective use and certainly had no retroactive effect upon the provisions for calculating lost margin and incentives that are in place for the various utilities' pilot projects. Peoples will need to request and obtain Commission approval prior to applying any recommendation of the work group.

Accordingly, Peoples will be required to calculate lost margins using an annual project-by-project approach for CIP years 1992-93 and 1993/94.

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[2] In the Matter of the Application of Peoples Natural Gas Company, a Division of UtiliCorp United, Inc. for Authority to Increase Its Rates for Natural Gas Service in the State of Minnesota, Docket No. G-011/GR-92-132, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER (February 22, 1993).

ORDER

1. Peoples' petition for recovery of lost margins and shareholder incentives is approved with the following modifications:

    a. environmental damage costs shall be excluded in the calculation of net benefits for the shareholder incentive;

    b. in calculating lost margins and shareholder incentives in connection with the Community Grant Program during the 1992/93 CIP year, recovery of lost margins and incentives shall be limited to those amounts associated with the Department-approved CIP budget for the Community Grant Program; and

    c. the Company shall be required to seek and obtain approval from the Commission to modify its current DSM financial incentive plan if it desires any change in that plan;

    d. the Company shall calculate lost margins using an annual project-by-project approach for CIP years 1992/93 and 1993/94.

2. Within 20 days of this Order, Peoples shall make a compliance filing reflecting the Commission's decisions in this matter.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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