STATE OF MINNESOTA
BEFORE THE PUBLIC UTILITIES COMMISSION

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In the Matter of Commission Review of Utility Performance Incentives for Energy Conservation

DOCKET NO. E,G-999/CI-08-133

In the Matter of Otter Tail Power Company's 2018 Demand-Side Management Financial Incentive and Annual Filing to Update the Conservation-Improvement Program Rider

DOCKET NO. E-017/M-19-256

COMMENTS OF THE OFFICE OF THE ATTORNEY GENERAL

INTRODUCTION

The Office of the Attorney General—Residential Utilities and Antitrust Division ("OAG") submits these Comments in response to the Commission's July 25, 2019 Notice of Comment Period on Otter Tail Power Company's ("Otter Tail" or "the Company") request to modify Minnesota's Shared-Savings Demand-Side Management Financial Incentive Plan. The Company argues that the Commission should remove the cap that limits a utility's incentive award to 30 percent of its total spending on conservation improvements ("CIP-expenditure cap"). The Commission should deny this request because the cap is needed to protect ratepayers from paying the kind of exorbitant incentives awarded under previous versions of the plan. Moreover, utilities have achieved record-breaking energy savings despite the cap, vitiating Otter Tail's claim that the plan as a whole does not adequately incentivize energy conservation.

BACKGROUND

I. CONSERVATION IMPROVEMENT PROGRAMS

The Minnesota legislature has recognized the importance of encouraging energy conservation in the utility sector.[1] To that end, Minnesota Statutes chapter 216B requires electric and natural gas utilities to spend a portion of their gross operating revenues on energy conservation improvements.[2]

Every three years, utilities must submit their plans for conservation-related spending to the Minnesota Department of Commerce ("Department") in the form of a "conservation-improvement program," or "CIP."[3] The Department evaluates a utility's CIP based on how well it meets the utility's energy-saving goal, expressed as a percentage of the utility's gross annual retail energy sales.[4]

The Commission must include the cost of a utility's CIP investments when setting rates, just as if the utility had spent the funds on furnishing utility service.[5] The statute allows, but does not require, the Commission to provide additional payments to utility shareholders to reward them for their CIP efforts.[6] These payments are commonly referred to as "demand-side management ('DSM') financial incentives."

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[1] *See* Minn. Stat. 216B.03 (2018) (requiring the Commission to set utility rates that encourage energy conservation "to the maximum reasonable extent").

[2] Minn. Stat. § 216B.241, subd. 1a (2018). "Energy conservation improvements" are projects that result in energy efficiency or energy conservation. *Id.*, subd. 1(e). They include measures like energy audits, appliance and lighting rebates, and other home construction guidelines. They generally do not include efficiency improvements to a utility's own facilities. *See id.*

[3] *See id.*, subd. 2 (discussing conservation-improvement programs).

[4] *See id.*, subd. 1c (discussing energy-saving goals). The Department has maintained the statutory savings goal of 1.5 percent for electric utilities and set a 1.0 percent goal for gas utilities.

[5] Minn. Stat. § 216B.16, subd. 6b(a) (2018).

[6] *Id.*, subd. 6c.

II. DSM INCENTIVES IN MINNESOTA: THE SHARED-SAVINGS MODEL

The Commission first looked into the possibility of awarding financial incentives for demand-side management in 1989,[7] and by the early 1990s, it had approved incentive plans for several utilities. By the late 1990s, however, the Department was expressing concern that the amount of the incentives that utilities were receiving was too high.[8]

The Department's concerns prompted the Commission to form a stakeholder group to study the issue and, ultimately, to adopt a new "Shared-Savings DSM Financial Incentive Plan" in April 2000.[9] The new incentive plan departed from prior utility incentive plans in several respects. Most significantly, under the new "shared savings" paradigm, a utility would be awarded a share of the net benefits generated by its CIP investments after reaching a minimum energy-savings threshold.[10]

The Commission has modified the incentive formula on multiple occasions since 2000, but has retained the core shared-savings structure. Since 2007, the earliest year for which comprehensive data are available, Minnesota electric and gas utilities have received shared-savings payments totaling $652 million, an annual average of $54 million.[11] Moreover,

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[7] *See generally In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Electric Utilities and Bidding Systems*, Docket No. E-999/CI-89-212, ORDER INITIATING PROCEEDING AND SOLICITING PROPOSALS AND COMMENTS (May 22, 1989).

[8] *See In the Matter of Otter Tail Power Company's Demand-Side Management Financial Incentive Project, Electric Utility Conservation Cost Recovery Report and Annual Filing to Update the CIP Rider*, Docket No. E-017/M-98-446, DEPARTMENT COMMENTS at 6–7 (June 1, 1998) (arguing that incentives were higher than needed to spur cost-effective investments in demand-side management); *id.* at 5 tbl.2 (showing that, from 1992 to 1997, incentives for the four largest investor-owned electric utilities grew from 0.01% to 1.81% as a percentage of their gross operating revenues).

[9] *In the Matter of Requests to Continue Demand-Side Management Financial Incentives Beyond 1998*, Docket No. E,G-999/CI-98-1759, ORDER APPROVING DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE PLANS (Apr. 7, 2000) (adopting parties' Joint Proposal filed November 1, 1999).

[10] "Net benefits" are calculated by subtracting the cost of a utility's CIP investments from the estimated avoided costs resulting from those investments.

[11] *See* Docket No. E,G-999/CI-08-133, DEPARTMENT'S REPORT ON THE IMPACTS OF THE 2010–2018 SHARED SAVINGS DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE ON INVESTOR-OWNED UTILITY CONSERVATION ACHIEVEMENTS AND CUSTOMER COSTS at 14 (July 1, 2019) (hereinafter "Department's 2019 Report") (summarizing CIP data for 2007–2018).

including utilities' CIP expenditures, the total conservation-related costs borne by ratepayers from 2007 to 2018 was more than $2.2 billion—well over $180 million per year on average.[12]

III. MODERATING INCENTIVES: THE CIP-EXPENDITURE CAP

Under the shared-savings incentive plan, the more cost-effectively a utility deploys its available CIP funds, the greater the net benefit—and therefore its incentive—will be. But the original shared-savings plan placed a limit on the overall size of the incentive: No matter the net benefit achieved, the incentive was capped at the lower of (a) 30 percent of the utility's Department-approved CIP budget or (b) 30 percent of the utility's actual CIP expenditures in a given year.[13] This limitation, known as a "CIP-expenditure cap," ensured that a utility's return on CIP investments would not grow far out of proportion to the amount invested.

In 2010, the Commission removed the CIP-expenditure cap as part of a major revision to the shared-savings financial incentive plan.[14] Immediately, incentive payments skyrocketed, increasing from about $20 million for all utilities in 2009 to nearly $60 million in 2010.[15]

After this surge, the Commission explored other means of moderating financial incentives, including limiting a utility's incentive to 20 percent of the net benefits achieved ("net-benefit cap").[16] However, these efforts had no appreciable effect on the overall amount of incentives awarded.[17]

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[12] *See id.*

[13] Docket No. E,G-999/CI-98-1759, ORDER APPROVING DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE PLANS at 3 (April 7, 2000).

[14] *See* Docket No. E,G-999/CI-08-133, ORDER ESTABLISHING UTILITY PERFORMANCE INCENTIVES FOR ENERGY CONSERVATION AT 8, 14 (Jan. 27 2010) (adopting "alternative incentive cap" in place of CIP-expenditure cap).

[15] *See* DEPARTMENT'S 2019 REPORT at 40 tbl.16, 46 tbl.21 (showing gas and electric incentives 2007–2018).

[16] Docket No. E,G-999/CI-08-133, ORDER ADOPTING MODIFICATIONS TO SHARED SAVINGS DEMAND SIDE MANAGEMENT FINANCIAL INCENTIVE at 9 (Dec. 20, 2012) (imposing net-benefit cap).

[17] *See* DEPARTMENT'S 2019 REPORT at 40 tbl.16 (showing that gas-utility incentives increased from $8.2 million in 2010 to $22.4 million in 2015), 46 tbl.21 (showing that electric-utility incentives increased from $50.8 million in 2010 to $55.0 million in 2015).

In August 2016, responding to calls from the Department, the OAG, and the Minnesota Chamber of Commerce to reform the shared-savings plan, the Commission again adopted major revisions to the plan.[18] The Commission simplified the formula for determining a utility's base incentive; ordered the net-benefit cap stepped down to 10 percent by 2019; and ordered a 30 percent CIP-expenditure cap phased in by 2019.[19] The following table shows the net-benefit and CIP-expenditure caps in effect for 2017–2019:

Table 1: DSM Incentive Caps 2017–2019

	Net-Benefit Cap	CIP-Expenditure Cap
2017	13.5%	40%
2018	12.0%	35%
2019	10.0%	30%

IV. MINNESOTA UTILITIES SEE RECORD LEVELS OF ENERGY SAVINGS IN 2017 AND 2018 DESPITE REDUCED INCENTIVE PAYMENTS.

Though the OAG and other parties had sought more stringent incentive controls, including a CIP-expenditure cap of 15 percent, the changes that the Commission made in 2016 did have a moderating effect on incentive payments. In 2017, the first year of the new caps, the total incentives awarded to electric and gas utilities dropped to $54 million from $83 million the previous year.[20] And in 2018, the second year of the phase-in, the total incentives paid again declined, this time to $52 million.[21]

Despite this drop in incentive payments, Minnesota utilities achieved record energy savings in 2017 and 2018. From 2007 to 2018, electric utilities achieved average first-year

[18] *See generally* Docket No. E,G-999/CI-08-133, ORDER ADOPTING MODIFICATIONS TO SHARED SAVINGS DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE PLAN (Aug. 5, 2016) (hereinafter "August 2016 order").
[19] *Id.* at 28–29.
[20] *See* DEPARTMENT'S 2019 REPORT at 40 tbl.16, 46 tbl.21.
[21] *Id.* Data for 2019 will not be available until next year.

energy savings of 586 million kilowatt–hours ("kWh").[22] In the past two years, 2017 and 2018, they achieved savings of 785 million kWh and 823 million kWh,[23] both of which were higher than in any preceding year and much higher than the average. From 2007 to 2018, gas utilities achieved average first-year energy savings of 2.7 million dekatherms ("Dth").[24] In 2017 and 2018, they achieved savings of 3.8 million Dth and 3.4 million Dth,[25] higher than every year but 2016 (3.4 million) and much higher than the annual average. Again, these substantial savings occurred despite the new incentive controls imposed in 2017.

V. Otter Tail's Request to Remove the CIP-Expenditure Cap

A. Initial Request for Retroactive Exemption from the CIP-Expenditure Cap (Docket No. 19-256)

On April 1, 2019, Otter Tail filed its annual petition to update the CIP rider, the billing mechanism through which it recovers CIP costs, including incentive payments.[26] The Company requested approval to recover some $3 million in incentives for its 2018 CIP activities. In reply comments, however, the Company made a new request: It asked the Commission to exempt it from the CIP-expenditure cap for 2018 and 2019.[27]

The immediate effect of granting this request would be to give Otter Tail an additional $1 million for 2018. The following table demonstrates how this would occur:

[22] *Id.* at 20 tbl.3.
[23] *Id.*
[24] *Id.* at 16 tbl.1.
[25] *Id.*
[26] *See* Docket No. E-017/M-19-256.
[27] Docket No. E-017/M-19-256, Otter Tail Reply Comments at 9 (June 24, 2019).

Table 2: Otter Tail's 2018 Incentive Caps

2018 CIP Expenditures	$9,008,847
35% CIP-Expenditure Cap	**$3,153,096**
2018 Net Benefits	$34,609,459
12% Net-Benefit Cap	**$4,153,135**

Under the incentive formula approved in the Commission's August 2016 order, a utility's incentive is limited to the lesser of the CIP-expenditure cap or the net-benefit cap. In Otter Tail's case, for 2018, the lower cap is the CIP-expenditure cap, at approximately $3.2 million. But if the Company were exempted from the CIP-expenditure cap in 2018, the net-benefit cap would instead limit its incentive to about $4.2 million.

The Department opposed Otter Tail's request because it would retroactively change the incentive formula to benefit a single utility.[28]

B. Request to Discontinue the CIP-Expenditure Cap for All Utilities in 2020 (Docket No. 08-133)

On July 1, 2019, the Department filed a report on statewide financial incentives in the generic DSM incentives docket. The Department recommended that the Commission continue using the existing shared-savings incentive formula in 2020, the last year of Minnesota utilities' current CIP triennial period.[29]

On July 15, Otter Tail filed reply comments reformulating its earlier request for a special exemption from the CIP-expenditure cap as a general request to discontinue the CIP-expenditure

[28] Docket No. E-017/M-19-256, DEPARTMENT REPLY COMMENTS at 18–19 (July 26, 2019).
[29] *See* DEPARTMENT'S 2019 REPORT at 59–61 (noting that the Department had approved an extension of utilities' 2017–2019 CIP through 2020).

cap for *all* utilities.[30] The Company provided no analysis of the potential impact of this new request on Minnesota ratepayers, or even on its own ratepayers.

ANALYSIS

I. SUMMARY OF ARGUMENT

Otter Tail wants the Commission to throw out the CIP-expenditure cap because it works. In 2017 and 2018, the cap protected ratepayers by limiting utilities' DSM financial incentives to 40 percent and 35 percent of their individual CIP investments. And it did so while simultaneously spurring utilities to achieve record levels of energy savings. This year, the CIP-expenditure cap will be fully phased in at 30 percent. Even at this reduced level, the cap allows utilities to earn a rate of return on CIP investments that is far beyond anything they could hope to earn on ordinary, rate-base investments.

Given that the Commission adopted the current incentive formula just three years ago, and that the combined impact of a 30 percent CIP-expenditure cap and a 10 percent net-benefit cap on 2019 incentives is still unknown, it seems premature to make major adjustments to the formula at this time. However, if the Commission believes changes are necessary, it should lower the net-benefit cap to better align it with the CIP-expenditure cap.

The CIP-expenditure cap reflects the Commission's judgment that utilities should earn no more than a 30 percent return on CIP investments. Therefore, the CIP-expenditure cap ought to dictate the net-benefit cap, not the other way around. Rather than removing the CIP-expenditure cap to ensure that utilities are able to reach the net-benefit cap, the Commission should lower the net-benefit cap to ensure that utilities reach it before the CIP-expenditure cap kicks in. The

[30] Docket No. E,G-999/CI-08-133, OTTER TAIL REPLY COMMENTS at 3–4, Attachment A (July 15, 2019).

OAG's preliminary calculations suggest that the appropriate net-benefit cap for Otter Tail is approximately eight percent.

II. THE COMMISSION SHOULD REQUIRE OTTER TAIL TO PLAY BY THE ESTABLISHED RULES FOR 2018 AND 2019.

Before turning to the general merits of the CIP-expenditure cap, the OAG briefly addresses Otter Tail's request to be retroactively exempted from the cap in 2018 and 2019. The Commission should deny Otter Tail's request because it is an untimely petition for reconsideration, because the CIP-expenditure cap operated as intended and treated Otter Tail fairly, and because making an exception for Otter Tail would be unfair to other utilities and would invite similar requests in the future.

A. Otter Tail's Request Is an Untimely Petition for Reconsideration.

The Commission adopted the CIP-expenditure cap in its August 2016 order. Only one utility, Xcel, sought reconsideration of that order.[31] Otter Tail, having sat on its rights in 2016, now seeks to overturn a Commission decision that is more than three years old. The Company's request is barred by operation of law.[32]

Otter Tail argues that "a full understanding of the impacts of the spending cap provision were unknown when the Commission approved the provision in 2016."[33] But it is immaterial whether Otter Tail understood every possible ramification of the order. It was clear in 2016 that, going forward, a utility's incentive award would be limited to the lesser of the net-benefit cap or the CIP-expenditure cap. The Commission's decision clearly contemplated that there would be situations in which the CIP-expenditure cap would be lower than the net-benefit cap; otherwise,

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[31] *See* XCEL RECON. PET. at 2 (Aug. 25, 2016) (requesting that the Commission set the net-benefit cap at 13.5 percent for the entire 2017–2019 CIP triennial). The Commission ultimately denied Xcel's petition.

[32] *See* Minn. Stat. § 216B.27, subd. 1 (2018) (requiring that petitions for rehearing be filed within 20 days of service of a Commission order).

[33] Docket No. E-017/M-19-256, OTTER TAIL REPLY COMMENTS at 8 (June 24, 2019).

there would have been no reason to impose the CIP-expenditure cap. The Commission should deny Otter Tail's untimely request to modify its order.

B. The CIP-Expenditure Cap Operated as Intended.

The CIP-expenditure cap was designed to rein in utility incentives by limiting their size relative to total CIP expenditures. In Otter Tail's case, it did exactly that. Without the CIP-expenditure cap, Otter Tail would have received 12 percent of net benefits, or $4.2 million. But because of the cap, Otter Tail instead received 35 percent of its CIP expenditures, or $3.2 million, saving the Company's ratepayers $1 million in incentive payments. Otter Tail is unhappy with the CIP-expenditure cap because it served its intended purpose.

Otter Tail estimates that it could have maximized its incentive under the cap by spending another $2 million on conservation improvements without creating any additional ratepayer benefits.[34] Fortunately, Otter Tail did not actually attempt to game the formula in this way. If it had, its incremental, nonbeneficial investment would almost certainly have been imprudent and subject to disallowance. The Company argues that it should receive an extra $1 million because it did not invest in hypothetical uneconomic conservation improvements. The Commission should not reward Otter Tail for declining to make imprudent investments.

C. The CIP-Expenditure Cap Treated Otter Tail Fairly.

Under the Commission's August 2016 order, all Minnesota utilities are subject to the same CIP-expenditure cap. Otter Tail claims that it is the only utility impacted by the cap.[35] This claim is not only irrelevant, but also misleading. While it is true that Otter Tail was the only utility to reach the CIP-expenditure cap in 2018, both Otter Tail and CenterPoint Energy hit

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[34] *Id.* at 6.
[35] Docket No. E,G-999/CI-08-133, OTTER TAIL REPLY COMMENTS at 4 (July 15, 2019).

the cap in 2017. That year, the cap reduced Otter Tail's incentive award by roughly $500,000,[36] while CenterPoint's award was reduced by fully $9.2 million as a direct result of the CIP-expenditure cap.[37] Despite experiencing much more of an impact from the cap than Otter Tail, CenterPoint never asked for special treatment from the Commission.

Besides ignoring these key facts, Otter Tail wrongly assumes that it is unreasonable for the CIP-expenditure cap to impact individual utilities differently. In reality, disparate impacts are only a problem if utilities are similarly situated, and Otter Tail is not similarly situated to other utilities in this case. The Company reached the CIP-expenditure cap because it undertook large commercial and industrial projects.[38] Such projects tend to produce substantial energy savings at a low cost, resulting in high net benefits. In other words, the CIP-expenditure cap prevented Otter Tail from receiving an outsized financial reward for picking low-hanging fruit.

D. Making an Exception for Otter Tail Would Be Unfair to Utilities Who Played by the Rules and Would Invite Similar Requests in the Future.

Minnesota utilities rely on the shared-savings incentive formula in planning their CIP investments. Occasionally, the formula results in some utilities, like Otter Tail and CenterPoint, receiving a lower incentive award than they might have hoped for. But making ad hoc exceptions to the formula when it suits one utility's purposes would be inequitable and would encourage similar requests from other utilities in the future when results do not go their way.

Otter Tail contends that the Commission has modified the incentive formula for a single utility in the past. However, the example that Otter Tail cites is distinguishable on its facts and involved a prospective—not retroactive—modification of the formula.

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[36] Docket No. E-017/M-19-256, DEPARTMENT REPLY COMMENTS at 15 (July 26, 2019).
[37] *Id.* at 14 n.16.
[38] *Id.* at 14.

In 2013, the Department recommended that Minnesota Power be subject to a higher net-benefit cap than other utilities because, otherwise, the company would have reached the cap before even achieving its approved energy-savings goal.[39] The Commission agreed and increased Minnesota Power's net-benefit cap effective the following year.[40]

Unlike Minnesota Power's case, Otter Tail has not articulated, much less substantiated, any concern that it will reach the CIP-expenditure cap before achieving its energy-savings goal. Moreover, the Commission granted Minnesota Power's exception prospectively, whereas here Otter Tail asks the Commission to grant an exception after the fact. The Commission should not grant special treatment to Otter Tail under these circumstances.

For all the foregoing reasons, the Commission should not allow Otter Tail to take $1 million out of its ratepayers' pockets—not counting the ratepayer impact in 2019—by retroactively changing the incentive formula established under a three-year-old Commission order. Moreover, for the reasons articulated in the next section of these Comments, the Commission should reject Otter Tail's request to change the formula going forward.

III. THE COMMISSION SHOULD RETAIN THE CIP-EXPENDITURE CAP.

Otter Tail, perhaps sensing that its request to be retroactively exempted from the CIP-expenditure cap is a nonstarter, has repackaged it as a request to remove the cap for all utilities prospectively. The Commission should reject this new request for the same reasons that it adopted the CIP-expenditure cap in 2016.

The Commission adopted the CIP-expenditure cap because it found that the cap would "preclude the possibility that incentives would grow to an unanticipated level as occurred in the 1990s" and that, when combined with the net-benefit cap, it would "leave utilities with

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[39] *See* E,G-999/CI-08-133, DEPARTMENT COMMENTS at 2–6 (Oct. 1, 2013).
[40] *See* E,G-999/CI-08-133, ORDER (Nov. 19, 2013) (adopting Department's recommendation).

appropriate incentives to pursue conservation, while reducing the aggregate amount of incentive payments ratepayers must bear."[41] The Commission predicted that a 30 percent cap would "fully motivate" a utility to invest in conservation, and that "barring larger earnings would have no appreciable effect on the utility's efforts."[42]

The Commission's prediction was correct. Across all utilities participating in CIP, incentive payments decreased from 48.8 percent of CIP expenditures in 2016 to 27.8 percent of CIP expenditures in 2018.[43] At the same time as incentive payments were decreasing, Minnesota utilities achieved record energy savings.[44] The Commission should retain the CIP-expenditure cap because it ensures just and reasonable rates while fully incentivizing cost-effective conservation.

A. The CIP-Expenditure Cap Is Needed to Achieve Just and Reasonable Rates.

The CIP-expenditure cap should be retained because it ensures that utilities earn a reasonable return on their CIP investments. Under Minnesota Statutes section 216B.03, "[e]very rate made, demanded, or received by any public utility . . . shall be just and reasonable." Any doubt as to reasonableness must be resolved in favor of ratepayers.

In its August 2016 order, the Commission agreed with the OAG, the Department, and the Minnesota Chamber of Commerce that a CIP-expenditure cap was essential to a formula that yields just and reasonable incentives. The OAG in particular identified three major failings of the then-existing incentive formula: (1) the formula had allowed utilities to earn, on average, a 50 percent return on their CIP investments;[45] (2) the formula permitted wide inequality among

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[41] AUGUST 2016 ORDER at 23.
[42] *Id.*
[43] *See generally* DEPARTMENT'S 2019 REPORT.
[44] *See supra* section IV.
[45] OAG COMMENTS at 26–28 (Jan. 19, 2016).

the incentives paid by ratepayers of different Minnesota utilities;[46] and (3) the formula resulted in incentives that were far more generous than in other states.[47]

The CIP-expenditure cap addressed each of these failings, helping ensure that the shared-savings incentive formula leads to just and reasonable rates.

1. The CIP-expenditure cap protects ratepayers by limiting incentives to a reasonable portion of a utility's CIP investment.

The Commission imposed the CIP-expenditure cap to limit the overall incentive cost that ratepayers would have to bear. While the net-benefit cap also contributed to incentive reductions in 2017 and 2018, only the CIP-expenditure cap guarantees that, going forward, utilities will not receive payments that are dramatically out of proportion to their CIP investments. Utilities receive full recovery of their prudent conservation investments through CIP riders, and the CIP-expenditure cap allows them an additional 30 percent return on these investments. This level of return is far beyond anything a utility could hope to earn through ordinary, rate-base investments, and removing the cap would only magnify the disparity.[48]

The proportionality backstop that the CIP-expenditure cap provides is especially important because the incentives are calculated using assumptions about utilities' avoided costs that change from year to year. Through the shared-savings formula, these hypothetical avoided costs are converted to real money that comes directly out of ratepayers' pockets. Ratepayers do receive a benefit in exchange for their incentive payments, but it makes good sense to tie the incentives to the concrete, verifiable metric of how much money a utility actually spends on CIP.

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[46] *Id.* at 25–26.
[47] *Id.* at 23–24.
[48] Otter Tail might argue that conservation investments merit a higher return than other investments because they reduce a utility's energy sales. However, the primary purpose of DSM incentives is not to make up for revenues lost due to conservation. If Otter Tail believes it is not being made whole for lost sales, the solution is to implement revenue decoupling—not to increase incentives.

The net-benefit cap alone cannot accomplish this goal because it is derived from net benefits, which are based on avoided-cost assumptions.

2. The CIP-expenditure cap minimizes disparities in the incentives paid by ratepayers of different utilities.

The avoided-cost assumptions that drive the net-benefit calculation vary not only from year to year, but also from utility to utility. A CIP-expenditure helps to minimize the resulting disparities among the incentives paid by ratepayers of different utilities.

Electric utilities' 2017 and 2018 CIP results demonstrate how the CIP-expenditure cap has prevented unreasonable incentive disparities. In those two years, Xcel and Minnesota Power, who did not reach the CIP-expenditure cap, received incentives in the range of 27 to 37 percent of their CIP investment.[49] Otter Tail, however, did reach the cap. Without it, the Company's ratepayers would have paid incentives worth nearly 50 percent of Otter Tail's CIP investment.[50] But thanks to the cap, Otter Tail's incentive was limited to 40 percent of its CIP investment in 2017 and 35 percent in 2018.

The CIP-expenditure cap has also prevented disparities in the incentives awarded to gas utilities. Without the cap, CenterPoint would have received a 2017 incentive worth nearly 70 percent of its CIP investment for that year.[51] Meanwhile, its fellow natural gas utilities, MERC and Xcel, would have received incentives worth only 16 percent and 29 percent of their

[49] *See* DEPARTMENT'S 2019 REPORT at 47 tbl.22 (showing electric utilities' incentives as a percent of CIP expenditures from 2007 to 2018).

[50] Applying the relevant net-benefit cap to Otter Tail's 2017 and 2018 net benefits yields a 2017 incentive equivalent to 49.1 percent of the utility's 2017 CIP expenditures and a 2018 incentive equivalent to 46.6 percent of its 2018 CIP expenditures. *See id.* at 37 tbl.14 (showing electric utilities' net benefits from 2007 to 2018); *id.* at 29 tbl.9 (showing electric utilities' CIP expenditures from 2007 to 2018).

[51] Applying a 13.5 percent cap to CenterPoint's 2017 net benefits yields an incentive equivalent to 69.6 percent of the utility's 2017 CIP expenditures. *See id.* at 34 tbl.12 (showing gas utilities' net benefits from 2007–2018); *id.* at 25 tbl.6 (showing gas utilities' CIP expenditures from 2007–2018).

respective CIP spending.[52] The CIP-expenditure cap prevented extreme inequity by limiting CenterPoint's 2017 incentive to 40 percent of its CIP investment.

It is not reasonable for ratepayers across the state to be paying vastly different returns on utility CIP investments. The Commission should maintain the CIP-expenditure cap to prevent differences in utility incentives that go far beyond any difference in performance.

3. The CIP-expenditure cap protects ratepayers by keeping Minnesota's incentives in line with those of other states.

In 2016, the OAG surveyed the 20 highest-ranked state energy-efficiency programs according to the American Council for an Energy-Efficient Economy ("ACEEE").[53] The principal source for that survey was a 2015 ACEEE article that has not since been updated.[54] However, the OAG recently reviewed ACEEE's online database, which is updated on a yearly basis, and did not uncover any changes that would significantly alter its previous analysis.[55]

One of the OAG's most noteworthy findings was that, of the states that used a net-benefit cap, Minnesota was the only top-20 state that did not also employ an expenditure-based cap.[56] For example, for gas utilities, Colorado combined a 20 percent net-benefit cap with a 25 percent expenditure cap. For electric utilities, it combined a 25 percent of net-benefit cap and a 15 percent expenditure cap. Similarly, Michigan combined a 25 percent net-benefit cap with a 15 percent expenditure cap for both electric and gas utilities.[57] Expenditure-based caps like those in

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[52] *See id.* at 41 tbl.17 (showing gas utilities' incentives as a percent of CIP expenditures from 2007–2018).
[53] *See* OAG COMMENTS at 17–20, 23–24, Attachment 2 (Jan. 19, 2016). At that time, Minnesota was ranked sixth among all states, a distinction it retained as of 2018. *See* WESTON BERG ET AL., ACEEE, THE 2018 STATE ENERGY EFFICIENCY SCORECARD at 22 tbl.6 (2018) (ranking states' utility energy-efficiency policies).
[54] *See* SETH NOWAK ET AL., ACEEE, BEYOND CARROTS FOR UTILITIES: A NATIONAL REVIEW OF PERFORMANCE INCENTIVES FOR ENERGY EFFICIENCY (2015).
[55] *See generally* ACEEE State and Local Policy Database, https://database.aceee.org/ (last visited Sept. 7, 2019).
[56] *See* OAG COMMENTS at 23 (Jan. 19, 2016).
[57] Colorado and Michigan's expenditure caps have since increased to 20 percent. *See* ACEEE State and Local Policy Database: Colorado, https://database.aceee.org/state/Colorado (click on "Utilities" tab) (last visited Sept. 7, 2019); ACEEE State and Local Policy Database: Michigan, https://database.aceee.org/state/Michigan (click on "Utilities" tab) (last visited Sept. 7, 2019).

Colorado and Michigan—and, since 2017, Minnesota—protect ratepayer interests because they tend to limit a utility's incentive before the net-benefit cap is reached.

Other states in the top 20 of ACEEE's ranking provide no financial incentives at all, including Minnesota's neighbors Iowa and Wisconsin, as well as Maryland, Oregon, and Washington. These states' presence at the top of the ranking demonstrates that ratepayers' interest in a strong utility energy-efficiency program can be satisfied even without a financial incentive.

Minnesota's CIP-expenditure cap protects ratepayers by keeping the state's financial incentives more closely in line with those of other high-achieving states. The Commission should decline Otter Tail's invitation to walk back the cap without any evidence that it has hampered statewide utility energy-efficiency efforts.

B. The Current Formula Incentivizes Cost-Effective Energy Conservation Consistent with Statutory Criteria.

As these Comments have shown, the shared-savings formula has operated as the Commission intended, moderating incentive payments in 2017 and 2018, while simultaneously spurring record levels of energy savings.[58] Otter Tail, however, contends that the CIP-expenditure cap should be removed from the formula because it does not encourage cost-effective energy conservation consistent with Minnesota Statutes section 216B.16, subdivision 6c. The crux of the Company's argument is that a CIP-expenditure cap, by its nature, incentivizes utilities to increase their CIP spending regardless of whether the additional spending is cost-effective. For the reasons discussed below, Otter Tail's argument should be rejected.

Minnesota Statutes section 216B.16, subdivision 6c(b), provides that in approving incentive plans, the Commission must consider, among other things, "whether the plan is likely

[58] *See supra* section IV.

to increase utility investment in cost-effective energy conservation" and "whether the plan links the incentive to the utility's performance in achieving cost-effective conservation."

In its August 2016 order, the Commission considered these factors, among others, and concluded that they supported adopting the current formula. Today, with two years of actual data available, the Commission need not guess whether the formula "is likely to" prompt utilities to increase their CIP investment, because they have demonstrably done so. Moreover, because the formula links the incentive award to the net benefits achieved, it ensures that utilities can only earn incentives if their conservation measures are cost-effective.

Otter Tail focuses on the CIP-expenditure cap in isolation, ignoring that the formula as a whole ties incentives to utility performance in achieving cost-effective energy conservation through its shared-savings structure. The current formula both links incentive payments to cost-effective conservation and protects ratepayers from funding lavish rewards. Removing the CIP-expenditure cap would weaken the formula's ratepayer protections. And, as explained in the next section, practical considerations prevent utilities from making uneconomic conservation investments simply to increase the expenditure cap.

C. Gaming the CIP-Expenditure Cap Is Not a Viable Strategy for Utilities.

Otter Tail argues that the CIP-expenditure cap creates an incentive for utilities to spend additional conservation dollars, with no additional ratepayer benefit, simply to drive up the cap and increase the ceiling on their incentive award. Otter Tail estimates, for example, that it could have increased its 2018 incentive by $1 million by spending another $2 million while creating zero new ratepayer benefits.[59] Yet the Company did not do so. And there are at least three

[59] Docket No. E-017/M-19-256, OTTER TAIL REPLY COMMENTS at 6 (June 24, 2019).

reasons, beyond pure altruism, that Otter Tail or any other utility is unlikely to manipulate the incentive formula in this way.

First, the Department of Commerce oversees utilities' CIP budgets and is required to evaluate programs "on the basis of cost-effectiveness and the reliability of technologies employed."[60] The Department is unlikely to approve a utility's CIP budget if the planned conservation measures are padded with unnecessary spending.

Second, for a utility to invest without obtaining any ratepayer benefits in the way Otter Tail suggests would be imprudent, and the resulting costs would not be recoverable through rates. The threat of cost disallowance for imprudent investments thus provides a significant disincentive for utilities to overspend on conservation improvements simply for the sake of driving up the CIP-expenditure cap.

Finally, as the Department points out, gaming the formula the way Otter Tail suggests is too difficult in practice to be a realistic strategy.[61] Such a strategy would require the utility to know with certainty, before the end of the year, its annual energy and demand savings, its total expenditures, and its net benefits. And as the Department demonstrates, this scheme could easily backfire, resulting in the utility earning a lower incentive than it would have received if it had simply focused on carrying out cost-effective projects.

For all these reasons, gaming the CIP-expenditure cap is not a realistic strategy for utilities. Spending caps are a common feature of energy-conservation incentive formulas across the country, and the Commission should decline to throw out Minnesota's cap based on Otter Tail's conjecture that a bad actor might seek to take advantage of the system.

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[60] Minn. Stat. § 216B.241, subd. 2(a).
[61] Docket No. E-017/M-19-256, DEPARTMENT REPLY COMMENTS at 16–18 (July 26, 2019).

IV. If the Commission Changes the Incentive Formula, It Should Reduce the Net-Benefit cap to Better Align It with the CIP-Expenditure Cap.

To the extent that Otter Tail has identified any legitimate issue with the shared-savings incentive formula, it is that the net-benefit cap is set too high. Two years' experience with the current formula has shown that, at least for Otter Tail, the CIP-expenditure cap can sometimes be triggered before the utility reaches the net-benefit cap. This has the effect of preventing the utility from earning its maximum share of net benefits under the net-benefit cap. The solution to this problem—if the Commission views it as a problem—is not to raise or remove the CIP-expenditure cap. The solution is to lower the net-benefit cap so that the utility reaches it before the CIP-expenditure cap is triggered.

The CIP-expenditure cap reflects the Commission's judgment that the maximum return utilities should receive on their CIP investments is 30 percent. Therefore, the CIP-expenditure cap should dictate the level of the net-benefit cap—not the other way around. The OAG used Otter Tail's 2018 CIP results to calculate the percentage of net benefits that would have yielded an incentive in line with a 30 percent CIP-expenditure cap:

Table 3: Otter Tail's 2018 Incentive Under Hypothetical 30% and 8% Caps

2018 CIP Expenditures	$9,008,847
30% CIP-Expenditure Cap	**$2,702,654**
2018 Net Benefits	$34,609,459
8% Net-Benefit Cap	**$2,768,757**

In 2018, an eight percent net-benefit cap would have allowed Otter Tail an incentive roughly equivalent to that provided by a thirty percent CIP-expenditure cap—approximately $2.7 million. (Of course, the 2018 CIP-expenditure cap was 35 percent, not 30 percent; Table 3 is simply meant to illustrate how a new net-benefit cap could be determined. Once 2019 data are available, the CIP-expenditure cap value could be recalculated and the net-benefit cap adjusted as necessary.) While the OAG does not recommend making changes to the incentive formula at this time, if the Commission believes changes are necessary, it should adopt a lower net-benefit cap for Otter Tail, or for all utilities, beginning in 2020.

CONCLUSION

Since 2007, Minnesota ratepayers have paid their utilities $652 million in incentive payments. This amount represents a return on investment of nearly 40 percent. The incentive reforms that the Commission instituted in 2017, including the CIP-expenditure cap and the net-benefit cap, have contributed greatly to bringing utility returns down to this 40 percent level. The Commission should not change course just two years later, reversing the progress that it has made, simply because one utility is unhappy with its incentive award.

For all the reasons discussed in these comments, the OAG recommends that the Commission deny Otter Tail's request to be exempted from the CIP-expenditure cap in 2018 and 2019, and that it continue the cap in 2020 and beyond. If the Commission believes the incentive formula needs to be modified due to the interaction of the two caps, it should lower the net-benefit cap to ensure that the net-benefit cap is reached before the CIP-expenditure cap.

Dated: September 12, 2019

Respectfully submitted,

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s/ **Peter G. Scholtz**

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September 12, 2019

Mr. Daniel Wolf, Executive Secretary
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101-2147

Re: In the Matter of Commission Review of Utility Performance Incentives for Energy Conservation
MPUC Docket No. E,G-999/CI-08-133

In the Matter of Otter Tail Power Company's 2018 Demand-Side Management Financial Incentive and Annual Filing to Update the Conservation-Improvement Program Rider
MPUC Docket No. E-017/M-19-256

Dear Mr. Wolf:

Enclosed and e-filed in the above-referenced matter please find Comments of the Minnesota Office of the Attorney General—Residential Utilities and Antitrust Division.

By copy of this letter all parties have been served. An Affidavit of Service is also enclosed.

Sincerely,

s/ **Peter G. Scholtz**
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Enclosure

AFFIDAVIT OF SERVICE

Re: In the Matter of Commission Review of Utility Performance Incentives for Energy Conservation
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MPUC Docket No. E-017/M-19-256

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

I hereby state that on 12th day of September, 2019, I e-filed with eDockets ***Comments of the Minnesota Office of the Attorney General—Residential Utilities and Antitrust Division*** and served the same upon all parties listed on the attached service list by e-mail, electronic submission, and/or United States Mail with postage prepaid, and deposited the same in a U.S. Post Office mail receptacle in the City of St. Paul, Minnesota.

s/ Judy Sigal
Judy Sigal

Subscribed and sworn to before me
this 12th day of September, 2019.

s/ Patricia Jotblad
Notary Public

My Commission expires: January 31, 2020.

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Ken	Smith	ken.smith@districtenergy.com	District Energy St. Paul Inc.	76 W Kellogg Blvd St. Paul, MN 55102	Electronic Service	No	OFF_SL_19-256_M-19-256
Anna	Sommer	ASommer@energyfuturesgroup.com	Energy Futures Group	PO Box 692 Canton, NY 13617	Electronic Service	No	OFF_SL_19-256_M-19-256
Russ	Stark	Russ.Stark@ci.stpaul.mn.us	City of St. Paul	390 City Hall 15 West Kellogg Boulevard Saint Paul, MN 55102	Electronic Service	No	OFF_SL_19-256_M-19-256
Cary	Stephenson	cStephenson@otpco.com	Otter Tail Power Company	215 South Cascade Street Fergus Falls, MN 56537	Electronic Service	No	OFF_SL_19-256_M-19-256
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Michael	Volker	mvolker@eastriver.coop	East River Electric Power Coop	211 S. Harth Ave Madison, SD 57042	Electronic Service	No	OFF_SL_19-256_M-19-256
Sharon N.	Walsh	swalsh@shakopeeutilities.com	Shakopee Public Utilties	255 Sarazin St Shakopee, MN 55379	Electronic Service	No	OFF_SL_19-256_M-19-256

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Robyn	Woeste	robynwoeste@alliantenergy.com	Interstate Power and Light Company	200 First St SE Cedar Rapids, IA 52401	Electronic Service	No	OFF_SL_19-256_M-19-256
Daniel P	Wolf	dan.wolf@state.mn.us	Public Utilities Commission	121 7th Place East Suite 350 St. Paul, MN 551012147	Electronic Service	Yes	OFF_SL_19-256_M-19-256