Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: August 27, 2015 .... **Agenda Item # **_8__**

Company: Minnesota Power

Docket No. **E-015/M-15-80**

In the Matter of Minnesota Power's 2014 Demand Side Management Financial Incentives and Annual Filing to Update the CIP Rider

Issue(s):

1. Should the Commission approve Minnesota Power's 2014 CIP tracker account?

2. Should the Commission approve an incentive of $6,237,702 for Minnesota Power's 2014 CIP achievements?

3. Should the Commission grant Minnesota Power's variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket?

4. Should the Commission modify the carrying charge applied to Minnesota Power's tracker balance for the CIP rider?

5. At what level should the Commission set Conservation Program Adjustment (CPA)?

Staff: Marc Fournier 651-201-2214

Relevant Documents

Initial Filing Minnesota Power CIP Consolidated Filing .... April 1, 2015

Corrected Comments of the Department of Commerce,
Division of Energy Resources (DOC) .... July 8, 2015
(Originally filed June 15, 2015)

Reply Comments Minnesota Power .... June 25, 2015

Response of the Department of Commerce to Reply Comments,
Division of Energy Resources .... July 13, 2015

The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

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I. Statement of the Issue(s)

1. Should the Commission approve Minnesota Power's 2014 CIP tracker account?

2. Should the Commission approve an incentive of $6,237,702 for Minnesota Power's 2014 CIP achievements?

3. Should the Commission grant Minnesota Power's variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket?

4. Should the Commission modify the carrying charge applied to Minnesota Power's tracker balance for the CIP rider?

5. At what level should the Commission set Conservation Program Adjustment (CPA)?

II. Relevant Statute

Minn. Stat. § 216.16, subd. 6c. states:

> **Incentive plan for energy conservation improvement.** (a) The commission may order public utilities to develop and submit for commission approval incentive plans that describe the method of recovery and accounting for utility conservation expenditures and savings. In developing the incentive plans the commission shall ensure the effective involvement of interested parties.
>
> (b) In approving incentive plans, the commission shall consider:
>
> (1) whether the plan is likely to increase utility investment in cost-effective energy conservation;
>
> (2) whether the plan is compatible with the interest of utility ratepayers and other interested parties;
>
> (3) whether the plan links the incentive to the utility's performance in achieving cost-effective conservation; and
>
> (4) whether the plan is in conflict with other provisions of this chapter.
>
> (c) The commission may set rates to encourage the vigorous and effective implementation of utility conservation programs. The commission may:

> (1) increase or decrease any otherwise allowed rate of return on net investment based upon the utility's skill, efforts, and success in conserving energy;
>
> (2) share between ratepayers and utilities the net savings resulting from energy conservation programs to the extent justified by the utility's skill, efforts, and success in conserving energy; and
>
> (3) adopt any mechanism that satisfies the criteria of this subdivision, such that implementation of cost-effective conservation is a preferred resource choice for the public utility considering the impact of conservation on earnings of the public utility.

The Conservation Improvement Project Rider was submitted in accordance with the Miscellaneous Tariff rules.

III. Background

The Shared Savings DSM financial incentive plan was approved by the Commission in Docket No. E,G-999/CI-08-133 on January 27, 2010. On December 20, 2012 the Commission issued its Order Adopting Modifications to Shared Savings Demand Side Management Financial Incentives (Modification Order). The Shared Savings approach emphasizes a 1.5 percent energy savings goal, and ties the incentive earned by the utility to pursuit of the 1.5 percent savings goal. The incentive mechanism sets a specific dollar amount per unit of energy saved that each utility will earn at energy savings equal to 1.5 percent of annual non-CIP-exempt retail sales. That dollar amount is referred to as the incentive calibration. The higher the calibration, the higher the incentive will be at all energy savings levels after the threshold. Specifically, each electric utility's incentive is calibrated so that when the utility achieves energy savings equal to 1.5 percent of retail sales, electric utilities will earn an incentive equal to $0.07 per kWh saved and gas utilities will earn $9 per thousand cubic feet (Mcf) saved.

Additional Background

On April 1, 2015, Minnesota Power (MP or the Company) submitted its annual Conservation Improvement Program (CIP) report (Report or Petition) for 2014 with the Commission the Petition contains the following sections:

- proposed recoveries and expenditures in the Company's CIP tracker account during 2014;
- proposed Conservation Program Adjustment (CPA) for 2015/2016, and;
- request for approval of a proposed Demand Side Management (DSM) financial incentive of $6,237,702.

The Minnesota Department of Commerce (DOC) filed its initial Comments on June 15, 2015. In our Comments, the DOC recommended that the Commission:

- approve Minnesota Power's 2014 CIP Tracker Account Activity;
- approve an incentive of $6,237,702 for Minnesota Power's 2014 CIP achievements; and
- grant MP a variance to Minn. Rules part 7820.3500 and 7825.2600 to permit the Company to continue combining the CPA with the Fuel Clause Adjustment on customer bills.

Minnesota Power agreed with these three DOC recommendations in its Reply Comments filed on June 25, 2015. Two issues remain in dispute, then: the Conservation Program Adjustment (CPA) and the carrying charge.

The DOC followed up on these two issues by requesting that the Company provide some additional analyses in its Reply Comments. First, the DOC asked for more explanation on the impact of a carrying charge on the CIP tracker account set equal to the Company's short-term cost of debt from its most recent general rate case as compared to the current carrying charge which is the Company's average weighted cost of capital (WACC) from its most recent general rate case. The DOC also asked MP to provide an estimate of the CPA using a fiscal year (July through June) approach in lieu of its current calendar year approach. Minnesota Power provided both these analyses in its Reply Comments.

IV. Parties' Comments

Conservation Program Adjustment (CPA)

Minnesota Power**:**

Minnesota Power requests the Commission approve the Company's proposed CPA factor of **$0.002334** per kWh to be effective without proration with bills rendered on or after July 1, 2015. Minnesota Power has calculated the CPA factor using a per-kWh methodology, as recommended by the Department and approved by the Commission in its September 22, 2010 Order, Docket No. E015/M- 10-266 and as reaffirmed in its January 12, 2012 Order, Docket No. E015/M-11-241. Minnesota Power anticipates again filing for CPA modification on April 1, 2016, making the effective period for this request essentially July 1, 2015, through June 30, 2016. Until Commission approval, the existing CPA factor will remain in effect.

The CPA factor is calculated as part of the annual CIP Consolidated Filing with a proposed effective date of July 1st of each year. Any variation from that timing can impact tracker balances, including carrying charges. Of note, Minnesota Power's year-end CIP Tracker balance has been negative for the past two years. Minnesota Power has traditionally used calendar year assumptions for developing the proposed CPA. Each year Minnesota Power requests an effective period of July through June for its CPA factor.

In its comments, the DOC suggests that Minnesota Power's approach to calculating its CPA is "unusual" in that it uses a combination of historical and forecasted accounting information based on a calendar year for a CPA factor that would have an assumed fiscal year effective period of July 2015 to June 2016. The Department has requested that Minnesota Power provide an estimated CPA using a "consistent timeframe," meaning a fiscal year convention akin to what other utilities use. In the estimate, the CPA significantly decreases because the higher CPA factor currently in effect is reflected for a longer period of time. The resulting CPA rate is **$0.000855**.

DOC:
The Department believes that the fiscal year approach to calculating the Company's CPA is preferable to its current approach because it uses a mid-year CIP tracker balance instead of the prior-year end balance as a starting point. This should provide the Commission with an additional three months of actuals of CIP cost recovery (January through March) and thus the estimate of the CIP tracker balance at the time the new CPA will become effective should be more accurate. One potential issue with MP's approach, however, is that it does not adjust the CPA to recognize the likelihood of MP being awarded a shared savings DSM financial incentive for its CIP achievements. MP has generally booked its shared savings incentives in the latter half of the calendar year for the previous year's results. One could argue that it is appropriate to include an adjustment of this type given the "matching principal" for revenues and expenses often cited by accountants.

To further assess the reasonableness of including a forecasted CIP incentive in the calculation of the fiscal-year CPA, the Department compared past forecasted incentive values with the incentives actually awarded to assess the risk of eroding the accuracy of the forecasted tracker balance. The Company's approved incentive for that five year period was 57 percent higher than the forecasted incentive on average. This historical information would suggest that an adjustment equal to the Company's forecasted incentive would be a conservative adjustment.

Consequently, the Department recommends that the Commission require MP to develop its 2015-2016 CPA using a fiscal year approach and to use the method the CPA that would be effective in the latter half of 2015 and the first half of 2016.

Carrying Charge on CIP Tracker

Minnesota Power**:**
In 2014, the Commission issued orders changing the carrying charge on the CIP Tracker account for Otter Tail Power Company, Xcel Energy, and Alliant (Interstate Power and Light). The Commission determined for those filings that the short-term cost of debt was the appropriate basis for a carrying charge. Along those lines, the Department has recommended that Minnesota Power "adopt the short-term cost of debt identified in its most recent general rate case (Docket No. E015/GR-09-1151) as the carrying charge for the Company's CIP tracker account." The

Department has further requested that Minnesota Power provide an updated estimate of its 2015-2016 CPA assuming the Commission approves its current short-term cost of debt as the carrying charge on the CIP Tracker account effective October 1, 2015. Minnesota Power did not have a short-term cost of debt in the capital structure approved in its last rate case. As such, if the carrying charge rate is to be changed, Minnesota Power requests Commission guidance on the applicable rate to use. So long as tracker balances and related cost recovery mechanisms remain relatively aligned and operating as intended, the carrying charge should not be a significant portion of the CIP Tracker balance. Further, the carrying charge is applied to both negative and positive tracker balances. This means that in months where the tracker balance is positive, "interest" is added to the tracker. Conversely, in months where the tracker balance is negative, the tracker balance is decreased with an "interest" credit to customers.

DOC:

The results for the change in the carrying charge assuming a fiscal year approach were somewhat surprising; the forecasted total carrying charge for the twelve month period using the Company's WACC was ($20,019) while the same estimate using Otter Tail Power Company's short-term cost of debt as a proxy was ($18,085).

While the ($1,934) difference in the annual forecasted carrying charge appears to be de minimus in this instance, the lower cost for carrying charges is likely to reduce costs for ratepayers in other scenarios. Thus, the Department continues to recommend that the Commission require MP to use a carrying charge based on the Company's short-term cost of debt, just like the Commission has been approving for other investor-owned utilities.

Although Minnesota Power did not include short term debt in its capital structure in its most recent rate case, the Department notes that MP has a multi-year credit facility (Agreement) in place that serves as the vehicle for the Company to borrow funds on a short-term basis (i.e. the functional equivalent of the Company's short-term cost of debt). The Department recommends that Minnesota Power use the appropriate forecasted interest rate under this Agreement as its short-term cost of debt in its calculation of the carrying charge on the CIP Tracker Balance.

V. Staff Discussion

Tracker Account

Staff agrees with the DOC that the 2014 tracker account was calculated correctly. As such, the Commission should approve Minnesota Power's 2014 CIP Tracker account balance of ($1,116,332) as reported by the DOC. To put this amount in perspective, below is the tracker balance from 2007:

Year	DSM Financial Incentive	Year-End Tracker Balance
2007	$349,334	$1,188,103
2008	$607,169	$1,870,428
2009	$878,709	$1,613,335
2010	$6,806,612	$662,926
2011	$7,772,885	$4,603,612
2012	$7,105,410	$4,337,461
2013	$8,733,448	($495,816)
2014	$6,237,702	($1,116,332)

Carrying Charge

With respect to the carrying charge applied to the CIP tracker, Staff recommends that Minnesota Power be required to change its carrying charge rate from its overall rate of return to a more short term rate. This is what the Commission did with the other three investor owned utilities in the state.[1] However, Minnesota Power did not have a short term cost of debt established in its last rate case. As such, the Commission will need to establish a proxy rate. The three options are provided in issue D below. The first is Minnesota Power's multi-year credit facility as recommended by the DOC. As pointed out by the DOC, this is functionally equivalent to the Company's short-term cost of debt. The DOC recommended that the forecasted interest rate under this Agreement as a short term cost of debt for Minnesota Power's CIP Tracker Balance.

A second possible proxy for Minnesota Power's short-term cost of debt for carrying charges for the CIP Tracker could be to use Otter Tail Power's short- term cost of debt. This rate was established in Otter Tail's last rate case.[2] Otter Tail and Minnesota Power are somewhat similarly situated. Notably, the DOC used Otter Tail's short-term cost of debt to approximate the change in carrying charge that could be expected by moving from the Company's overall rate of return to the lower short-term cost of debt.

The third possible proxy is the two-year Treasury bond rate. There is Commission precedent for this approach. In docket G-004/M-14-358, the Commission used the two year U.S. Treasury bond rate as a proxy for Great Plains Natural Gas Company's CIP Tracker balance because Great Plains, like Minnesota Power, did not have a short-term cost of debt established in its most recent rate case. In its Order in Docket G-004/M-14-358, the Commission determined that:

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[1] Please see the Commission's Orders in Otter Tail Power E-017/M-14-201 (September 26, 2014), in Interstate Power and Light E-001/M-14-284 (December 17, 2014), and in Xcel Energy E-002/M-14-287 (December 17, 2014).

[2] Please see the Commission's Findings of Fact, Conclusions, and Order dated April 25, 2011, Docket No. E-017/GR-10-239. The short Term cost of debt established in that rate case was 0.79%.

> In this case, however, the Company has no authorized cost of short-term debt; none was set in its last rate case. The Commission will therefore direct the Company to use the two-year U.S. Treasury Bond rate as of October 29, 2014. Both Company and Department concurred in this approach, which the Commission agrees offers the best proxy in the record for the gas utility's current cost of short-term debt. The new rate will become effective prospectively, beginning in the month following the date of this order.

Staff believes that the Commission could reasonably go in one of two directions. It could choose a rate on a specific day such as September 9, 2015. This is what was done in the Great Plains case. Alternatively, it could pick the average of the daily rates since the beginning of 2015.

CPA

With respect to the CPA level, the CPA rate should be set with the goal of maintaining the tracker account reasonably on either side of zero. Minnesota Power recommended a CPA of $0.002334. This rate level assumed that it would be implemented on July 1, 2015. Depending upon when it is implemented, it may result in over collection. This is the case given that the higher current rate is being collected for a significant period of time beyond July 1, 2015.

The DOC calculated a CPA rate of $0.001882. This calculation utilizes a CIP Tracker Account balance which utilizes June 30, 2015 (fiscal year) as the end of the prior period rather than December 31, 2014. In addition, this rate also assumed 100% of the forecasted 2015 CIP incentive. As with the previous rate level, the accuracy of its recovery will depend heavily upon when it is implemented.

A third rate of $0.000855 was calculated by Minnesota Power using the fiscal year approach using June 30, 2015 as the end of that fiscal year. Commerce argued that this approach is more accurate in that it relies on more actual data rather forecasted data. However, this calculation does not adjust the calculation of the CPA recognizing that Minnesota Power is awarded the shared DSM financial incentive for its CIP achievements.

Finally, the Commission may wish to require Minnesota Power to update its CPA recognizing that the rate is being implemented after the original assumed date of July 1, 2015. This would recognize the Company has been generating revenue at the existing CPA rate of $0.00175. The Commission should require the Company to do this as part of a compliance filing within 10 days from the date of the Commission's Order in this matter.

The DOC and MP are in agreement on the granting of a variance as outlined in MP's original petition; staff agrees with the parties.

VI. Commission Options

A. Should the Commission approve Minnesota Power's 2014 CIP tracker account?

1. Approve Minnesota Power's 2014 CIP tracker account as indicated at page five of the DOC's July 8, 2015 comments.

2. Do not approve Minnesota Power's 2014 CIP tracker account.

B. Should the Commission approve an incentive of $6,237,702 for Minnesota Power's 2014 CIP achievements?

1. Approve Minnesota Power's 2013 financial incentive for CIP achievements.

2. Do not approve Minnesota Power's 2013 financial incentive for CIP achievements.

C. Should the Commission grant Minnesota Power's variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket?

1. Grant the rule variance to allow Minnesota Power to combine the Conservation Program Adjustment (CPA) in with the fuel clause adjustment (FCA) line item on customer's bills.

2. Do not grant the rule variance to allow Minnesota Power to combine the CPA in with the fuel clause adjustment (FCA) line item on customer's bills.

D. Should the Commission modify the carrying charge applied to Minnesota Power's tracker balance for the CIP rider? [3]

1. Require Minnesota Power to calculate the carrying charge on its CIP tracker account using the CIP tracker account using the rate from its multi-year credit facility (Agreement) in place that serves as the vehicle for the Company to borrow funds on a short-term basis (i.e. the functional equivalent of the Company's short-term cost of debt). The modification shall be effective as of the date of the Commission's Order in this docket.

2. Require Minnesota Power to calculate the carrying charge on its CIP tracker account using as a proxy the short-term cost of debt rate established in Otter Tail Power's last rate case, Docket No. E-017/GR-10-239. The modification shall be effective as of the date of the Commission's Order in this docket.

3. Require Minnesota Power to calculate the carrying charge on its CIP tracker account using as a proxy the short-term cost of debt rate the average 2015 daily

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[3] In Minnesota Power's last rate case, Docket No.E-015/GR-09-1151, the Commission did not establish a short-term cost of debt in establishing the Company's capital structure.

two year treasury rate. The modification shall be effective as of the date of the Commission's Order in this docket.

4. Modify the carrying charge to be equal to the two year U.S. Treasury Bond rate as of September 9, 2015. The modification shall be effective as of the date of the Commission's Order in this docket.[4,5]

5. Do not modify the carrying charge from the overall rate of return which is currently used.

6. Take other action the Commission deems appropriate.

E. What rate level for the CPA should the Commission approve for the first billing cycle in the month following Commission approval, assuming reasonable time for implementation and customer notice?

1. Require Minnesota Power to calculate a CPA rate recognizing that it has been generating revenue since July 1, 2015 at the higher rate of $0.00175 and using a fiscal year approach, and file that rate in a compliance filing within 10 days of the date of the Commission's Order.

2. Require Minnesota Power to calculate its CPA using the information included DOC Table 2 of the DOC's July 13, 2015 reply comments as a basis for the time period July 2015 through June 2016 and divide that estimated recoverable tracker balance by the appropriate CIP-eligible kilo-watt hour sales for the time period during which the 2015-2016 CPA would remain in effective as recommended by the DOC.

2. Set the CPA at $0.002334 as originally recommended by the Company.

3. Set the CPA at $0.001882 as calculated by the DOC in its reply comments.

4. Set the CPA at $0.000855 as calculated by Minnesota Power in reply comments.

5. Leave the CPA at its current level of $0.00175.

VII. Staff Recommendation

[5] In docket G004/M-15-422, the DOC recommended that the Commission require Great Plains, in future petitions for approval of its CIP Tracker and demand side management incentive, to update the interest rate used to calculate carrying charges to reflect the two year U.S. Treasury bond rate as of the time the Company is preparing the petition.

Staff recommends items A1, B1, C1, D (no recommendation), and E1.