

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Nancy Lange	Chair
Dan Lipschultz	Commissioner
Matthew Schuenger	Commissioner
Katie J. Sieben	Commissioner
John A. Tuma	Commissioner

In the Matter of Otter Tail Power
Company's 2018 Conservation Cost
Recovery Adjustment and 2017 Electric
Demand Side Management Financial
Incentive

ISSUE DATE: October 30, 2018

DOCKET NO. E-017/M-18-119

ORDER APPROVING TRACKER
ACCOUNT, APPROVING FINANCIAL
INCENTIVE SUBJECT TO TRUE-UP,
SETTING CCRA, AND GRANTING
VARIANCE

PROCEDURAL HISTORY

On March 30, 2018, Otter Tail Power Company (Otter Tail or the Company) filed its 2017 Conservation Improvement Program (CIP) Status Report, proposed 2017 Demand-Side Management (DSM) Financial Incentive, and proposed 2018/2019 Conservation Cost Recovery Adjustment (CCRA).

In its filing, Otter Tail asked the Commission to take the following actions:

1. Approve the 2017 transactions in its CIP tracker account, the account used to track costs incurred, incentives earned, and amounts recovered in rates in connection with the Company's CIP activities;
2. Approve an incentive payment of \$2,642,360 for energy savings achieved in 2017 under the financial-incentive mechanism adopted by the Commission,¹ and to allow the Company to carry forward a portion of the 2017 savings and net benefits to 2018;
3. Authorize the Company to increase its CCRA, the rate rider used to recover amounts booked to the CIP tracker account, from \$0.00536 per kilowatt-hour (kWh) to \$0.00600 per kWh; and
4. Grant a variance to Minn. R. 7820.3500(K) and 7825.2600 to allow the Company to combine the CCRA and fuel-clause adjustment on customer bills.

On May 30, the Minnesota Department of Commerce, Division of Energy Resources (the Department), filed comments recommending that the Commission approve Otter Tail's petition

¹ See generally *In the Matter of Commission Review of Utility Performance Incentives for Energy Conservation Pursuant to Minn. Stat. § 216B.241, Subd. 2c*, Docket No. E,G-999/CI-08-133.

with certain adjustments. In particular, the Department recommended that the Commission reject the Company's proposal to carry forward savings and net benefits to 2018.

On June 13, Otter Tail filed reply comments revising its incentive proposal. Rather than carrying forward energy savings and net benefits to be reflected in the 2018 incentive, the Company requested that it be allowed to count budgeted expenditures for a streetlight-replacement project that had been planned for 2017, but not actually commenced that year, in the calculation of its 2017 incentive.

On July 3, the Department filed a response to the Company's reply comments. It opposed Otter Tail's new incentive proposal, arguing that CIP expenditures should not be counted before they are realized, and that even if Otter Tail had begun the streetlight-replacement project in 2017, certain project costs could not be counted in the incentive calculation because the streetlights are utility property.

On July 13, Otter Tail filed additional reply comments.

On August 1, the Department filed additional response comments.

On October 4, 2018, the Commission met to consider the matter.

FINDINGS AND CONCLUSIONS

I. Regulatory Background

The Minnesota Legislature has set a goal of "achiev[ing] annual energy savings equal to 1.5 percent of annual retail energy sales of electricity and natural gas."² To that end, Minnesota Statutes section 216B.241, subdivision 2, requires public utilities to develop energy conservation improvement programs (CIPs) designed to reduce energy use.

Under its CIP, a utility may, for example, offer rebates to help residential customers purchase energy-efficient appliances or to encourage business customers to make energy-efficiency upgrades to their buildings. The Department of Commerce sets individual utilities' energy-savings goals³ and approves CIPs,⁴ while the Commission determines, under its ratemaking authority, how rebates and other CIP costs are recovered.⁵

The Legislature has also authorized the Commission to approve a system of financial incentives to encourage utilities to promote energy conservation:

- (a) The commission may order public utilities to develop and submit for commission approval incentive plans that describe

² Minn. Stat. § 216B.2401.

³ Minn. Stat. § 216B.241, subd. 1c.

⁴ *Id.*, subd. 2.

⁵ *Id.*, subd. 2b; Minn. Stat. § 216B.16, subd. 6b.

the method of recovery and accounting for utility conservation expenditures and savings. . . .

- (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.⁶

The Commission has established a framework for determining conservation incentives based on a utility's CIP expenditures in a given year, the energy savings achieved, and the resultant net economic benefit. It has modified this framework from time to time. For the year 2017, utilities are entitled to a share of the net benefits of their conservation improvement programs under the following conditions:

⁶ Minn. Stat. § 216B.16, subd. 6c.

1. An electric utility must achieve energy savings of at least 1% of retail sales to be entitled to receive an incentive.⁷
2. The incentive increases as the total savings approaches 1.7% of retail sales. Beyond that point, the incentive is capped at 13.5% of the net benefits generated (net-benefits cap).⁸
3. In addition, the incentive is capped at 40% of CIP expenditures (CIP-expenditure cap).⁹

II. 2017 Financial Incentive

A. The Company's Request

For 2017, Otter Tail reported CIP expenditures of \$6,605,899, energy savings of 52,497,167 kWh, and net benefits of \$23,626,518. These energy savings represent 3.02% of the Company's historic average retail sales to CIP-eligible customers and therefore qualify for the maximum 13.5% share of the net benefits, or about \$3.2 million. However, the CIP-expenditure cap independently limits Otter Tail's maximum incentive to \$2,642,360.

Otter Tail's 2017 CIP originally included spending to retrofit Company-owned streetlights with light-emitting diodes ("LED streetlight project" or "the project"). However, due in part to lengthy regulatory proceedings to approve a related streetlight tariff,¹⁰ the project was not commenced in 2017. Because the budgeted funds were not actually spent in 2017, Otter Tail did not include them in its financial-incentive calculation, making the incentive smaller than it otherwise would have been.

In its initial filing, Otter Tail proposed to carry forward the energy savings and net benefits rendered superfluous by the CIP-expenditure cap and to count them toward its 2018 incentive. Otter Tail argued that this proposal would recognize its high level of CIP achievement in 2017 and avoid penalizing the Company for circumstances outside its control that prevented it from beginning the LED streetlight project in 2017.

In reply comments, the Company revised its proposal. Instead of proposing to carry forward a portion of 2017 savings and net benefits, it requested that it be allowed to count the budgeted 2017 costs for the LED streetlight project toward its 2017 incentive. According to Otter Tail, this change would increase the incentive from \$2,642,360 to \$2,938,110.

⁷ Docket No. E,G-999/CI-08-133, Order Adopting Modifications to Shared Savings Demand-Side Management Financial Incentive Plan, at 28 (August 5, 2016).

⁸ The net-benefits cap decreases to 12% in 2018, and to 10% in 2019. *Id.*

⁹ The CIP-expenditure cap decreases to 35% in 2018, and to 30% in 2019. *Id.* at 29.

¹⁰ See generally *In the Matter of Otter Tail Power Company's Petition for Approval of the Company's Proposed LED Street and Area Lighting Rate Schedule 11.07 and Associated LED Implementation Plan*, Docket No. E-017/M-17-152.

B. Positions of the Parties

1. The Department

The Department recommended that the Commission reject Otter Tail's proposal to include the budgeted costs for the LED streetlight project in the calculation of the Company's 2017 incentive. The Department acknowledged the delay caused by the proceeding to approve a new streetlight tariff but argued that careful review was required due to the complexity of the issues involved. The Department also argued that the delay simply means that these costs will be recognized in 2018 when they are actually incurred, allowing them to be counted toward next year's incentive.

The Department stated that, while the Commission has authority over CIP incentives, Minnesota law does not expressly permit utilities to shift CIP expenses to a different year for purposes of calculating incentives. It recommended that the Commission not allow this practice because it would be inconsistent with Minn. Stat. § 216B.16, subd. 6c—in particular, the statute's requirements that an incentive plan (1) increase utility investment in cost-effective energy conservation and (2) be compatible with the interest of utility ratepayers.

If the Commission does allow the project's budgeted costs to count toward Otter Tail's 2017 incentive, the Department recommended that it exclude at least one component—a CIP rebate worth approximately \$180,000.

The Department noted that the Commission has prohibited counting energy savings from utility-owned CIP projects toward earning a financial incentive.¹¹ Because the LED streetlight project involves Company-owned facilities, the Department concluded that it would not be appropriate for Otter Tail to count the project's rebate toward the CIP-expenditure cap for purposes of calculating the Company's financial incentive.

In its August 1 comments, the Department changed its position, stating that it would not oppose including the rebate costs in the financial-incentive calculation once those costs were incurred. But at the Commission hearing, the Department again argued that the Commission might not want to allow the CIP rebate to count toward Otter Tail's financial incentive in light of the prior order.¹²

2. Otter Tail's Response

Otter Tail argued that the Commission can and should consider budgeted LED streetlight project expenses in the 2017 financial-incentive calculation. The Company reiterated that it had intended to spend the entire 2017 CIP budget but was unable to do so due to a longer than expected tariff-approval process, which significantly impacted its financial incentive. Furthermore, shifting the

¹¹ See *In the Matter of the Minnesota Department of Commerce's Request that the Commission Adopt Ratemaking Standards for Utility-Owned CIP Projects*, Docket No. E,G-999/DI-12-1342, Order Determining Ratemaking Treatment of Utility CIP Project Costs and Requiring Further Filings, at 4 (July 16, 2013) (reasoning that utilities already have sufficient incentive to minimize the energy efficiency of their own operations).

¹² *Id.*

streetlight costs to 2018 subjects them to a reduced net-benefits cap (12%) and reduced CIP-expenditure cap (35%).

Otter Tail argued that Minn. Stat. § 216B.16, subd. 6c, governs the development of an incentive mechanism, not how the mechanism is later applied. It further argued that, even if the statute does apply to its proposal, treating the streetlight project expenses as if they had been incurred in 2017 would be consistent with the statute. The Company maintained that its 3.02% energy savings in 2017—which it characterized as a record for both Otter Tail and electric utilities in Minnesota—was a significant achievement that benefitted ratepayers and should be rewarded.

Finally, Otter Tail argued that the project's rebate cost should be counted for purposes of calculating the CIP-expenditure cap. The Company stated that a CIP rebate is not a financial benefit to the utility because it reduces the need for upfront capital investment, decreasing rate base and return on investment. Otter Tail argued that if the Commission does not count rebate expenses toward the financial incentive, the Company would have to reevaluate whether this and other CIP projects should receive priority over non-CIP capital projects.

C. Commission Action

The Commission concurs with Otter Tail that, under these circumstances, it is appropriate to recognize the budgeted LED streetlight project expenses in calculating the Company's 2017 financial incentive.

Otter Tail had planned to start the project in 2017. However, implementation depended on the parallel proceeding to approve a new streetlight tariff. That proceeding took longer than expected through no fault of the Company's, and as a result, Otter Tail was not able to begin the project in 2017 as planned. This had an adverse impact on the Company's 2017 CIP incentive, reducing the CIP-expenditure cap and thereby limiting Otter Tail's ability to share in the net benefits of the savings realized in 2017.

The Department argued that allowing these costs to be counted in 2017 would conflict with Minn. Stat. § 216B.16, subd. 6c. But, putting aside the issue of whether that statute applies here, the Commission finds Otter Tail's proposal to be consistent with the statute. Recognizing these costs in 2017 is likely to increase utility investment in cost-effective energy conservation by rewarding efforts to advance an innovative project that was unexpectedly delayed by the regulatory process. It is compatible with the interest of utility ratepayers, who will benefit from the efficiencies of the LED streetlights. And it rewards the utility's conservation efforts that achieved a record 3.02% energy savings in 2017.

The Department also argued that a July 16, 2013 Commission order may preclude the project's CIP rebate from being counted toward the financial incentive. That order was the result of a Department investigation into CIP projects involving utility-owned facilities. For example, a utility might use a CIP rebate to cover the cost of a recommissioning study to determine the feasibility of energy upgrades to its headquarters.

The Commission concluded that utilities should be able to participate in CIP in that manner. However, it also concluded that “utilities should not be allowed to count the energy savings from their own CIP projects toward earning a DSM financial incentive.”¹³ This was primarily because

the purpose of DSM financial incentives is to neutralize, at least in part, the significant disincentive to conservation posed by lost energy sales. These incentives compensate utilities for a portion of sales lost to conservation and have proven to be effective tools for maximizing utility participation in conservation efforts. Here, however, there are no lost energy sales, just cost savings like those enjoyed by any utility customer who has installed efficiency improvements.¹⁴

The Department argued that, just as the savings from a utility-owned CIP project cannot be counted toward a utility’s incentive, so also must CIP-rebate costs for utility-owned projects not count toward the incentive. The Commission concludes that this issue is not sufficiently developed to be resolved at this time. It will approve an incentive of \$2,938,110 for Otter Tail’s 2017 CIP achievements—which reflects the LED streetlight project costs—subject to true-up after this issue is addressed further in next year’s CIP proceeding.

Below, the Commission addresses the remaining, undisputed, aspects of Otter Tail’s CIP filing.

III. 2017 CIP Tracker Account Activity Approved

Otter Tail requested approval of its report on recoveries and expenditures recorded in the Company’s CIP tracker account during 2017. Otter Tail’s 2017 CIP tracker account activity is summarized below in Table 1.

Table 1: Summary of Otter Tail’s 2017 CIP Tracker Account

Description	Time Period	Amount
Beginning Balance	December 31, 2016	\$4,835,852
CIP Expenses	January 1 – December 31, 2017	\$6,605,899
2016 Financial Incentive	Approved in 2017 for 2016	\$5,031,678
Carrying Charges	January 1 – December 31, 2017	\$105,386
Base-Rate Recovery	January 1 – December 31, 2017	(\$3,217,008)
CCRA Recovery	January 1 – December 31, 2017	(\$5,999,462)
Ending Balance	December 31, 2017	\$7,362,345

The Department reviewed Otter Tail’s CIP tracker account and concluded that the Company correctly calculated its ending balance for 2017. It recommended that the Commission approve

¹³ July 16, 2013 order, at 4.

¹⁴ *Id.*

Otter Tail's 2017 CIP tracker account activity as summarized above. The Commission agrees with the Department that the Company's 2017 tracker account activity should be approved and will so order.

IV. Conservation Cost Recovery Adjustment

CIP costs are recovered in two ways: through the Conservation Cost Recovery Charge (CCRC), a component of base rates that recovers baseline CIP costs, and through the Conservation Cost Recovery Adjustment (CCRA), an automatic rate-adjustment mechanism, or rider, that trues up differences between actual CIP costs and those recovered through the CCRC.

The CCRA is recalculated each year based on the previous year's CIP tracker balance, expected CIP spending and recoveries in the current year, and other considerations. In this year's CIP filing, Otter Tail asked to increase its CCRA from \$0.00536/kWh to \$0.00600/kWh, an increase of approximately 11.9%.

The Department observed that Otter Tail's proposed CCRA should reduce the tracker balance to about \$1.7 million by September 2019 and allow it reach zero within another year after that. The Department concluded that the Company's request was reasonable and recommended that the Commission approve its requested CCRA of \$0.00600/kWh. The Commission concurs and will so order.

V. Billing-Rules Variance

Like other Minnesota utilities, Otter Tail gives customers notice when it changes the amount of the CCRA and then combines the CCRA with other costs recovered through its fuel clause.

Instead of identifying the CCRA separately on customers' bills, the Company combines it with other fuel-clause costs in a single line item labeled "Resource Adjustment." This practice requires a variance to Minn. R. 7820.3500(K) and 7825.2600, which require that customer bills separately itemize the fuel clause. The Company has been granted similar variances since 1995, when it first began recovering CIP costs through a rider.

Under Minn. R. 7829.3200, the Commission is authorized to vary any of its rules upon making the following findings:

1. Enforcing the rule would impose an excessive burden upon the applicant or others affected by the rule;
2. Granting the variance would not adversely affect the public interest; and
3. Granting the variance would not conflict with any standards imposed by law.

The Commission will vary Minn. R. 7820.3500(K) and 7825.2600, making the following findings:

1. Enforcing the separate-itemization requirement of these rules would impose an excessive burden on the Company, by forcing it to incur substantial unnecessary expense, and on its

ratepayers, by forcing them to adjust to an unfamiliar billing format, without meaningful benefit.

2. Varying the rules would not adversely affect the public interest, since the purpose of the itemization requirement would be served by the annual customer notice provided by the Company and by the comprehensive CIP information on its website.
3. Varying the rules would not conflict with any standards imposed by law.

The Commission will so order.

ORDER

1. The Commission approves a financial incentive of \$2,938,110 for Otter Tail's 2017 conservation improvement program (CIP) achievements, subject to a true-up after resolution in next year's CIP proceeding as to whether the LED street lighting expenditures qualify as part of the CIP-incentive calculation.
2. The Commission approves Otter Tail's 2017 CIP tracker account resulting in a December 31, 2017 tracker balance of \$7,362,345.
3. The Commission approves a CCRA of \$0.00600 per kWh, to be effective the first day of the month following this order's issuance.
4. The Commission grants Otter Tail a variance to Minnesota Rules parts 7820.3500(K) and 7825.2600 for one year after the date of this order.
5. Otter Tail shall submit a compliance filing within ten days of this order with revised tariff sheets reflecting the Commission's determinations in this matter.
6. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Daniel P. Wolf
Executive Secretary



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