

Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: November 24, 2014.....**Agenda Item #15

Company: Minnesota Energy Resources Corporation (MERC, the Company)

Docket No. **G-011/M-14-369**

In the Matter of MERC's 2013 Demand Side Management Financial Incentives and Annual Filing to Update the CIP Rider

- Issue(s):
1. Should the Commission approve MERC's 2013 CIP tracker account?
 2. Should the Commission approve an incentive of \$2,492,730 for MERC's 2013 CIP achievements?
 3. At what level should the Commission set the conservation cost recovery adjustment (CCRA) for 2014/2015?
 4. Should the Commission approve MERC's proposed bill message with the appropriate modifications to reflect an accurate effective date and gas CIP Adjustment Factor as determined by the Commission?
 5. Should the Commission find that MERC has complied with the Commission's Order in Docket No. G011/M-13-369 regarding the filing of conservation cost repayment adjustment schedules?
 6. Should the Commission eliminate the carrying charge or otherwise modify its application to MERC's tracker balance for the CIP rider effective with the date of the Commission's Order?

Staff: Marc Fournier651-201-2214

Relevant Documents

Initial Filing MERC May 1, 2014

Revised Petition for Approval of CIP Tracker,
DSM Incentive, and CCRA MERC August 25, 2014

Comments of the Department of Commerce,
Division of Energy Resources (DOC) September 2, 2014

Reply Comments MERC	September 12, 2014
Compliance Filing-MERC Financial Incentive, and Conservation Cost recovery Adjustment	September 15, 2014
Commission Order Approving Financial Incentive, Setting Conservation Cost Recovery Adjustment, Reducing Carrying Charges, and Varying Rules Docket No. E-017/M-14-201	September 26, 2014
Reply Comments of the Department of Commerce, Division of Energy Resources	October 9, 2014
Additional Reply Comments MERC	October 14, 2014

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 MERC's 2013 CIP tracker account?
2. Should the Commission approve an incentive of \$2,492,730 for MERC's 2013 CIP achievements?
3. At what level should the Commission set the conservation cost recovery adjustment (CCRA) for 2014/2015?
4. Should the Commission approve MERC's proposed bill message with the appropriate modifications to reflect an accurate effective date and gas CIP Adjustment Factor as determined by the Commission?
5. Should the Commission find that MERC has complied with the Commission's Order in Docket No. G011/M-13-369 regarding the filing of conservation cost repayment adjustment schedules?
6. Should the Commission eliminate the carrying charge or otherwise modify its application to MERC's tracker balance for the CIP rider effective with the date of the Commission's Order?

II. Relevant Statute

Minn. Stat. § 216B.16, subd. 6c.

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.

II. Background

On May 1, 2014, Minnesota Energy Resources Corporation (MERC or the Company) filed a petition requesting approval of its 2013 natural gas CIP (Conservation Improvement Program) report for 2013. On August 25, 2014, the Company filed a revised petition correcting errors in its CIP Tracker Account and Demand Side Management (DSM) financial incentive. The revised petition contains Financial Incentive on 2013 Performance of \$2,492,730, and a proposed decrease in the 2014/2015 Gas Conservation Cost Recovery Adjustment (CCRA). The Petition includes a report of proposed recoveries and expenditures in MERC's gas CIP tracker account during 2013, a proposed change in the currently approved gas CCRA, a proposed incentive of \$2,492,730 for its 2013 CIP achievements, and request for approval to consolidate MERC's PNG and NMU CIP tracker accounts.

Comments were filed by the Minnesota Department of Commerce (DOC) on September 2, 2014.

On September 12, 2014, reply comments were filed by MERC. On September 15, 2014, MERC made a compliance filing notifying Commission that it has suspended collection of the CCRA factor for MERC-PNG customers. The DOC filed reply comments on October 9, 2014.

In its initial filing, MERC provided in its *Petition* the benefit/cost results of the revenue requirements test associated with the Company's 2013 gas CIP. According to the Company, this test results in \$17,668,017 of net benefits from CIP activities in 2013. MERC also stated that its CIP activities achieved energy savings in 2013 of 424,827 million cubic feet (MCF) of natural gas. Based on the terms and conditions of its approved DSM incentive plan, MERC requested approval of a DSM financial incentive of \$2,492,730.

As one can see in the table below, MERC's incentive jumped between 2009 and 2010, as did all other utilities:

DSM Gas Financial Incentives 2009-2013

	2009	2010	2011	2012	2013
Xcel	\$965,307	\$2,264,511	\$2,833,206	\$2,682,879	\$5,416,936
Center Point Energy	\$1,394,200	\$3,933,921	\$4,590,392	\$3,207,411	\$10,890,131
Great Plains	\$0	\$18,915	\$37,707	\$114,763	\$24,137
Interstate Power	\$86,463	\$85,716	\$15,349	\$20,097	\$37,207
Minnesota Energy Resources Corp.	\$582,288	\$2,292,375	\$2,587,948	\$2,729,531	\$2,492,730

III. Parties' Positions

MERC: MERC agrees with the DOC's recommendations for the following as listed below:

1. MERC agreed with the DOC recommendation to approve MERC's 2013 DSM financial incentive of \$2,492,730 to be included in the Company's CIP tracker account no sooner than the issue date of the Commission's Order in the present docket;
2. MERC agreed with the DOC recommendation to approve MERC's 2013 CIP tracker account activities as summarized in the Department's Comments;
3. MERC agreed with the DOC recommendation to approve the revised gas CCRA of \$0.00554 per therm for all of MERCs Minnesota customer classes, to be effective January 1, 2015, or on the first billing cycle in the next full month after Commission approval, whichever is later. The approval is conditioned on the Company submitting, within 10 days of the issue date of the Order in the present docket, a compliance filing with the relevant tariff sheets and necessary calculations that comply with the Commission's determinations;
4. MERC agreed, consistent with the DOC recommendation to include the following bill message (with the appropriate date) following the date of the Order in the present docket, or January 1, 2015, whichever is later:

Effective [insert date], a CCRA (conservation cost recovery adjustment) has been included on your bill. The CCRA is an annual adjustment to true-up under-recovery or over-recovery of CIP (conservation improvement program) expenses. Effective [insert date], the CCRA rate will be \$0.000554 per therm;

5. MERC agreed that the Commission should find that MERC has complied with the Commission's Order in Docket No. G011/M-13-369 regarding the filing of conservation cost repayment and adjustment schedules.

Carrying Charge

The single point of difference between MERC and the Department was the carrying charge. The Department recommended the following:

Eliminate the carrying charge MERC applies to the CIP tracker balance beginning with the month following the date of the Commission's Order. In the event the Commission decides not to eliminate carrying charges on the entire CIP tracker account, the Department recommends that the Commission not allow carrying charges on MERC's DSM financial incentive.

In Additional Reply Comments submitted on October 14, 2014, MERC disagreed with the DOC's recommendation that the Commission disallow carrying charges on the CIP tracker account on a going forward basis. However, upon further review of the Commission's decision In the Matter of Otter Tail Power Company's 2013 Demand-Side Management Financial Incentives and Annual Filing to Update the CIP Rider, Docket No. E-017/M-14-201, MERC believes approval of carrying charges at MERC's authorized short-term cost of debt is the most reasonable approach, and also is most consistent with the approach adopted by the Commission with respect to Otter Tail Power Company.

In MERC's case, use of the twelve month term typical of short-term debt is appropriate and corresponds to the twelve month period CIP costs are typically carried in the CIP tracker account. As such, the Commission should approve carrying charges at the short-term cost of debt for MERC.

IV. Staff Discussion

Staff agrees with the DOC that the 2013 tracker account was calculated correctly. As such, the Commission should approve MERC's three 2013 ending CIP Tracker account balances of (\$276,955) MERC-NMU, \$12,182,462 MERC-PNG, and \$2,598,585 MERC Consolidated as reported by the DOC.¹

With respect to the 2013 CIP incentive amount, Staff agrees with the DOC that the amount of \$2,492,730 should be approved by the Commission. With respect to the carrying charge applied to the CIP tracker, Staff agrees with the DOC that it should be eliminated for two reasons. First, Staff believes that the current carrying cost structure provides a perverse incentive for any

¹ During 2013, MERC consolidated the MERC-NMU and MERC-PNG CIP tracker accounts. Prior to July 2013, MERC-PNG and MERC-NMU were accounted for in separate CIP Trackers. Beginning in July 2013, they have been accounted for in a consolidated tracker.

Company to maintain the CCRA at relatively low level and carry a significant positive tracker account balance. This increases the cost of the CIP over the long run.²

Second, Staff believes that the goal should be to carry a zero balance as much as possible in the tracker account. By having a carrying charge of any size, it will reduce the likelihood of such an outcome.³ Again, the goal should be to keep CIP costs at a minimum. In this context, having an incentive structure which facilitates this outcome, generally will facilitate the achievement of the desired outcome.

With this in mind, Staff believes that the Commission's September 26, 2014 Order Approving Financial Incentives, Setting Conservation Cost Recovery Adjustment, Reducing Carrying Charges, And Varying Rules in Docket No. E-017/M-14-201 is quite instructive and useful for this matter.⁴ In that Order, the Commission modified the carrying charge on the CIP tracker-account balance to the short-term cost of debt set in the Company's last rate case. In its Order at page 6, the Commission determined the following:

The Commission concurs with the Chamber and the Department that it is no longer appropriate to grant the Company carrying charges on unrecovered CIP costs at its authorized rate of return. The Commission will, however, grant carrying charges at the Company's short-term cost of debt, as explained below.

The Commission defended its determination that using the authorized rate of return would be excessive and may not be appropriate in the rate rider/tracker account context at page 7:

Here, the Commission concurs with the Chamber and the Department that granting carrying charges at Otter Tail's authorized rate of return would be excessive. While the CIP financial incentives making up the bulk of the CIP tracker account serve an important public-policy purpose, they are not the kind of costs—out of pocket costs—for which rate-of-return treatment can be most readily justified.

Additionally, the Commission reasoned that the generous carrying charges were appropriate at the beginning of the DSM financial incentives as a way to facilitate the success of the program. The Commission Order provided the following reasoning at page 7:

² MERC's year-end tracker balance has generally increased over the last six years. In 2008 to 2010, it increased. It decreased in 2011 from 2010. It increased in 2012 from 2011, and increased in 2013 from 2012.

³ Staff notes that a lower carrying charge will result in a reduced incentive for maintaining a significant tracker balance.

⁴ At the Commission's October 30, 2014 Meeting, the Commission in dockets Nos. G001/14-283, E001/M-14-284, E002/M-14-287, G002/M-14-288, G004/M-14-358, and G008/M-14-368, made decisions consistent with its Order in Docket No. E-017/M-14-201.

Further, the factual context that led to setting carrying charges at the overall rate of return no longer applies. As the Department pointed out, in 1992—and for years thereafter—demand-side management financial incentives were small, the financial-incentive program was new, and it was important to use whatever tools were at hand to encourage its success. The incentives are now sizeable, the program is well established, and Otter Tail itself stated at hearing that reducing or eliminating carrying charges would not affect its conservation commitment or efforts, just its approach to rate amelioration.

Finally, the Commission reasoned that there is no perfect mapping between the cost recovery period and interest rates. However, the short-term cost of debt is the closest match. The Commission's Order stated the following at page 7:

While there is no exact match between this additional twelve-month recovery period and a standard interest rate, the Commission concurs with the Department and the Chamber that the authorized cost of short-term debt is the closest match contained in the record. The twelve-month term typical of short-term debt corresponds to the twelve-month period CIP costs are typically carried in the tracker account. And, while the additional twelve months of recovery necessitated by the moderated CCRA level is anomalous, the short-term debt rate is still more consistent with the public interest than the overall rate of return, given the nature of these costs—cash financial incentives—and the relatively short term—two years—within which they will be recovered.

Finally, the CCRA rate should be set with the goal of bringing the tracker account to zero in a timely but reasonable manner. In the event the Commission eliminates or reduces the carrying charges, it would be reasonable to bring the tracker to zero as quickly as possible. At the same time, the Commission needs to be mindful of the rate impact on the Company's customers. With the factors identified above in mind, Staff believes that it would be reasonable to set the CCRA rate at a level of \$0.00554 per therm. This rate strikes an appropriate balance between moving the tracker balance to zero and customer impact. Next year, the Company should evaluate the progress that has been made, and propose a rate which would continue the progress to bring the tracker balance to zero.

V. Commission Options

A. Should the Commission approve MERC's 2013 CIP tracker account?

1. Approve MERC's 2013 CIP tracker account as indicated at pages four through six of the DOC's September 2, 2014 comments.
2. Do not approve MERC's 2013 CIP tracker account.

B. Should the Commission approve an incentive of \$2,492,730 for MERC's 2013 CIP achievements?

1. Approve MERC's 2013 financial incentive for CIP achievements.

2. Do not approve MERC's 2013 financial incentive for CIP achievements.
- C. At what level should the Commission set the conservation cost recovery adjustment (CCRA) for 2014/2015?
1. approve the revised gas CCRA of \$0.00554 per therm for all of MERCs Minnesota customer classes, to be effective January 1, 2015, or on the first billing cycle in the next full month after Commission approval, whichever is later. The approval is conditioned on the Company submitting, within 10 days of the issue date of the *Order* in the present docket, a compliance filing with the relevant tariff sheets and necessary calculations that comply with the Commission's determinations;
 2. approve the revised gas CCRA of \$0.00065 per therm for all of MERCs Minnesota customer classes, to be effective January 1, 2015, or on the first billing cycle in the next full month after Commission approval, whichever is later. The approval is conditioned on the Company submitting, within 10 days of the issue date of the *Order* in the present docket, a compliance filing with the relevant tariff sheets and necessary calculations that comply with the Commission's determinations;
 3. approve the current MERC-PNG gas CCRA of \$0.042 per therm for all of MERCs Minnesota customer classes, to be effective January 1, 2015, or on the first billing cycle in the next full month after Commission approval, whichever is later. The approval is conditioned on the Company submitting, within 10 days of the issue date of the *Order* in the present docket, a compliance filing with the relevant tariff sheets and necessary calculations that comply with the Commission's determinations;
- D. Should the Commission approve MERC's proposed bill message for publication in the billing month immediately following the date of the *Order* in this docket with the appropriate modifications to reflect an accurate effective date and gas CIP Adjustment Factor as determined by the Commission?
1. Approve MERC's proposed bill message with the modifications that the effective date and gas CCRA listed in the bill message be updated in the compliance filing to reflect the Commission's determinations of the effective date and approved rate.
 2. Do not approve MERC' proposed bill message.
 3. Delegate authority to the executive secretary to approve customer notices for the duration of this proceeding.⁵

⁵ If the Commission chooses this option, in the event of a change of any circumstances which require a

- E. Should the Commission find that MERC has complied with the Commission's Order in Docket No. G011/M-13-369 regarding the filing of conservation cost repayment adjustment schedules?
1. Find that MERC has complied with the Commission's Order in Docket No. G011/M-13-369.
 2. Do not find that MERC has complied with the Commission's Order in Docket No. G011/M-13-369.
- F. Should the Commission eliminate the carrying charge or otherwise modify its application to MERC's tracker balance for the CIP rider effective with the date of the Commission's Order?
1. Modify the carrying charge to reflect the Company's Short-term cost of debt established in the Company's last rate case, Docket No. G-011/GR-13-617. The modification shall be effective as of the date of the Commission's Order in this docket.
 2. Do not eliminate the carrying charges to the tracker balance for the CIP rider effective with the date of the Commission's Order.
 3. Eliminate the carrying charges to the tracker balance for the CIP rider effective with the date of the Commission's Order.
 4. Modify the application of the carrying charge to exclude the Company's financial incentive when determining the amount of carrying charges allowed for recovery.
 5. Take other action the Commission deems appropriate.

VII. Staff Recommendation

Staff recommends items A1, B1, C1, D1 or D3, E1, and F1.

modification of the notice, the matter would not have to come back before the Commission. The matter could be addressed by the Executive Secretary. As such, this would increase flexibility for all involved in the process. The parties may wish to address this issue in the course of comments which they make before the Commission.