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August 17, 2011

Patricia Van Gerpen
Executive Director
SD Public Utilities Commission
500 E. Capitol Ave.
Pierre, SD 57501

Re: EL11-008 - In the Matter of the Filing by Otter Tail Power Company Regarding Its 2010 and 2011 Energy Efficiency Plan Update, and

EL11-012 -In the Matter of the Filing by Otter Tail Power Company Regarding its Proposed South Dakota Energy Efficiency Plan for 2012-2013

Dear Ms. Van Gerpen:

This letter is filed in regards to the above-referenced dockets currently before the Commission. These filings relate to the energy efficiency programs conducted by Ottertail Power Company (OTP or Company). The first filing contains the 2010 program results report. In addition, it includes a request to the Commission to update the incentive calculation method from the currently approved "shared saving" method to the "fixed percentage incentive" method. The second filing is the Company's proposed energy efficiency plan for the period of 2012 – 2013.

Staff believes the requested action is appropriate and recommends Commission approval. This recommendation is based on review of the filings and discussion with company representatives.

Report for 2010 Program Results

OTP's 2010 report shows its energy efficiency efforts continue to be effective in its South Dakota service territory. This is especially true in the direct impacts realized from commercial programs currently in place. Although some programs have proven less effective, this is to be expected as the best combination of energy efficiency programs is often developed through trial and error. OTP continues to work with Staff to develop the most effective combination of programs and improve the programs it offers.

Fixed Percentage Incentive

When OTP first began its energy efficiency efforts, it was not clear which type of incentive mechanism was most appropriate for these programs. In part, this is because OTP was the first utility to establish these programs in South Dakota. As OTP and Staff have continued to gain experience with energy efficiency plans, certain weak points have been identified. Specifically, it has become apparent the incentive mechanism currently in place for OTP needs to be updated.

Since the establishment of OTP's first energy efficiency programs, it has utilized a "shared savings" incentive calculation mechanism. The method is based on energy savings, spending, and net benefits. It has since displayed certain inadequacies and is no longer favored by the Company or Commission Staff. The "shared savings" method was meant not only to create an incentive for utility's performance, but more importantly, to make up for lost margins. However, it appears this method accomplishes neither purpose effectively.

Although OTP has consistently displayed good faith when executing its energy efficiency programs, even going so far to independently revise its filing to reflect higher anticipated savings in June of 2010, Staff disfavors the "shared savings" for its potential to hinder energy efficiency efforts. Due to the difficulty in setting proper goals, Staff is concerned the incentive calculation could encourage participants to provide low energy efficiency goals to ensure the goals are met to avoid loss of incentive return. Furthermore, basing the lost margin calculation on performance alone is a poor mechanism for compensating the utility for lost margins.

As a result of extensive workshops conducted by Commission Staff and South Dakota utilities, Staff finds the "fixed percentage incentive" method to be the most reasonable option. This mechanism has been approved for energy efficiency programs established by Black Hills Power. Staff recommends OTP be allowed to use the same mechanism in the calculation of its incentive for 2010 program results and going forward.[1]

[1] A detailed discussion of the recovery of lost margins, the fixed percentage incentive as a mechanism, and benefit cost tests, is included in Staff's Memorandum for Docket EL11-002.

Finally, no additional funds are required to apply the fixed percentage incentive to OTP's 2010 program results. The Company developed the currently approved unit charge of $0.00063 per kWh on the assumption it would fully achieve its stated goals. As such, an incentive return of $78,900 was factored into the unit charge. If the fixed percentage incentive method is applied to 2010 results, the Company will receive $73,145. This remains within the budgeted amount and will require no additional customer charge. As such, Staff believes it is within the public's best interest to approve OTP's request to apply the fixed percentage incentive to 2010 results.

2012-2013 Program

As stated above, the second filing before the Commission is OTP's proposed energy efficiency program plan for the period of 2012 – 2013. The plan consists of nine programs to accomplish an annual 2,274,260 kWh in energy savings and 671.27 kW in demand savings. This represents an approximate increase of 7% in energy and 3% in demand, as compared to the 2010-2011 plan. The proposed budget for this program is $280,000 per year which is an approximate 6% increase.

Residential Demand Control

The programs proposed for the 2012 – 2013 plan are programs continued from 2010 – 2011 with certain variations. However, not all programs currently in effect are contained in the proposed plan. The Company has excluded the Residential Demand Control program after completion of the 2011 year.

The Residential Demand Control program provides rebates to residential customers to purchase in-home demand response devices. Use of these items allows the Company to control energy usage for the appliances, and reduce usage when home energy load goes above a predetermined level. In addition to rebates, participating customers receive a lower energy rate for allowing OTP to control their load.

This program was excluded from the 2012-2013 plan due to lack of customer participation. No OTP customers participated in the Residential Demand Control program during the 2010 period. The Company attributes this lack of interest to possible market penetration, higher than expected hours of control, and decreasing price differential on energy rates. Because the program is producing no energy savings and will cause additional budget requirements, Staff agrees with this exclusion.

Program Flexibility and Financial Incentive

For its 2012 – 2013 plan, OTP requests a degree of flexibility in implementing its programs. This would include a degree of flexibility in executing the programs described in the filing and flexibility in the budget proposed for these programs. The Company suggests any major modifications will be proposed to the Commission prior to taking effect. Major modifications include the ability to begin new projects, increase the overall plan budget by more than 30%, and closing projects.

Staff does not object to a level of flexibility in implementing the plan. However, Staff recommends the incentive payment available to OTP, based on the fixed percentage incentive method, be limited to a fixed percentage of the approved budget.

Sincerely,

Ryan Soye
Staff Attorney