TO: COMMISSIONERS AND ADVISORS

FROM: BRIAN ROUNDS AND KAREN CREMER

SUBJECT: GE12-001 STAFF RECOMMENDATION

DATE: MAY 8, 2014

STAFF MEMORANDUM

In its most recent filing, NorthWestern Energy (NWE) proposes a new Demand Side Management (DSM) Plan that is the result of years of discussions with Staff. Although somewhat unique when compared to other utility DSM offerings in the state, Staff ultimately recommends approval of the DSM Plan as a 2-year pilot. This document will provide a brief summary of the plan followed by a discussion of the aspects of the plan that might be considered a departure from past approved plans.

Timing is an issue in this case. NWE is requesting an effective date of June 1, 2014, giving the Commission two potential meetings to discuss. Staff recognizes the small amount of time allowed for Commissioners and Advisors to review but chose to place this on the Commission's May 13 agenda so that it might have a chance to ask questions or make modifications for a May 27 approval, if needed.

BACKGROUND

Although the first filing in this docket was made in January of 2012, the history of NWE's DSM Plan starts with the proceedings in Docket GE09-001. In that docket, NWE filed a DSM Plan on October 1, 2009, which the Commission approved with conditions on May 11, 2010. The conditions, which removed a residential lighting rebate program and required changes to the lost margin recovery mechanism, ultimately resulted in NWE abandoning the plan.

Following Staff workshops on lost revenue recovery resulting in the fixed percentage incentive as the preferred method, NWE filed a new DSM Plan in January of 2012 that opened the current docket. Again, Staff took issue with certain aspects of the proposal that resulted in an update to the plan in December of 2012. As NWE and Staff were coming to an agreement in the spring of 2013, Commission concerns over MidAmerican Energy's programs and subsequent plans for a workshop on benefit-cost tests again delayed implementation. Following the workshop and subsequent Commission decisions on other DSM dockets, NWE filed their most recent DSM Plan on April 23, 2014, with resulting tariff revisions filed on May 6, 2014.

Since the most recent update, Staff has worked informally to clarify certain points of the DSM Plan and will include those points in the following summary.

SUMMARY

The DSM Plan proposed by NWE requests the implementation of a 2-year pilot which includes a number of programs that span all of NWE's electric and natural gas customers in South Dakota. During the first year, NWE would offer residential energy audits and rebates for use in existing residential and commercial buildings. Rebates for new construction would be added the second year. For the most part, the programs would be carried out by a third party contractor, bid out competitively by NWE.

Similar to all other DSM programs approved by the Commission, NWE suggests maintaining a tracker account updated annually as participation and forecasted sales fluctuate. For over- and under-collections, the tracker account will have interest applied or credited monthly at the rate of return from NWE's last approved natural gas or electric rate case. Following the first year of implementation, NWE will file a true-up that necessarily adjusts the tracker account along with the Company's Plan for June 2016 through May 2017.

The budgets requested by NWE for the first two years of operation are $2.04M and $1.89M, respectively. NWE proposes to split the total budget evenly between electric and natural gas customers and use the same rate across all customer classes. The result is an electric rate of $0.0008/kWh and a natural gas rate of $0.0167/therm. Average bill impacts of the proposed rates are listed in the table below.

Average Monthly Bill Impacts Electric

	kWh Usage	DSM Charge	Average Monthly Bill	DSM % of Bill
Residential	976	$0.82	$82	1.00%
Comm./Indust.	6,596	$5.55	$477	1.16%

Average Monthly Bill Impacts Natural Gas

	Therm Usage	DSM Charge	Average Monthly Bill	DSM % of Bill
Residential	66	$1.10	$57	1.95%
Comm./Indust.	410	$6.84	$260	2.63%

For recovery of lost margins, NWE requests using the fixed percentage incentive now common amongst other utilities. The proposed incentive would be calculated as a percentage of the actual expenditures[1]. NWE's proposed incentives of 30 percent of the electric budget and 7.79 percent of the natural gas budget are similar to other programs

[1] Staff recommends capping the incentive as a percentage of the approved budget if NWE were to overspend.

approved by the Commission. The 30 percent incentive is the current incentive approved for the electric programs of Otter Tail, Xcel, and Black Hills Power. 7.79 percent is their most recently approved rate of return in NG11-003, similar to what the Commission has approved for MidAmerican and MDU's natural gas programs.

ISSUES

As mentioned above, NWE's DSM Plan includes some unique concepts that have not been previously considered or approved by the Commission. Staff is satisfied with the filing, but we felt the need to point out issues that may be considered new or controversial.

The first and probably most noticeable issue is the lack of data included in NWE's filing. Compared to some filings the Commission receives, NWE provided little data at the individual program level. NWE argues much of the data is not available due to never having implemented programs here. This data issue is pervasive, flowing into many of the other issues mentioned below. However, Staff does not feel compelled to require the detail at this point. We assume much more detailed analysis will be provided as experience is gained and participation numbers are realized.

The cost effectiveness of the programs is difficult to gauge without additional data. NWE has stated to Staff that all programs outside of the residential audit "have been designed to be cost effective based on screening of individual measures at relevant avoided costs to pass the Total Resource Cost (TRC) test at a value of 0.9 or greater." NWE also intends to "minimize cream skimming", meaning they will try to acquire all cost effective DSM, not just the least expensive. In the past, Staff has pushed for the least expensive DSM, but in light of last year's workshops, we see the participatory benefit of including more programs (so long as they are cost effective). Again, it would be nice to have more information on how the programs were vetted, but Staff agrees that many of the assumptions used will be speculative given the lack of experience in South Dakota. Finally, NWE estimates the first year of the DSM Plan will pass the TRC test with a value of 1.28.

The appropriate rate design is also difficult to determine without additional data, and NWE recommends simply splitting the costs in half across electric and natural gas customers and applying the same rate across customer classes within those utilities. In the past, we have attempted to minimize cross-subsidies by making sure the customers benefiting from the programs were the customers paying for the programs. The simple rate design proposed by NWE is, again, the result of a lack of experience in operating these programs in South Dakota. Similar to Staff's positions above, we are not opposed to this rate design, but we assume a more complex rate design will be devised once we have the proper information. One way to mitigate this might be to require NWE to reassign costs based on benefits in next year's true-up filing.

Another issue with NWE's lack of experience implementing these programs here is an inherent uncertainty in the budget. As a result, NWE is requesting the flexibility to shift budgets between programs and potentially overspend by as much as 30 percent. NWE believes that "budget flexibility during the initial years of implementing a new DSM program is critical to its overall success." Staff agrees that delaying or terminating programs as a result of budget constraints can create confusion and result in unnecessarily inefficient programs. We recommend allowing the budget flexibility, however, we also recommend capping the incentive as a percentage of the fixed budget or the actual expenditures, whichever is lower, so as not to incent the Company to overspend.

Newly requested in this filing is the use of a third party contractor to implement many programs in the Plan. Although this is new, Staff is supportive as the contractor should be selected through a competitive process and overhead should be reduced as a result of limited training required on NWE's part.

Finally, Staff felt the need to point out that NWE selected individual rebate programs that passed a TRC test of 0.9 rather than 1.0. The discount is assumed to account for "costs associated with environmental and social impacts of energy supply sourced from fossil fuels", often referred to as "externalities." In the past, the Commission has excluded externalities on some issues; therefore, Staff views this as a Commission decision and takes no position here. Given the lack of program-level benefit-cost data, one suggestion might be to set a guideline (i.e. moving the screening up to a TRC of 1.0) for the 2016-2017 program based on results from the first year of data.

RECOMMENDATION

Staff recommends approving NWE's DSM Plan as filed, effective June 1, 2014, with the added clarification that incentive levels are capped as a percentage of the approved budget.