STAFF MEMORANDUM

TO: COMMISSIONERS AND ADVISORS

FROM: KRISTEN EDWARDS AND PATRICK STEFFENSEN

RE: NG14-004 – In the Matter of the Filing by Montana-Dakota Utilities Co. for Approval of its Revised Conservation Tracking Adjustment

DATE: June 17, 2014

Commission Staff (Staff) submits this Memorandum in analysis of the Conservation Tracking Adjustment (CTA) filing made by Montana-Dakota Utilities Co. (MDU).

OVERVIEW

MDU has been offering natural gas energy efficiency programs since its initial demand side management portfolio (NG05-016) was approved by the Commission in February 2006. In a Commission Order (NG11-006) dated March 20, 2012, MDU received approval for its current three-year (2012-2014) natural gas portfolio. This filing, made May 9, 2014, requests Commission approval of MDU's new CTA rate which will 1) consolidate the Black Hills and East River rates consistent with the Commission decision in MDU's most recent rate case, NG12-008, 2) true-up the actual recoveries and actual expenditures during the 2013 plan year, and 3) recover estimated expenditures for the 2014 plan year. The proposed $0.043/dk CTA rate represents a $0.032/dk increase for customers in the Black Hills area and a $0.020/dk increase for customers in the East River area.

2013 PROGRAM RESULTS

2013 marked a year of increased participation and energy savings for MDU with the residential furnace programs leading the way. Total program participation rose from 354 participants in 2012, to 639 total participants in 2013, including an increase from 220 to 401 participants among the residential furnace programs. Likewise, MDU is projecting increased lifetime energy savings with 80,535 in lifetime dk savings for the 2013 plan year compared to 20,848 dk projected for the 2012 plan year. Once again, the residential furnace programs led the way with 68,958 lifetime dk savings for 2013.

This translates into much improved benefit/cost ratios for 2013 compared to 2012. The Total Resource Cost (TRC) test score rose 44% from the 1.17 received in 2012 to the 1.68 in 2013.

Looking at individual programs, the High-Efficiency (95+%) furnace program for new dwellings had a 53% increase in score from 0.77 in 2012 to 1.18 in 2013. The same program for existing dwellings rose 64% from 1.18 in 2012 to 1.93 in 2013. In summary, every DSM program MDU has in effect experienced an increased TRC score in 2013, and they all exceed 1.0, meaning the benefits of the programs outweigh the costs of the programs.

STAFF CONCERNS

Filing Delay

According to Section No. 3, Sheet No. 31 of MDU's natural gas tariff, "Monthly bills beginning with the first billing cycle each March 1 will be adjusted by the application of the Conservation Tracking Adjustment rate indicated below." In response to Staff Data Request 1-1, MDU stated "the filing was inadvertently delayed" and if necessary would request waiver of Rate 90 to implement a ten month amortization period. Staff believes returning to a consistent March 1st effective date is more important than the minimal smoothing of rates this would provide, and only wishes to stress the importance of prompt filings in the future.

Rate Consolidation

With this filing, MDU proposes to consolidate the rates for the Black Hills area and East River area into one CTA rate for their entire South Dakota natural gas territory. Staff is in agreement with this proposal as 1) demand side management costs represent costs which are homogeneous between service areas and 2) the decision is consistent and to a significant extent necessary with the rate consolidation approved in rate case docket NG12-008.

Class Cross-Subsidization

Participation among MDU's commercial customers continues to lag behind residential participation. In 2012, commercial customer rebates accounted for $1,200 out of $74,444 in total program rebates, or 1.6%. In 2013, commercial customer rebates accounted for $2,100 out of $150,370 in total program rebates, or 1.4%. These percentages are troubling considering MDU's commercial customers pay the same CTA rate as their residential customers.

MDU states in response to Staff Data Request 2-1 "rebates based on the size of the furnace or water heater are generally not offered in utility rebate programs" and "offering varying rebates dependent on the size of the furnaces and water heaters may lead customers installing larger units than needed which ultimately may make the unit less efficient due to improper sizing". Staff has some disagreement with each of these points. Regarding the first point, the other approved natural gas energy efficiency plan currently in effect in South Dakota, MidAmerican Energy Company's, utilizes increasing rebate levels based on furnace btu rating for their non-residential program. Regarding MDU's second point, Staff believes rebate levels can be set at a proportion of the marginal cost of the larger unit, such that an incentive is created for the larger customers while eliminating any risk of inefficient purchases.

MDU does go on to state in their response to Staff Data Request 2-1 “Montana-Dakota plans to do additional outreach to both Trade Allies and commercial customers through meetings and direct mail”. Staff is comfortable with this initial game plan for two reasons. 1) This one-size-fits-all approach has resulted in fewer dollars getting doled out for energy efficiency than an approach which pays larger rebates for larger units. 2) While this rebate style may be unusual, MDU has experienced excelling popularity in the residential program and deserves a chance to work the same turnaround on the commercial sector.

Budget Overage

In docket NG12-007, the Commission approved a 2013 energy efficiency budget of $97,150 with incentive allowed on spending up to 125% of budget, or $121,438. This filing indicates MDU’s actual expenses in 2013 were $168,026 resulting in an overage of $70,876 or 73%. Staff recognizes these cost overruns were not the result of increased spending in the overhead areas of advertising and administration, but were simply the additional variable costs of the rebates due to the popularity of the residential furnace program. It appears virtually all of this overspending was returned to customers through rebates, which does serve to lessen the impact, and staff understands and is sympathetic as to why MDU continued to honor rebates over and above the budget. However, staff is unsympathetic to the fact MDU did not take the initiative to request Commission approval prior to the overages.

STAFF RECOMMENDATION

Staff recommends the overage above the incentive threshold of $121,438 be shared equally between shareholders and ratepayers. This equates to a $46,588 overage and a $23,294 disallowance from rates.

2013 Budget	$97,150
Incentive Threshold	1.25
Incentive Threshold	$121,438
2013 Actual	$168,026
Overage	$46,588
Disallowance	**$23,294**

This reduction in allowed costs results in a new CTA rate of $0.038 as provided in MDU’s Exhibit 3, Page 1 with Disallowance. Staff recommends approval of this $0.038 CTA rate with a July 1, 2014 effective date and approval of the 2014 budget and incentive range expressed in MDU’s Exhibit 5.