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March 7, 2008



**VIA Electronic Transmission Filing**

Dusty Johnson, Chairman  
Gary Hanson, Vice Chairman  
Steve Kolbeck, Commissioner  
South Dakota Public Utilities Commission  
500 East Capitol Avenue  
Pierre, South Dakota 57501-5070

RE: South Dakota Staff comments In the Matter of the Filing by Otter Tail Power Company for Approval of an Energy Efficiency Partnership Plan for 2008

Dear Gentlemen:

On November 3, 2006, the South Dakota Commission asked for general comments from utilities on an energy efficiency plan for South Dakota Customers. On January 4, 2007, the Commission asked that utilities respond with their proposals by March 30, 2007, either with a formal filing or a letter indicating that we were not interested in expanding our energy efficiency programs in South Dakota.

On March 29, 2007, Otter Tail Power Company (the Company) filed a comprehensive plan to address energy efficiency needs of South Dakota customers. The plan was based on market potential in South Dakota, a blend of energy efficiency technologies covering major end uses and all customer classes, and a supporting budget and cost recovery methodology.

On August 10, 2007, South Dakota staff issues data requests relevant to the Company's filing. On September 12, 2007, the Company responded to the data requests.

On March 3, 2008, Otter Tail Power Company received Staff comments on the above mentioned filing. The Company understands the Commission intends to meet on March 11, 2008, to discuss the comments. Otter Tail Power Company wishes to thank South Dakota staff for their thoughtful consideration of the Company's proposal. We further commend South Dakota Commissioners for desire to promote a regulatory environment that encourages companies to develop, implement and promote energy efficiency programs.

Our attached comments address the major issues within Staff's response to our filing. If you have any questions or concerns please contact me at 218-739-8303.

Sincerely,

Kim Pederson, Manager  
Market Planning

Enclosure

**Otter Tail Power Company Response to South Dakota Staff comments  
In the Matter of the Filing by Otter Tail Power Company for Approval  
of an Energy Efficiency Partnership Plan for 2008**

**March 7, 2008**

**Overview**

The Company supports the South Dakota Public Utilities Commission goal of the need to manage growing energy use through Demand Side Management programs including energy efficiency and conservation. The Company believes it has proposed a portfolio of very cost-effective programs for Commission Staff's consideration. The Plan includes 10 programs, saves 16,661,065 kwh over the life of the programs and 351 kw, at an approximate total cost of \$180,700 or \$.01 cent per kwh. Otter Tail Power Company's plan results in \$1,157,920 in net benefits to the utility and \$1,141,880 in net benefits to total resource/society. The benefit/cost test results are indicated below:

Participant:	2.70
Ratepayer impact:	1.04
Total resource:	3.29
Utility test:	7.41

Otter Tail Power Company filing on March 29, 2007 was based on a request for an energy efficiency filing by the South Dakota Commission. We compiled that filing based on twenty-plus years of conducting an energy efficiency plan in Minnesota. Our findings are based on engineering estimates, field tests, and customer response. We have utilized energy impacts based on some of the most stringent analysis in the country, and most recently an extensive statewide energy deemed savings data collection methodology conducted completely by an independent third party firm. The calculations are used to determine overall cost-effectiveness of the programs. All the utilities in Minnesota and the state regulators are working together to refine our energy savings and lifetime technology data and to come to agreement on energy impacts associated with energy efficiency installations.

Otter Tail Power Company has put forth this plan as a low-cost resource to cost-effectively manage energy growth while offering South Dakotans a chance to lower their energy bills. However, we have no intention of pushing South Dakota into an energy-efficiency plan they do not support. The Company will continue to promote a wide range of demand-side management programs and innovative rates, as it has done for a number of years. However, we require cost recovery, a reasonable return, and an incentive to offset lost sales or we cannot pursue an energy efficiency plan in South Dakota.

It is with that spirit that we attempt to clarify a few points. Most importantly, we support our original filing as submitted. Modifications to that filing without clear benefits and costs may be challenging, and not necessarily cost-effective for Otter Tail Power Company. However, we are open to discussions.

**Staff analysis**

There appear to be two primary areas of concern by Staff. Staff has offered in their comments that Otter Tail's plan as filed "goes too far" and advocates for a "substantially reduced plan." We are glad to work with Staff on a revised proposed plan, but we are not clear on what that plan would be. Through informal discussions the Company has learned that rebates for Energy Star

appliances and electric water heaters may be appealing to Staff. The Company has not found rebates for Energy Star appliances to be cost-effective and we are willing to show our analysis to Staff. While we appreciate Staff's support for rebating electric water heating, we believe it most appropriate to include only controlled service water heating rebates where applicable. In addition, we may want to consider a minimum efficiency level. Minnesota does not allow rebates for electric water heaters in its energy efficiency plan.

Generally speaking, Staff is concerned that the plan as a whole allows for recovery of costs from the entire population of ratepayers for the benefit of a few. While it is true that the participants in the program benefit the most, society as a whole and in this case the ratepayers of South Dakota also benefit. This is due primarily to the overall lost cost of the program at approximately \$.01 cent per kwh.

Specifically, Staff offer the following key points of concern:

- Rebates in some programs are unnecessary; energy savings benefits should be enough to make consumers install energy efficient technologies
- Company administrative costs in some programs are too high
- Free riders should be included in most program analysis
- There is no need for a utility incentive to conduct cost-effective energy efficiency

While the Company does not intend to debate the issues in detail, we do provide comment for additional insight.

### Rebates and administrative costs

We support our proposal for rebates in lighting, motors, and heat pumps, as well as the customized incentive Grant Program. We believe our administrative costs are reasonable for a first year launch, and this is supported by our low-cost per kwh saved and cost per kw saved, as the table below illustrates:

Otter Tail Power Company South Dakota Energy Efficiency Program	Annal kwh saved	Budget	Technology Life	Lifetime kwh saved	Cost per kwh	kw saved	Cost per kw
HOTPACKS	28,548	\$ 4,000	5	142,740	\$ 0.03	5.86	\$ 683
RESIDENTIAL DEMAND CONTROL*	4,836	\$ 9,900	15	72,540	\$ 0.14	52.75	\$ 188
AIR SOURCE HEAT PUMPS - RESIDENTIAL	32,621	\$ 8,800	15	489,315	\$ 0.02	50.23	\$ 175
GEOHERMAL HEAT PUMPS - RESIDENTIAL	48,361	\$ 5,600	15	725,415	\$ 0.01	34.93	\$ 160
AIR CONDITIONING CONTROL*	1,468	\$ 12,600	15	22,020	\$ 0.57	31.83	\$ 396
CHANGE A LIGHT	153,503	\$ 11,100	5	767,515	\$ 0.01	21.55	\$ 515
GRANT	687,804	\$ 57,000	15	10,317,060	\$ 0.01	148.50	\$ 384
MOTORS	57,594	\$ 13,100	15	863,910	\$ 0.02	8.56	\$ 1,530
LIGHTING	280,176	\$ 22,400	10	2,801,760	\$ 0.01	70.00	\$ 320
AIR SOURCE HEAT PUMPS - COMMERCIAL	16,520	\$ 7,000	15	247,800	\$ 0.03	9.73	\$ 719
GEOHERMAL HEAT PUMPS - COMMERCIAL	14,066	\$ 2,700	15	210,990	\$ 0.01	9.72	\$ 278
INDIRECT IMPACT PROJECTS - RESIDENTIAL - UPD	0	\$ 22,500		0			
INDIRECT IMPACT PROJECTS - COMMERCIAL	0	\$ 4,000		0			
INDIRECT IMPACT PROJECTS - OTHER - UPDATED	0	\$ -		0			
<b>TOTAL - ALL PROGRAMS</b>	<b>1,325,497</b>	<b>\$ 180,700</b>		<b>16,661,065</b>		<b>444</b>	<b>\$ 407</b>
<b>Cost per kwh</b>					<b>\$ 0.01085</b>		

### Free Riders & Free Drivers

Staff disagrees with the research conducted by the Company, other utilities, and the Legislative Auditor's office on free riders and free drivers, but Otter Tail Power Company supports our findings and conclusions on this issue. The generally accepted conclusion is that free riders

and free drivers cancel each other out. Therefore, we have not used either in our analysis except on a very limited basis.

In addition, South Dakota customers have had very limited exposure to energy efficiency programs. In order to encourage customers to take out their existing systems, for example lighting or motors, rebates are necessary to encourage customers to accelerate the changeout and replace their existing technology with a higher efficiency motor or lighting system. Customers will rarely retrofit their system on the basis of energy savings alone, especially in a relatively low energy cost state like South Dakota.

### **Cost recovery and financial incentive**

The Company is pleased that Staff agrees with the Company's position that cost recovery is critical to an effective energy efficiency plan. However, Staff is concerned with the financial incentive the Company has proposed.

The Company has proposed a return on the money invested in these projected but not yet recovered from customers equal to Otter Tail's cost of capital. The carrying charge the Company proposes is 8.89%. The Company requires a rate of return at least equal to our cost of capital on supply-side investments.

In order to reduce the negative financial impact of lost energy sales on the company, Otter Tail Power Company provided a number of examples of shared savings incentives that could be utilized. Our example in the original filing included a bonus based on achieved energy savings greater than the goal, capped at 30% of spending. Other mechanisms exist such as a shared savings incentive mechanism proposed by Xcel, where the customers receive 85 percent of the net benefits achieved and the Company retains 15 percent as a performance incentive. That plan as proposed calculates the net benefits using the Total Resource Cost (TRC) test. The 15 percent net benefits model is intended to approximate the financial losses associated with offering the energy efficiency programs. Xcel proposes an incentive cap equal to 35 percent of the year's energy efficiency budget. The cap is proposed to maintain a reasonable balance between the incentive and spending, as well as encourage the utility to maximize the cost-effectiveness of its portfolio. We are open to discussing what the appropriate percent of net benefits or caps might be.

At this time the Company is not requesting authority to explicitly recover its lost margins, although the Company may request such authority in the future.

Staff is concerned about tracking and the difficulty regulating these mechanisms. The Company has such a mechanism in place in Minnesota and has become accustomed to the details involved in documenting and tracking such a mechanism. We would be happy to discuss the details with Commission Staff. It may be best and easiest if the same financial incentive mechanism was in place for all utilities. The Company is open to meeting with interested parties and Commission Staff to work through the details.

### **Cost to Customers**

The Company believes that the cost for this program to customers is modest. The table below indicates the average annual cost for this plan. As you can see, the average residential customer will pay less than \$1 per month, based on the Company's current estimates.

2006	Total Annual CIP Recovery per Customer - Surcharge & Rate Impact
Residential - Urban	\$8
Rural Residential	\$9
Cottages	\$3
Farms	\$15
Commercial - Urban	\$15
Rural Commercial	\$24
Large Commercial - Ladish & Pipelines	\$0
Large Commercial - All Others	\$499
Streetlighting	\$62
Other Sales to Public Authorities	\$27
TOTAL RETAIL Revenue	\$17
*Potential incentive capped at a percentage of net benefits not included in calculations	
Annual South Dakota Conservation Recovery Charge	
Carrying charge	
Total CIP impact (surcharge + rate impact)	
Conservation Recovery Rate (by half-year)	

**Conclusion**

The Company has proposed a cost-effective energy efficiency plan for its South Dakota customers at a reasonable cost. For an average residential customer, the plan will cost less than \$1 per month, even if the maximum bonus is achieved, which is unlikely in a first year program. All components of the plan are linked and critical to the outcome of the program. As the Company indicated in the beginning, it does not intend to push South Dakota into a plan it does not support. However, we cannot support a program that is not cost-effective for us to do so.

The Company continues to support our original plan, and we are open to discussing the most appropriate financial incentive methodology.