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October 26, 2009



Patricia Van Gerpen  
Executive Director  
South Dakota Public Utilities Commission  
500 East Capitol Avenue  
Pierre, South Dakota 57501-5070

Dear Executive Director Gerpen:

On March 29, 2007 Otter Tail Power Company ("Company") proposed its South Dakota Energy Efficiency Partnership Plan to the South Dakota Public Utilities Commission ("Commission"). On May 8, 2008, the Company proposed modifications to the plan. The plan was discussed with Commission Staff ("Staff") and the Commission at its May 20, 2008, meeting. On July 28, 2008, the Order approving the Energy Efficiency Plan was signed by the Commission. Over the next few weeks informal discussion occurred between South Dakota Staff and the Company. Word-of-mouth advertising and high and volatile fossil fuel prices that existed at the time generated significant interest in a few of the programs, and specifically those offering efficient heating solutions. On August 27<sup>th</sup>, 2008, the Company updated Commission staff and requested greater budget flexibility. Staff indicated the Company had latitude within programs but needed to keep within the formally approved budget.

The programs officially launched September 1, 2008 and the first budget period was through December 31, 2009. Otter Tail Power Company proposed in its initial plan to file annually, beginning March 10, 2010 for approval of the previous year's expenses, any modifications to the following year's budget, and to true up any imbalances to the South Dakota Energy Efficiency tracker and cost recovery rider.

The purpose of this filing is to update the Commission on our 2009 program through September 30, 2009, and ask the Commission for approval of our 2010 portfolio. We are also asking for budget and financial incentive modifications. The details of our request are attached.

We are available to meet with the Commission and Staff on the details of this filing, and any other ideas the Commission may have to foster wise energy use by South Dakotans. If you have any questions, please feel free to contact me at 218-739-8303.

Sincerely,

Kim Pederson, Manager  
Market Planning

Attachment

October 21, 2009

**SOUTH DAKOTA ENERGY EFFICIENCY PARTNERSHIP**

**Otter Tail Power Company Energy Efficiency Plan for 2010**

Otter Tail Power Company is pleased to present for the South Dakota Public Utilities Commission's consideration an update through September and propose a slightly revised plan to market energy efficiency to our South Dakota customers in 2010. The South Dakota Public Utilities Commission (PUC) has encouraged all investor-owned electric and natural gas utilities in South Dakota to be part of an Energy Efficiency Partnership (EEP) to significantly reduce energy use. Otter Tail Power Company was the first utility in South Dakota with an approved plan, which the Company launched in late 2008.

We are pleased to inform the Commission that the South Dakota EEP was embraced by South Dakotans with a great deal of enthusiasm and support. Participation in the program has been excellent. Preliminary results are generally positive relative to participation and budget. Final energy and demand savings goals will be filed as part of our March 10, 2010 filing.

SOUTH DAKOTA ENERGY EFFICIENCY PLAN - 2008/2009				Last budget modified date: 8/27/2008		
Otter Tail Power Company				Actual results through: 9/30/2009		
	2008/2009 BUDGET			PARTICIPATION		
	ORIGINAL APPROVED BUDGET	MODIFIED BUDGET (8/2008)	ACTUAL BUDGET (9/2009)	PROPOSED	ACTUAL (9/2009)	% of GOAL
<b>DIRECT IMPACT PROJECTS</b>						
<b>RESIDENTIAL</b>						
Residential Demand Control	\$9,900	\$6,800	\$1,209	8	2	25%
Air Source Heat Pumps -Residential	\$8,800	\$8,800	\$16,551	13	30	231%
Geothermal Heat Pumps -Residential	\$5,600	\$6,000	\$16,052	4	19	475%
Air Conditioning Control	\$12,600	\$9,500	\$2,633	30	18	60%
Total -Residential	\$36,900	\$31,100	\$36,445	55	69	125%
<b>COMMERCIAL</b>						
Grant	\$57,000	\$0	\$51,990	4	5	125%
Motors	\$13,100	\$5,000	\$14,365	22	17	77%
Lighting	\$22,400	\$4,500	\$41,772	12	12	100%
Air Source Heat Pumps -Commercial	\$7,000	\$35,000	\$9,235	6	13	217%
Geothermal Heat Pumps -Commercial	\$2,700	\$106,000	\$15,623	1	31	3100%
Total -Commercial	\$102,200	\$150,500	\$132,985	45	78	173%
Total -Direct Impact	\$139,100	\$181,600	\$169,430	100	147	147%
<b>INDIRECT IMPACT PROJECTS</b>						
Advertising & Education	\$18,000	\$3,000	\$4,547	625	565	90%
Total -Indirect Impact	\$18,000	\$3,000	\$4,547	625	565	90%
<b>EEP DEVELOPMENT</b>						
	\$46,788	\$25,000	\$21,963			
<b>TOTAL - ALL PROGRAMS</b>	<b>\$203,888</b>	<b>\$209,600</b>	<b>\$195,940</b>	<b>725</b>	<b>712</b>	<b>98%</b>
Note: Actual energy and demand savings to be determined after 12/31/09						
Heat pump participation is based on # units installed.						
The commercial geothermal reflects 31 units installed however they were all done by one customer.						

## History

The SD Energy Efficiency Plan included programs for all customer classes and major end uses showing potential for energy savings. The Plan as originally approved included 8 programs intended to achieve approximately 1,143,446 kWh in annual energy savings at an approximate total cost of \$210,000 in 2009, including additional expenditures to cover development costs. Tracker balance carrying costs and a financial incentive are also part of the plan, and in addition to the budget stated here.

Cost recovery was approved through an energy efficiency adjustment factor of \$0.00063 effective with bills rendered on and after October 1, 2008 ([Rate Designation M-62S](#)).

After the plan was approved Otter Tail and Commission Staff worked together to establish communication plans, launch details, and program and budget modification protocols. At the time of our filing, we proposed to evaluate this plan on an ongoing basis and notify the Commission of major modifications in a timely fashion. The Company suggested that major modifications included new programs, increases to the budget by more than 30%, or closing programs. This is in line with procedures established in other jurisdictions.

One particular variable that proved most difficult to predict in our proposal was estimating labor and participation. We based our estimates on our history of energy efficiency programs in Minnesota. However, we were not sure how South Dakotans would respond to the opportunity to participate in energy savings programs, and cautioned Staff that it may require some flexibility. We proposed that we would monitor budgets closely and if budgeted expenses needed to be increased by more than 30%, we would notify the South Dakota Commission Staff. We proposed that the plan remain fairly flexible and dynamic, with minimal administrative overhead required both on our part and the PUC's. Staff granted flexibility within individual programs but indicated that any increase to the overall budget would need formal Commission approval.

On August 27, 2008, we notified Commission Staff that the Energy Efficiency Plan was being well received, stemming mostly from word-of-mouth advertising, energy management representative customer contacts, and Company and Commission press releases. Spurred on by high fossil fuel prices at the time, customers were facing tough energy choices and turning to energy efficiency as the solution. We asked for reconsideration of Staff's decision, encouraging greater flexibility in the overall budget as long as the program remained cost-effective. The flexibility was needed to provide customers with reasonable expectations and assurances of incentives that affect their purchasing decisions.

In carrying out the Commission's final order, Staff indicated that the Company was not allowed to exceed the overall approved budget or risk recovering cost. We were allowed to shift program dollars as needed, but keep within the approved budget. The Company was cognizant of Staff's desire to manage costs to customers and is respectful of the desire to keep rates low. We have abided by Staff's recommendations and we imposed modifications to individual programs to keep within overall budget limitations.

## **Current situation**

The Company points to three significantly limiting barriers to effective implementation, illustrative examples, and proposed modifications:

### **1. Greater budget flexibility**

Propose budget modifications be allowed up to 30% overall as long as cost-effectiveness parameters are in place

In order to abide by the limitations on budgets, the Company developed a tracking system by program so that customers who were considering installation of an approved energy efficient technologies were placed in a queue. The Company could not guarantee customers that if they moved ahead with their installation they would be granted a rebate. Rebates would be granted on a first-come, first-serve basis once receipt of payment and installation was confirmed. This created great uncertainty and frustration for some customers, and became an overly burdensome paperwork challenge for the Company. In addition, the lack of flexibility could have created a negative public relations event rather than what started out to be a positive experience.

The Company notified customers when budget caps were reached, with many customers unable to receive incentives. In addition, customers were taken out of the queue if adequate paperwork was not completed in a timely fashion. We also placed the Grant Program launch on hold and cut back on the Advertising and Education program in order to stay within the overall budget.

The Company wishes to emphasize that it did not necessarily need greater budget flexibility for its own administrative and customer service labor; rather flexibility was needed primarily to provide incentives to customers who were interested in investing in an energy efficient technology. In the end, the administrative expense associated with tracking customers in the queue likely resulted in more administrative costs per installation than would have occurred had greater overall flexibility been established.

### **2. Grant Program modification**

Change the \$10,000 per customer incentive cap

The Grant Program as it exists was a collaborative design between Staff and the Company. Both parties were interested in determining how a program with caps on incentives per customer and ranking of grant approval by cost-effectiveness could be implemented. The Grant incentive budget was limited to \$40,000 and a maximum incentive per customer of \$10,000.

Experience with the Grant Project in 2009 indicates several opportunities for enhancements for program participants by allowing added flexibility. The incentives of a maximum \$10,000 per participant are too restrictive. Further, the project places higher priority on applications from municipal, county, and state government facilities than from private entities or investor-owned businesses. This limitation was frustrating for private entities struggling in a depressed economy.

The Company believes the budget cap of \$10,000 per participant may inherently limit the incentive for customers to actively seek opportunities to make large investments in significant and long-term energy savings. The limitation may be so significant that customers who can save substantial amount of energy may not apply because the grant is too small to cover a reasonable percentage of incremental costs.

Allow private entities to compete on equal footing with public entities for grants

To partner with commercial and industrial customers on large energy efficiency projects, Otter Tail's experience indicates that the Company needs to offer incentives to consistently push the market toward higher end-use efficiency in industrial processes. Specifically, the Company's experience in promoting the Grant project to commercial and industrial customers in South Dakota confirms that incentives offered under the Grant project are not just funds directed to free riders. The program does influence the commercial and industrial market segment and offers the following illustrative example:

- Approximately 35 commercial and industrial customers replied with interest to a letter sent in July promoting the Grant project and opening up an application period.
- Of these 35 customers, 21 submitted applications for efficiency incentives through the Grant Program.
- The Company has approved grants for 5 of these customers, totaling \$37,390.
- 4 of the 5 customers are public entities.
- A 6th grant is currently being analyzed for inclusion in the 2009 EEP.

The Company proposes a process to independently evaluate the cost effectiveness of all proposed projects. Any project, regardless of size, would be eligible for incentive payment as long as the Company's evaluation for cost effectiveness indicated that the proposed project passes all necessary cost effectiveness tests.

Utility energy efficiency incentives are not a tax; rather the incentives are a proven, cost effective alternative to building generation facilities. Since all customers are paying an equal surcharge for this alternative to generation, all customers should have equal opportunity to participate in the program.

Change the name to Custom Efficiency Project

While the Company has operated a comparably named program in other jurisdictions, the name 'grant' created some confusion to customers. To further enhance flexibility, Otter Tail suggests changing the name of the Grant Project to the Custom Efficiency Project.

**3. Approve extension of the existing portfolio in 2010**

Preliminary results indicate that the South Dakota energy efficiency portfolio is on track. Programs are encouraging customers to invest in energy efficiency. Qualifying efficiency levels are reasonable and appropriate. It should be noted that in order to qualify for federal stimulus dollars, efficiency levels may need to be higher. The Company will research this further.

<b>SOUTH DAKOTA ENERGY EFFICIENCY PLAN - 2010</b>		
<b>Otter Tail Power Company</b>		
	<b>2010 Proposed Budget</b>	<b>2010 Proposed Participants</b>
<b>DIRECT IMPACT PROJECTS</b>		
<b>RESIDENTIAL</b>		
Residential Demand Control	\$5,000	5
Air Source Heat Pumps -Residential	\$15,000	20
Geothermal Heat Pumps -Residential	\$20,000	10
Air Conditioning Control	\$8,000	25
<b>Total -Residential</b>	<b>\$48,000</b>	<b>60</b>
<b>COMMERCIAL</b>		
Grant	\$60,000	6
Motors	\$10,000	15
Lighting	\$30,000	12
Air Source Heat Pumps -Commercial	\$30,000	10
Geothermal Heat Pumps -Commercial	\$50,000	2
<b>Total -Commercial</b>	<b>\$180,000</b>	<b>45</b>
<b>Total -Direct Impact</b>	<b>\$228,000</b>	<b>105</b>
<b>INDIRECT IMPACT PROJECTS</b>		
Advertising & Education	\$10,000	625
<b>Total - Indirect Impact</b>	<b>\$10,000</b>	<b>625</b>
EEP DEVELOPMENT	\$25,000	
<b>TOTAL - ALL PROGRAMS</b>	<b>\$263,000</b>	<b>730</b>

At the time of our original filing we proposed that unless the programs were not cost-effective, that we be allowed to extend the portfolio into 2010. While we have not finalized details, preliminary evaluations indicate that the current programs are cost effective.

Development of 2010 promotional material is in process. In order to include South Dakota energy efficiency plans in that material, as well as provide for a smooth transition into 2010, the Company is requesting that we receive approval for the portfolio at this time. The Company plans to file a status report, including details on program evaluation results and approval of cost recovery in March of 2010, at which time we will likely ask for approval for any known modifications for 2011. In this way the transition for customers remains relatively seamless, and customers and the Company can plan accordingly.

#### **4. Financial Incentive**

##### Incentive is too restrictive with budget cap in place

As part of the Commission's approval of our energy efficiency plan, a financial incentive for kilowatt-hours was also approved. The incentive is based on savings, costs, and net benefits, which include benefits from production costs decreases, generation, transmission, distribution credits, and sales tax costs increases. From these total benefits, program costs, including rebates and administrative costs are subtracted.

The incentive is designed to engage if the Company reaches 100% of the proposed savings goal. If budget flexibility exists, the incentive is sufficient for a first-year program. However, with the lack of budget flexibility, any incentive is practically unattainable as the Company must be precise and achieve perfect balance among all outcomes including energy and demand savings, as well as budgets. The maximum incentive allowed was based on step increases in net benefits, which are not achievable without greater budget flexibility.

Therefore, we propose the 2010 incentive be modified to begin at when the company reaches 30% of the energy savings goal if greater budget flexibility is not approved; at 90% if flexibility is approved as proposed.

#### **Conclusions**

Otter Tail Power Company applauds the South Dakota Commission's logical and sensible approach to energy efficiency. We believe the portfolio is practical and all customers will benefit.

We suggest the modifications proposed by the Company are reasonable and will help the Company provide better customer service while encouraging energy efficiency investments. We would anticipate continuation of this effort as long as it remains cost-effective for us to do so, and adequate cost recovery is in place. The PUC can expect a full cost-recovery filing in March of 2010, including the 2009 financial incentive calculation and any necessary modification to the energy efficiency adjustment factor. We likely will also propose any known modifications to the plan for 2011 at that time.

In summary, the Company proposes the following:

1. Approve the 2010 South Dakota Energy Efficiency Plan participation and budget goals as proposed.
2. Modify the Grant Program cap per customer, eligible entities, and project name.
3. Allow the company to increase the overall budget by 30% as long as cost-effectiveness parameters are maintained. Any increase over 30% must be approved by the Commission.
4. Modify the financial incentive to allow the company a reasonable chance to earn an incentive.