

STATE EE/RE TECHNICAL FORUM
Call #8 Decoupling Energy Sales from Revenues
and
Other Approaches to Encourage Utility Investment in Efficiency

The Minnesota Approach
by
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I. . DESCRIPTION OF SHARED SAVINGS INCENTIVE

A. Minn. Stat. 216B.16, subd. 6b and 6c. (Energy Conservation Improvement and Incentive Plan for Energy Conservation).

1. Subd. 6b. All investments and expenses of a public utility incurred in connection with energy conservation improvements must be recognized and included by the Commission in the determination of just and reasonable rates as if the investments and expenses were directly made or incurred by the utility furnishing the utility service.

2. Subd. 6b(b). [some large electric customer facilities are exempted]

3. Subd.6c. Authorizes the Commission to order public utilities to develop and submit for commission approval incentive plans and describe the method of recovery and accounting for utility conservation expenditures and savings. In approving the plans, the commission must consider:

- a. Whether the plan is likely to increase utility investment in cost-effective energy conservation;
- b. Whether the plan is compatible with the interest of utility ratepayers and other interested parties;
- c. Whether the plan links the incentive to the utility s performance in achieving cost-effective conservation; and
- d. Whether the plan is in conflict with other statutory provisions.

B. Minn. Stat. 216B.241 (Energy Conservation Improvement)

1. Subd. 1a. Each public utility shall spend and invest for energy conservation improvements the following amounts:

- a. for a utility that furnishes gas service, 0.5 percent of its gross operating revenues from service provided in the state; and
- b. for a utility that furnishes electric service, 1.5 percent of its gross operating revenues from service provided in the state; and
- c. for a utility that furnishes electric service and that operates a nuclear-powered electric generating plant within the state, [Xcel Energy] two percent of its gross operating

revenues from service provided in the state.

2. [gross operating revenues do not include revenues from exempted large electric customers]

3. Subd. 1b. Conservation Improvement by Cooperative Association or Municipality.

a. Each cooperative electric association and municipality must spend and invest for energy conservation improvements.

b. For a municipality, 0.5 percent of its gross operating revenues from the sale of gas and 1.5 percent of its gross operating revenues from the sale electricity [excludes gross operating revenues from certain large electric customer facilities]

c. For a cooperative electric association, 1.5 percent of its gross operating revenues from service provided in the state [excludes gross operating revenues from certain large electric customer facilities indirectly through a distribution cooperative electric association.

C. Utilities are rewarded with a specific percentage of the net benefits (as measured by the utility test) created by actual investments in conservation. The percentage of net benefits awarded increases as the percentage of energy-savings goal achieved increases. Since in general, net benefits also increase as the amount of energy savings increases, the incentive increases quickly. We designed the incentive that way because we understand that each additional amount of energy saved may cost more than the previous amount.

1. The incentive is calibrated such that at 150% of the energy-savings goal, the utility would receive about 30% of the utility s conservation expenditure budget as required by statute.

2. Under the incentive design, utilities are also rewarded for delivering their programs more cost-effectively. This occurs because more net benefits are created when actual costs are lower than projected.

II. MINNESOTA EXPERIENCE AND HISTORY

A. Lost Margin Recovery Incentive Replaced with the Shared Savings Incentive in 1999

1. Both lost-margin recovery incentives and Decoupling were policies *Du Jour* during the early 1990s. Because lost-margin recovery was cumulative, utilities began recovering financial incentives that were greater than their actual conservation expenditures. This, in effect, doubled the cost of conservation to the ratepayer. (By 1998 the lost margins we up to 40 Million dollars a year.)

2. In 1998, the Department of Commerce (at that time the Department of Public Service) recommended the incentive be changed. After nearly a year of prolonged negotiations among all the interest groups, a Shared-Savings Financial Incentive was submitted to the Commission as a settlement among the Department, Utilities, and Environmental Groups. The Joint Proposal was presented as meeting the four criteria for such incentives established in Minnesota Statutes and

overcoming the objections of various parties to the previous Lost Margin Recovery Incentive .

B. The Before and After/How is the Shared Savings Incentive Working?

1. Given the statutory requirement that utilities spend a set percentage of revenues on conservation, it is difficult to determine the effect of the lost margin recovery incentive versus the shared savings incentive. Although conservation investments dropped immediately after lost Margin recovery was ceased, since that time conservation investments have recovered, remained stable and appear to be cost-effective. (See table showing the conservation investments 1996-2004).

2. The shared savings incentive appears to be working, although this can not be empirically demonstrated due to the Statute requiring utilities to make a specific level of investment in conservation. Informally, utilities have indicated that the reason that utility management is willing to support conservation investments are:

a.. Recovery of the conservation investment is guaranteed including a carrying charge on these investments and an annual automatic adjustment to rates to recover these investments.

b. The financial incentive makes the investments more palatable.

C. The Minnesota Experience/Advise To Other States Looking at Financial Incentives.

1. We do not recommend the Lost Margin Recovery route. The incentive gets too big too quickly and continues to grow since the lost margins are cumulative (the gift that keeps on giving). If a state decides to use Lost Margin Recovery, it could limit recovery of the lost margin to two years, or set a reasonable cap. Theoretically, utilities are not rewarded for cost-effective expenditures under Lost Margin Recovery.

2. The incentive should be structured to increase the incentive for behavior that you want, such as increased energy savings and increased cost-effectiveness.