

MEMORANDUM

To: MPSC Staff and MPSC Commissioners of the State of Missouri

From: Great Rivers Environmental Law Center

KCP&L

Missouri Department of Natural Resources

Natural Resources Defense Council

Renew Missouri

Sierra Club Missouri Chapter

Date: July 21, 2010

Re: Collaborative Statement on current Draft MEEIA Rule

This memo is submitted on behalf of the Natural Resources Defense Council, the Missouri Department of Natural Resources, KCP&L and Light, Renew Missouri, the Great Rivers Environmental Law Center and the Sierra Club Missouri Chapter. We first want to recognize the substantial work that has taken place over the past six months to produce the current draft rule, and express our appreciation for the staff, consultants and other stakeholders who have prioritized this effort so that Missouri can begin to realize the enormous benefits of energy efficiency for its electric utility customers, economy and environment. Substantial progress has been made over these months, and we look forward to seeing this work result in Missouri taking a leadership role in maximizing this most cost-effective, beneficial, in-state energy resource.

As we move into a new docket and phase of the rulemaking, there are certain critical issues that remain unresolved. The objective of these comments is to focus on four key areas in which the rules must be substantially revised to ensure that the goals of the Missouri Energy Efficiency Investment Act are achieved.

Before diving into the details, we want to emphasize the importance of ensuring that there is a balance in the rules between ensuring that the financial incentives reward utilities for making appropriate efforts to capture as much savings as is cost-effective for its customers, and insisting upon clear and stringent accountability on the part of utilities for delivering the promised energy savings. The following four sections seek to ensure that both the incentives and the accountability mechanisms are adequate so that stakeholders can be confident that their resources are being used appropriately toward achieving the statutory goal of “all cost-effective potential” and that utilities can be sure their financial incentives are in proper alignment in following through on this goal.

A. Performance Targets –

The statute sets a goal of capturing all cost-effective energy efficiency potential and the current rule creates two opportunities for the commission to ensure that the programs are designed to meet this goal. The first opportunity is when the demand-side program plan is filed for approval, and the second is when the demand-side programs are evaluated and a determination is made as to whether a performance incentive has been earned. We agree with the draft rule that both the DSM market potential studies, along with a set of gradually-increasing targets that are based on the experience of leading states and utilities, should be the basis for setting the performance goals and approval of the plans. We would support a presumption that Missouri is capable of meeting a set of graduated annual incremental targets, that are informed by the market DSM potential studies that identify the electric utility-specific DSM potential while recognizing the unique characteristics of a given service territory and where such targets may be modified by the Commission either to increase or decrease the target based on results contained in the DSM potential study. However, we have remaining concerns that the current draft will not ensure that the performance goals and targets are set in a clear, transparent and consistent way at appropriate levels to ensure reasonable progress toward the “all cost-effective” efficiency goal.

4 CSR 240-20.094(3) provides that one criteria for approval is that the programs and plans, “Are consistent with a goal of achieving all cost-effective demand-side savings.” Further, the rule establishes guidelines in 4 CSR 240-094(2) by which the utility may demonstrate that the programs are expected to achieve all cost-effective savings, specifically that the commission “shall use the greater of the annual realistic achievable energy savings and demand savings as determined through the utility’s market potential study or the following incremental annual demand-side savings goals...” We urge the commission to make the following revisions to this section:

- a. The rule should specify the baseline against which the numerical targets in section 4 CSR 240-094(2)(A)(1-8) are calculated. For example, the proposed target for 2012 is 0.3% of total annual energy, and 1.0% of annual peak demand. The rule should specify that “total annual energy” refers to actual electric utility retail sales, either in the immediately preceding year, or an average of sales over the previous three years. This approach would be consistent with how other states have set their utility energy savings targets, including Ohio (average of previous three years), and Illinois (sales in the immediately preceding year).
- b. There is an apparent drafting error, in 240-094(2)(B)(9), which states that for 2020 and every year thereafter, the cumulative goal will remain static at 9.9% while at the same

time, the annual incremental goal continues to be 1.9% annually. Logically, if the utility continues to capture savings amounting to 1.9% of their previous year's sales, the cumulative savings will compound over time beyond the 9.9% that would be achieved in 2020.

- c. Given the potentially critical role of the utility potential study in creating the performance goals and subsequently determining the level of performance incentive, it is important that the potential study be conducted in a collaborative way that provides confidence in its results. To this end, we appreciate that this draft rule clarifies that the study must be conducted by an independent third party. Without this independence, there is a concern that the utilities would be in a position to set the very standards against which their performance will be judged and potentially rewarded. However, we would echo the June 25 joint comments of Missouri DNR, NRDC and KCP&L, in urging that these rules also set out process guidelines that establish a clear role for the commission staff and other stakeholders to review the methodology and assumptions of the potential study as it is being developed, to avoid any appearance that the utility is able to inappropriately influence the outcome of the study. Specifically, 4CSR 240-3.164(2)(A) should be revised so that the last sentence of the first full paragraph would read: "The current market potential study shall be prepared by an independent third party, with opportunities for commission and stakeholder review and input in the planning stages of the analysis including review of assumptions and methodology in advance of the performance of the study..."
- d. To further ensure the integrity of the target setting process, whereby the potential study findings regarding how much saving potential exists will play a significant role, we strongly suggest that the definitions of "Technical potential," "Economic potential," "Realistic achievable potential" and "Maximum achievable potential" in 4 CSR 240-3.164 be deleted and replaced with the nationally recognized definitions of technical, economic, achievable and program potential developed through a public-private partnership of experts and contained in the National Action Plan for Energy Efficiency. Those definitions are found on page 2-4 of the document entitled "Guide for Conducting Energy Efficiency Potential Studies," found here:
http://www.epa.gov/cleanenergy/documents/suca/potential_guide.pdf.
- e. We recommend that the same targets used to approve a demand-side program plan be used to determine whether the utility has earned a performance incentive. Specifically, section 240-20.093(2)(G) provides that a utility may propose a performance incentive though which they may retain a portion of the shared net benefits of the programs. How large a share of the benefits the utility would be able to retain would be dependent on

whether they met or exceeded their performance target, and by how much. This section specifically states that: “Annual energy and demand savings targets approved by the commission for use in the DSIM utility incentive component are not necessarily the same as the incremental annual energy and demand savings goals and cumulative annual energy and demand savings goals specified in 4 CSR 240-20.094(2).” This is reiterated in the definition of “Annual energy savings target” at 4 CSR 240-20.093. This language creates unnecessary confusion and uncertainty, and should be deleted. Further, the rule should clarify that the guidelines in 4 CSR 240.20.094(2) are, in fact, the same targets that will be used to measure the utility’s performance to determine whether and how much of a performance incentive should be awarded.

- f. Along with requiring that programs and program plans are 1. consistent with the “all cost-effective” standard and 2. have reliable evaluation, measurement and verification plans, section 240-20.094(3)(A) as written requires that such plans: “(3) are estimated to be beneficial to all customers in the customer class in which the program is proposed, regardless of whether the program is utilized by all customers in that customer class.” Item 240-20.094(3)(A)(3) echoes language from S.B. 376 but in a different context. Specifically, SB 376 (4) conditions *cost recovery* for demand-side programs on such programs being “beneficial to all customers in the customer class in which the programs are proposed, regardless of whether the programs are utilized by all customers.” In contrast, the draft of 240-20.094(3) states that the commission shall approve demand-side programs and program plans themselves based on this condition, among others, including that they are cost-effective as indicated by a TRC greater than one. As this condition for *program approval* is not required by the enabling legislation, 240-20.094(3)(A)(3) should not be included in the rule.
- g. Performance against any demand-side program savings target should also give credit to utilities that have taken the lead to advance demand-side programs in the recent past. Not doing so effectively penalizes the utilities within the state that have been proactive in realizing the very savings that the law attempts to encourage. The rule can accomplish this by providing specific language that makes it clear that ongoing savings resulting from measures installed within 2 years of the first program year shall count towards achievement of up to a limited amount of that year’s performance targets as identified in 4 CSR 240-094(2)(A)(1-8).

B. **Aligning Utility Incentives** – The statute is unambiguous that it seeks to level the playing field between demand and supply side investments for utility resource planning. Toward that end, the commission is required to, “(1) Provide timely cost recovery for utilities; (2) Ensure that utility financial incentives are aligned with helping customers use energy more efficiently and in a manner

that sustains or enhances utility customers' incentives to use energy more efficiently; **and** (3) Provide timely earnings opportunities associated with cost-effective measurable and verifiable efficiency savings.” While the commission is given considerable discretion to decide how to accomplish each of these actions, there is no discretion to pick and choose between these three actions. Rather, they all must be addressed.

The staff in its current draft has taken steps to ensure that cost recovery for utilities is accomplished on a more timely basis, and has offered the utilities the opportunity to file a performance incentive mechanism that would provide an earnings opportunity. These steps seek to address the first and third of the steps required by the statute. However, the second step of ensuring that the financial incentives a utility faces are aligned with helping customers use energy more efficiency, has been largely ignored.

It is well understood and extensively documented that utility revenues rise when sales rise, and the converse is equally true – if sales are falling revenues are falling. Thus, Missouri utilities have a strong disincentive to invest in energy efficiency, and the magnitude of the disincentive is substantial. In a 2008 Report to the Minnesota Public Utility Commission on decoupling, the Regulatory Assistance Project (RAP) provided an example to illustrate the effect of changes in sales, both up and down, on a utility's earnings.¹ In the hypothetical, a 1% change in revenues had an effect about ten times greater on utility earnings; for example, a 2% gain or loss in revenues caused a 23.76% gain or loss in earnings. The extent to which some portion of a utility's revenue requirement is a pass-through, such as utility fuel and net interchange costs, can mitigate the magnitude of the difference but cannot eliminate it.

The statutory direction to the commission to align utility incentives such that utilities are encouraged to support energy efficiency investments that save customers money is rendered meaningless if this powerful disincentive is not addressed in a meaningful and timely manner in this rulemaking.

A fairly simple change in language can begin to address this issue. The definition of “Demand-side programs investment mechanism” in 4 CSR 240-20.093(M) says that, “The DSIM may include, in combination and without limitation: 1. Cost recovery of demand-side program costs through capitalization of investments in demand-side programs; 2. Cost recovery of demand-side program costs through a demand-side program cost tracker; 3. Accelerated depreciation on demand-side investments; and 4. Utility incentive based on the achieved performance level of approved demand-side programs.” Again, this current language partially addresses timely cost recovery and an

¹ Regulatory Assistance Project, *Revenue Decoupling: Standards and Criteria, A Report to the Minnesota Public Utilities Commission*, 36 (2008).

opportunity for earnings, but does not acknowledge or allow a correction for the throughput incentive described above, which rewards utilities for maintaining or increasing sales. We strongly recommend that a fifth bullet be included in this definition that explicitly invites utilities to file a DSIM that also includes a mechanism that would eliminate the strong financial disincentive described above.

Again, we would echo the June 25 joint comments of Missouri DNR, NRDC and KCP&L, in urging that the rules specify: 1) cost recovery be accomplished using either direct expense recovery or an average of three years projected and/or historic expenses; 2) that utilities shall be granted a mechanism to remove the throughput incentive as part of the DSIM; and 3) any additional incentive be provided by the sharing of net benefits.

- C. Relationship to the IRP** – There is broad recognition among the stakeholders that the relationship between this rule and the pending IRP rule must be carefully considered and clarified. Unfortunately, confusion as to the relationship between the two processes persists in the current draft.

We believe that the IRP process may not result in a set of DSM resources that are adequate to meet the MEEIA goal of all cost-effective potential, and, therefore, the IRP results should not be a limiting factor in approval of the DSM plans submitted under the final rule.

Therefore, we recommend the following modifications to Item 240-20.094(3)(A)(4): “For demand-side programs and program plans that have a total resource cost test ratio greater than one (1.0), the commission shall approve demand-side programs or program plans, and annual demand and energy savings targets for each demand-side program it approves, provided it finds that the utility has met the filing and submittal requirements of 4 CSR 240-3.164(2) and the demand-side programs and program plans ... (4) Are included in the electric utility’s preferred plan, have been analyzed through the integration process required by 4 CSR 240-22.060 to determine the impact of the demand-side programs and program plans on the net present value of revenue requirements of the electric utility, or will be so analyzed in the future. A program that does not have a positive NPVRR is not necessarily disqualified from inclusion in a cost-effective DSM portfolio.”

- D. Development of a Statewide Efficiency Collaborative** - Currently, all of the investor-owned utilities in Missouri conduct utility-specific stakeholder collaboratives to review progress toward the energy savings goals for which ratepayer funds have been or will be allocated.

We believe that there would be benefits to creating a parallel statewide collaborative to serve a set of key functions, including:

- (1) To receive and share information on new developments and programs;

- (2) To develop a Missouri Technical Resource Manual (TRM);
- (3) To explore joint programs where such programs could reduce program costs and increase savings; and
- (4) Discuss program results, including successes, challenges and mid-course corrections.

Performing these functions in a statewide, rather than an isolated utility-specific collaborative would provide the following benefits:

- It provides a forum for shared learning on how programs are performing in the field and what adjustments have worked and could benefit other utilities;
- Utilities with smaller DSM staff can benefit from utilities that have more staff and resources to design and run programs;
- It provides a forum for stakeholders to discuss and make recommendations on statewide demand-side program policy matters, including such things as developing a framework for application of net-to-gross ratios;
- It provides a forum for bringing all stakeholders up to speed on new program designs that have met with success in other states. For example, guest speakers from the U.S. DOE, or program vendors can present new program opportunities to all utilities and stakeholders together;
- For stakeholders with smaller staffing resources, it allows for more effective use of existing staff time and more effective participation overall.

Therefore, this rule should strongly encourage the electric utilities to participate in a statewide collaborative for the purposes such as those enumerated above, by rule in this proceeding.