



**DEMAND-SIDE MANAGEMENT:
DETERMINING APPROPRIATE SPENDING LEVELS
AND COST-EFFECTIVENESS TESTING**

**APPENDIX B: DSM INCENTIVE LANGUAGE FROM
COMMISSION DECISIONS**

Prepared for:

Canadian Association of Members of Public Utility Tribunals
(CAMPUT)

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There was a request by CAMPUT that we try to provide some specific language on DSM incentives. A full survey of DSM incentive language and mechanisms is a large effort and outside the scope of this Issues Paper; however, an attempt was made to go to specific Commission decisions where these incentive mechanisms were adopted to illustrate the details of several of these mechanisms.

Examples are presented for: Arizona, Massachusetts; Minnesota; Nevada, and New Hampshire. While this constitutes several examples, many of the issues in establishing incentives are addressed in these examples.

Arizona

The shareholders of Arizona Public Service will be allowed a performance incentive for DSM program results, according to the Arizona Corporation Commission's Decision No. 67744 in April 2005.¹

“Funding for DSM comes in both base rates (\$10 million per year) and through implementation of an adjustor (average of \$6 million per year). DSM funding will be used for “approved eligible DSM-related items,” including “energy-efficiency DSM programs,” a performance incentive, and low income bill assistance. APS is obligated to spend \$13 million in 2005 on DSM projects.”²

In the Decision, the footnote to the phrase “a performance incentive” directs the reader to paragraph 45 of the Settlement, which is appended to the Decision. It reads:

“APS will be permitted to earn and recover a performance incentive based on a share of the net economic benefits (benefits minus costs) from the energy-efficiency DSM programs approved in accordance with paragraph 41. Such performance incentive will be capped at 10% of the total amount of DSM spending, inclusive of the program incentive, provided for in the Agreement (e.g., \$1.6 million out of the \$16 million average annual spending referenced in paragraphs 40 and 44 or \$4.8 million over the initial three-year period). Any such performance incentive collected by APS during a test year will be considered as a credit against APS' test year base revenue requirement. The specific performance incentive will be set forth in and approved as part of the Final Plan referenced in paragraph 48.”

Massachusetts

In Docket 04-11, the Massachusetts Department of Transportation and Energy (DTE) updated NSTAR's shareholder incentives for efficiency as follows:

“NSTAR Electric proposed to (1) fix the after-tax shareholder incentive at five percent; (2) set the threshold level of performance at 75 percent; (3) set the exemplary level of performance at 110 percent; and (4) slightly reallocate the weights assigned to the savings and value determinants.

¹ <http://www.cc.state.az.us/utility/electric/APS-FinalOrder.pdf>

² *Ibid.*, page 20.

. . . Under its proposal, the Company's shareholder performance incentive would amount to approximately \$3.025 million based on energy efficiency expenditures of about \$60.5 million in 2004. Under its threshold and exemplary proposal, NSTAR Electric's shareholder incentive payment amount would range from 75 percent to 110 percent of its 2004 energy efficiency expenses. NSTAR Electric noted that a shareholder incentive would not be earned if an energy efficiency program failed to achieve the threshold level of 75 percent of design level performance (id.). NSTAR Electric stated that even if an energy efficiency program accomplished more than 110 percent of design level performance, the shareholder incentive for such a program would nonetheless be capped at the 110 percent level.

. . . In determining incentive levels, the Department must reach a balance between two objectives: (1) promoting effective programs, and (2) protecting the interest of ratepayers.

While NSTAR Electric's proposed five percent after-tax rate exceeds the rate now provided in the DTE Guidelines, it is near the middle of the range that DOER proposed in D.T.E. 98-100, and this rate was approved for NSTAR Electric's 2003 Energy Efficiency Plan. The Department reaffirms that an incentive must be large enough to promote good program management, but small enough to leave almost all of the energy efficiency funds to directly server customers. The Company's proposal balances these two objectives, and is consistent with DOER information that the Department used in formulating the DTE Guidelines.

. . . NSTAR Electric raised the threshold performance level form the 70 percent approved in D.T.E. 03-48, to 75 percent, which is now in conformance with the D.T.E. Guidelines at § 5.2. Also in D.T.E. 03-48, at 13, the Department approved the use of an exemplary performance level of 110 percent of design level for use in calculation of shareholder incentives for 2003. In consideration of Department precedent, DOER's conclusions, and the support of the energy efficiency stakeholders, the Department finds that the Company has demonstrated the reasonableness of its proposal to set the exemplary performance level at 110 percent of performance goals. Accordingly, the Department accepts the Company's proposal to establish a threshold performance level of 75 percent and exemplary performance level of 110 percent of design level."³

Minnesota

According to Chris Davis at the Minnesota Department of Commerce (DOC): "In addition to the cost recovery and tax adjustments mentioned in the statute, the PUC agreed to a significant incentive mechanism in 1999 proposed by DOC, utilities, environmental groups and others. It is a performance-based incentive designed to increase the share of net benefits the utility receives in proportion to goal attainment. The filing for incentives made by Xcel Energy summarizes this incentive:

"In 1999, the Commission approved a new DSM Incentive Mechanism (Docket No. E002/m-99-508). Under this incentive mechanism, Xcel Energy's performance bonus (financial incentive) is based on a percent of net benefits achieved. The Company earns an incentive for achievement between 90 and 150 percent of its minimum-spending equivalent energy savings goal. The "goal" is equal to the number of kilowatt-hours that the Company is expected to save when it meets its minimum spending

³ From Docket 04-11, available at <http://www.mass.gov/dte/electric/04-11/819order.pdf>

requirement. The financial incentive is capped at the lesser of 30 percent of the DOC Commissioner-approved or actual CIP spending.”⁴

This approach was also summarized in the interview conducted with the Minnesota Department of Commerce. The Conservation filings are made to the DOC by Xcel Energy. Based on discussions with the DOC, the incentive begins when a utility reaches 91% of its goal, and is calibrated so that when a utility reaches 150% of the energy savings goal set by the DOC, the utility is eligible for "shared net benefits" of 30% of the program budget. Ratepayers fund this incentive during the following year when the PUC adjusts rates. A tracker account is used to determine how much of the utility's energy conservation charges have already been collected in rates, and to compare this amount to a utility's expenditures and incentives received. The net amount is rolled into the "resource charge" along with fuel charges, etc. It is not separated out as a separate line item. These charges have been on the order of 1.45% of charges in a recent case.”

Nevada

Shareholder Incentives

“1. The Commission may, upon the request of a utility or an intervening party pursuant to subsection 2 or upon its own motion, make a determination as to whether to designate a facility of the utility as a critical facility. Such a determination may be made in conjunction with an order issued by the Commission pursuant to subsection 1 of [NAC 704.9494](#) or in another proceeding on the matter.

2. A utility and any party granted intervener status may request that the Commission designate a facility of the utility as a critical facility for the purpose of:

- (a) Protecting reliability;
- (b) Promoting diversity of supply and demand side sources;
- (c) Developing renewable energy resources;
- (d) Fulfilling specific statutory mandates;
- (e) Promoting retail price stability; or
- (f) Any combination of paragraphs (a) to (e), inclusive.

Such a request must be accompanied by supporting analysis and documentation.

3. If the Commission designates a facility as a critical facility, the utility may request that incentives associated with that facility be included in rates in an application to change general rates filed pursuant to [NAC 703.2201](#) to [703.2481](#), inclusive. The incentives may include, without limitation:

- (a) Earning an enhanced return on equity on the designated critical facility over the life of the facility;
- (b) The inclusion in the rates of construction work in progress associated with the designated facility; and

⁴ 2003 DSM Financial Incentive Calculations Cost-Effectiveness and Performance Mechanism Report – Reference Docket No. E002/m-99-508.

(c) Designating costs incurred to construct the designated critical facility in a regulatory asset account, to be recorded as a subaccount to Account 182.3 (Other Regulatory Assets). The utility may recover the regulatory asset pursuant to subsection 3 of [NAC 704.9523](#).”⁵

New Hampshire

In 1999, the New Hampshire Energy Efficiency Working Group proposed a shareholder incentive mechanism that was adopted by the NHPUC in November 2000:

“The Group recommends that utilities be entitled to earn shareholder incentives. The shareholder incentive approach agreed to by the Group is based on the performance of the programs measured in terms of their actual cost-effectiveness and energy savings relative to the projected cost-effectiveness and energy saving savings, respectively. Separate target incentives are proposed for the residential and C/I sectors set at 8% of the total program and evaluation budgets for each sector. Superior performance could be rewarded by up to 12% of the planned sector budgets.”⁶

The mechanism is as follows:

- 1) The proposed shareholder incentive is a sliding scale incentive with two components. The first, *the cost-effectiveness component*, is based on the relationship between the projected New Hampshire Cost-Effectiveness test (NHCE) and the actual year-end NHCE. The second, *the energy savings component*, is based on the relationship between the projected lifetime kWh savings from installed measures (planned savings) and the lifetime kWh savings from actual installations (installed savings).
- 2) There will be two separately calculated incentives – one for the combined programs in the *residential sector* and one for the combined programs in the *commercial/industrial (C/I) sector*.
- 3) Target or Design Performance
 - a) In each sector, a utility that achieves an actual NHCE equal to the projected NHCE and installed savings equal to the planned savings earns a before tax incentive of 8.0% of its planned energy efficiency program budget for that sector.
 - b) The proposed shareholder incentive will be calculated as follows:
 - i) Residential Sector Incentive = [actual NHCE ÷ projected NHCE] * [4% * residential planned energy efficiency budget], plus [installed savings ÷ planned savings]*[4%*residential planned energy efficiency budget]
 - ii) C/I Sector Incentive = [actual NHCE ÷ projected NHCE] * [4% * C/I planned energy efficiency budget] plus [installed savings ÷ planned savings]*[4%*C/I planned energy efficiency budget]
 - c) A utility will not earn anything on the cost-effectiveness component of its incentive in a sector if the actual NHCE for the combined programs in that sector is less than 1.0

⁵ NAC 704.9484, available at <http://www.leg.state.nh.us/NAC/NAC-704.html#NAC704Sec9484>

⁶ From Order 23,574, issued November 2000 and available online at <http://www.puc.state.nh.us/Regulatory/Orders/2000ords/23574e.pdf>

- d) A utility will not earn anything on the energy savings component of its incentive in a sector if the actual energy savings for the combined programs in that sector is less than 65% of its planned energy savings.
- e) A utility's incentive in a given sector will be capped at 12% (before tax) of its planned energy efficiency budget. There is no cap on either component of the incentive as long as the combined incentive for any sector does not exceed 12% of that sector's planned budget.
- f) "For incentive calculation purposes only, planned energy efficiency budget" is defined as the total program budget minus shareholder incentives and lost fixed cost recovery, if any.
- g) The avoided costs used in calculating the actual NHCE shall be those used to calculate the Commission-approved projected NHCE.
- h) This incentive mechanism shall remain in place through the end of the transition service period of the last utility to introduce retail choice. At that time, the incentive structure will be revisited, along with the over-riding review of energy efficiency programs.
- i) The percentage incentive rates provided for in this proposal may be adjusted in the event of an extended period of either significant inflation or deflation following the effective date of this proposal.
- j) Any variance in spending for any individual program of 20% under or over budget shall require Commission approval.
- k) Final annual shareholder incentives will be determined retrospectively.⁷

⁷ The complete report is available at <http://www.raabassociates.org/main/projects.asp?proj=11&state=Completed>