MEMORANDUM

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

From: KCP&L
Missouri Department of Natural Resources
Natural Resources Defense Council

Date: June 25, 2010

Re: Collaborative Statement in Support of Enabling MEEIA Rulemaking

Introduction

The parties appreciate the opportunity to review and provide comment on the most recent draft of the proposed rules to implement MO SB376 (the "Missouri Energy Efficiency Investment Act" or "MEEIA"). This most recent draft further reinforces the commitment that MPSC Staff, the electric utilities, and the stakeholders have in working toward implementation of the bill through this regulatory rulemaking process. While the parties may separately file specific red-lined comments for Staff's consideration, our comments as represented in this memorandum represent our shared assessment of the most recent draft with an eye toward what has been accomplished and where opportunities to further the draft still exist.

Before we present our specific feedback on the most recent draft of proposed rules, it is important to keep in mind the original intent of the legislation embodied by the MEEIA. In adopting the MEEIA, the Missouri General Assembly recognized that electric utility sponsored demand-side management (DSM) represents a significant resource that has the potential to provide considerable value for the State of Missouri and set a goal of capturing all of the cost-effective potential for electricity savings. The legislation further recognized that the current cost recovery construct related to such investments in electric utility-sponsored DSM serves as a critical deterrent to the realization of the potential of this resource.

While we recognize that the MEEIA was primarily focused on both encouraging electric utility sponsored investment in DSM and removing the disincentives for investment that currently exist, we also recognize that the rulemaking related to implementation of the MEEIA must also address several additional areas that go hand-in-hand with building the right level of confidence among all stakeholders in the development of this most important resource. The items discussed below represent our collective view of the characteristics embodied by any successful implementation of rules consistent with the original intent of the MEEIA and are organized by five major themes: 1) Encouragement of DSM Investment; 2) Determination of the Level of DSM Investment 3) Timely Recovery and Approval; 4) Importance of Flexibility and 5) Transparency and Accountability. <u>It is imperative to highlight that these collective comments must be integrally considered, in combination, where inadequately addressing any of these individual issues will be significantly detrimental to the successful accomplishment of the objectives set forth in the MEEIA.</u>

1. **Encouragement of DSM Investment**

Financial Incentive Alignment

As discussed above, the creation of an environment where utilities are encouraged to make sound investments to capture all of the cost effective DSM potential in Missouri's economy is a core objective of the MEEIA. In order to create such an environment, three key areas must be effectively addressed: 1) program cost recovery; 2) the electric utility throughput incentive whereby under conventional ratemaking, utilities are rewarded financially for higher sales volume; 3) appropriate incentives to further encourage DSM investment. All three of these key components are specifically enumerated in the MEEIA.

Any rule enacted out of the MEEIA must provide clear and effective guidance on how each of these three issues will be addressed. Overall, we are encouraged by the evolution of the most recent Staff draft rule where language has been added to address the areas of program cost recovery and returns on investment (via a shared benefit performance incentive). We do, however, believe that the reality of the throughput disincentive exist as it pertains to the advancement of electric utility investment in DSM and should be explicitly acknowledged in the final rule along with a more explicit framework that addresses each of the three key areas identified above.

In order to provide greater clarity, it would be more appropriate for the rules to specify how each of the three key areas is to be addressed. It is our recommendation that the rules specify: 1) cost recovery be accomplished using either direct expense recovery or an average of three year 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. We believe adopting this approach is consistent with conventional practices and will accomplish the goals of MEEIA. Furthermore, if the framework is adequately clear then discussions can be more productively focused on performance targets.

It is our view that without effectively addressing all three of these issues, utilities will continue to face significant financial barriers to maximizing their use of cost-effective DSM as a core resource.

2. **Determination of Level of DSM Investment**

While it is imperative that the key financial considerations discussed above are effectively addressed in the final rule, equally important is the process of determining the level of DSM that the electric utility programs should seek to capture. The MEEIA answers this question by setting a goal of "all cost-effective" savings, and specifies the total resource cost test as the preferred test to determine cost-effectiveness. The staff has wisely and appropriately included a shared-savings performance incentive which allows the electric utility to keep a portion of the savings it produces, the proportion of which grows depending on how much the electric utility has met or exceeded a performance goal. The determination of how the performance goals are set is, therefore, another critical element of this rule.

Operationally, the goal of all cost-effective savings must be determined in the process of approving a three-year electric utility plan. The electric utilities and all stakeholders need to clearly understand how the Commission will determine whether a given plan, when implemented, will meet the goal, and how the Commission will also determine the extent to which utilities have exceeded this goal for the purposes of the aforementioned performance incentive.

The current Staff draft does not provide clarity in this regard. In the current draft, there are at least three moving parts that are relevant to determining just how much DSM will be pursued and captured by the utilities. First, the draft contemplates the completion of electric utility-specific DSM potential studies, which would inform the setting of a target for each program in the course of the plan approval. Second, the draft sets out a set of annual incremental saving targets that, if higher than the realistic achievable potential identified in the potential studies, would serve as a proxy for "all cost-effective" savings. And finally, the electric utility's integrated resource planning process (IRP) would be used to further refine what DSM programs are to be advanced and, thus, how much savings could be approved. The statement in rule 093(2)(G) which states that, "Annual energy and demand savings targets established by the commission for the DSIM electric utility incentive component are not the same as the goals for all cost-effective demand-side savings established by the commission in accordance with 4 CSR 240-20.094(2)," makes even less clear the relationship between the potential studies, the performance targets and the all cost-effective energy savings goal. Compounding the confusion is the statement in 094(3)(A), which describes a process whereby the commission will set targets that are: "Consistent with the goal of achieving all cost-effective demand-side savings." This statement seems logical, but inconsistent with the previous statement in 093(2)(G).

Given this opportunity to refine the clarity in the current Staff rule draft, we would urge the following changes to provide increased transparency, clarity and confidence in the determination of whether a electric utility DSM plan will achieve the goal of all cost-effective savings:

A. 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.
B. We agree with the Staff rule that both the market DSM 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 with the DSM potential study.

C. We are in agreement that, for the sake of the integrity of this process, it is not appropriate for an electric utility to set its own performance goal. Therefore, significant commission oversight of and collaborative input into the utility potential studies is necessary. We therefore recommend that the rules set process guidelines for incorporating the input of commission staff and other stakeholders in the preparation of the potential study.
D. We have not been able to agree upon the specific annual incremental savings targets in section 094(2). We will each file separately as to our views on the targets in the current draft.

3. <u>Timely Recovery and Approval</u>

The need to address the key items discussed in Section 1 above (program cost recovery, throughput incentive and appropriate incentive) in a timely manner is also a very core objective of SB376. It is clear that the latest Staff draft aspired to provide more clarity in this area within the rules. While we continue to believe that it is critical to address program cost recovery and the throughput incentive within twelve months of any investment in DSM, we recognize that the current draft affords the opportunity for individual electric utilities to address such issues in their respective program plan and DSIM (Demand-Side Investment Mechanism) filings.

In the area of timely approval of DSM program plans and cost recovery related investment mechanisms, we also recognize that the Staff's most recent draft appears to advocate DSM cost recovery mechanisms to be approved and established at the time of a rate case filing while the DSM program plans could be approved at a separate time. It is our preference to understand the investment mechanism prior to implementation of programs. As such, we recommend that the DSIM mechanism be approved simultaneous with DSM program plans. This would allow electric utilities to know and understand the cost recovery mechanism prior to making those investments. We understand that the mechanism cannot be implemented until a general rate case. We concur with the Staff's revised view that DSM program plans will be approved within 120 days of an application being filed, which is consistent with the Resource Planning timeline. We also believe that to further encourage investments in DSM, appropriate rate adjustments must be allowed between rate case proceedings. We believe adjustments between rate cases tend to be relatively minor compared to compounding adjustments over time.

Lastly, we do believe that the DSM program approval language in the most recent staff draft could benefit from revised language related to how programs are approved. Essentially, the proposed electric utility plans must be either approved or rejected by the Commission. Should the Commission make modifications to the electric utility's proposed plans, the electric utility should have the option to accept or reject such modifications in order to avoid a situation where the electric utility is compelled to implement a modified plan that it does not support.

4. **Importance of Flexibility**

We appreciate staff's recognition of the need for flexibility as Missouri's electric utilities develop plans and gain experience in our somewhat different service territories. Staff further demonstrates its recognition of the need for flexibility by including language to review the proposed rules in four years and we agree that this is a valuable addition to the rule.

We have, however, identified further areas where additional flexibility is warranted. The most recent rule draft outlines a process for annual adjustments of DSIM rates. We appreciate the addition of this language into the rule. The rule does not, however, address adjustments that may be needed for the potential addition of new programs, modifications to existing programs or removal of programs during the program plan horizon. We believe that this is necessary to support continued innovation in program development.

The rule also contains a few potentially onerous filing requirements including the naming of implementers in the DSM plan filing and requiring proof that similar programs have been implemented at another utility or as a pilot. These requirements will require electric utilities to hire implementers prior to getting plans approved and may prevent innovative, but effective programs from being approved.

5. **Transparency and Accountability**

We believe that in order to truly develop an appropriate and reliable level of DSM investment within the State of Missouri, all stakeholders must have an adequate level of trust in the electric utilities' investment in this most important resource. We believe that this trust will increase over time, but will be supported by processes and interactions that encourage both transparency and accountability. The Staff has taken steps to develop such processes and interactions through introduction of periodic reporting, well considered rules for evalution, measurement and verification, the removal of the words "highly confidential" in reference to the annual reports and the development of collaboratives which will provide key stakeholders a voice into the DSM development process.

Again, we appreciate the efforts of Staff and thank you for the opportunity to provide comments. We look forward to continuing to work to develop rules consistent with the original intentions of the MEEIA that will lay the groundwork for the development of DSM resources that will serve the State of Missouri for many generations in the future.