Exhibit No.:	_____
Issue(s):	Demand Side Investment Mechanism
Witness/Type of Exhibit:	Kind/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	EO-2012-0142

REBUTTAL TESTIMONY

OF

RYAN KIND

Submitted on Behalf of
the Office of the Public Counsel

UNION ELECTRIC COMPANY D/B/A AMEREN MISSOURI

Case No. EO-2012-0142

April 13, 2012

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a Ameren Missouri's Filing to Implement Regulatory Changes Furtherance of Energy Efficiency as allowed by MEEIA	))))	**Case No. EO-2012-0142**

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am a Chief Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.

3. I hereby swear and affirm that my statements contained in the attached affidavit are true and correct to the best of my knowledge and belief.

Ryan Kind

Subscribed and sworn to me this 13th day of April 2012.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 23, 2013
Cole County
Commission #09754037

Jerene A. Buckman
Notary Public

My commission expires August 23, 2013.

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1. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name, title, and business address.

A. Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102.

Q. Please summarize your educational and employment background.

A. I have a B.S.B.A. in Economics and a M.A. in Economics from the University of Missouri-Columbia (UMC). While I was a graduate student at UMC, I was employed as a Teaching Assistant with the Department of Economics, and taught classes in Introductory Economics, and Money and Banking, in which I served as a Lab Instructor for Discussion Sections.

My previous work experience includes several years of employment with the Missouri Division of Transportation as a Financial Analyst. My responsibilities at the Division of Transportation included preparing transportation rate proposals and testimony for rate cases involving various segments of the trucking industry. I have been employed as an economist at the Office of the Public Counsel (Public Counsel or OPC) since 1991.

Q. Have you testified previously before this commission?

A. Yes, prior to this case I submitted written testimony in numerous gas rate cases, several electric rate design cases and rate cases, as well as other miscellaneous gas, water, electric, and telephone cases.

Q. Have you provided comments or testimony to other regulatory or legislative bodies on the subject of utility regulation and restructuring?

A. Yes, I have provided comments and testimony to the Federal Energy Regulatory Commission (FERC), the Missouri House of Representatives Utility Regulation Committee, the Missouri Senate's Commerce & Environment Committee and the Missouri Legislature's Joint Interim Committee on Telecommunications and Energy.

Q. Have you been a member of, or participant in, any work groups, committees, or other groups that have addressed electric and gas utility regulation and policy issues?

A. Yes. I am currently a member of the National Association of State Consumer Advocates (NASUCA) Electric Committee, and the Stakeholder Steering Committee (SSC) of the

Eastern Interconnection Planning Collaborative (EIPC). I have served on the Missouri Department of Natural Resources Weatherization Policy Advisory Committee, as the public consumer group representative to the Midwest ISO's (MISO's) Advisory Committee and as the small customer representative on both the NERC Operating Committee and the NERC Standards Authorization Committee. During the early 1990s, I served as a Staff Liaison to the Energy and Transportation Task Force of the President's Council on Sustainable Development.

Q. What is the purpose of your testimony?

A. This testimony responds to the Demand-Side Management (DSM) Program cost recovery proposal of the Union Electric Company (UE or the Company) in its Application to Approve DSIM Filing, Request for Variances and Motion to Adopt Procedural Schedule (Application), and supporting documentation, including the 2013-2015 Energy Efficiency Plan (Report) and Supplemental Direct Testimony of William R. Davis.

Q. How is your testimony organized?

A. My testimony is organized as follows:

1. Introduction and Qualifications.
2. Summary of Conclusions and Recommendations.
3. UE's Request for Variances
4. Variances that UE Requires But Failed to Request.
5. General Principles in Designing Shareholder Incentives.
6. Experience in Other States in Designing Shareholder Incentives.
7. UE's Proposal.
8. OPC Recommendation for an Alternative Mechanism.

2. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Q. Please summarize your primary conclusions.

A. The OPC supports the implementation of a well-designed Demand-Side Program Investment Mechanism (DSIM); one that is consistent with the DSIM rules (4 CSR 240-20.093) and strikes an appropriate balance between incentivizing the Company to implement successful DSM programs and protecting the interests of ratepayers.

However, UE's proposal does not come close to striking that balance. My testimony identifies several problems with UE's proposal, summarized below:

- UE's shared net benefits mechanism would essentially allow the Company to recover "lost revenues" from its DSM programs above the level of lost revenues as this term is defined in 4 CSR 240-20.093(1)(Y). The DSIM rules (see 4 CSR 240-20.093(2)(G)1) clearly limit the lost revenue recovery to those that result from Commission-approved DSM programs that cause sales to drop below the sales level used to set the rates in the most recent rate case.

- UE's shared net benefits incentive is designed to achieve two separate goals; recover lost revenues and provide the Company with an incentive to implement successful energy efficiency programs. Conflating these two goals in one mechanism is inconsistent with industry practices, results in an unpredictable and volatile shareholder incentive mechanism, and creates the potential for significant over-recovery of lost revenues, performance incentives, or both.

- The Company is requesting incentives that are dramatically higher, on a normalized basis, than the level of shareholder incentives provided to most other utilities, including utilities with much more aggressive DSM programs.

- The total amount of revenues that the Company is requesting through its DSIM is excessive and results in a significant increase in the total costs that need to be recovered from customers in order to implement DSM programs.

Q. Please summarize your primary recommendations.

A. I recommend the following:

- The Commission should reject the Company's request for a variances from 4 C.S.R 240-20.093(2)(H) and 4 C.S.R 240-20.093(2)(H)(3).

- The Commission should reject the Company's request for a variance from 4 CSR 240-20-094(6)(J).

- The Commission should reject the Company's proposal for a shared benefits incentive, because it: (1) is designed to collect 100% of lost revenues regardless of the actual amount of any deficiency in recovering fixed costs, (2) is based on

unverified estimates of total net benefits instead of actual net benefits verified through EM&V as provided for in the rule, and (3) is redundant with the Company's proposed performance incentive.

- The Commission should require the Company to modify its performance incentive in the following ways:
  - The amount of funds that are made available to the Company for the performance incentive (at various levels of performance) should be determined on the basis of (i.e. as a percentage of) projections of energy efficiency program costs, not on the total level of benefits achieved.
  - The amount of funds that are awarded to the Company (i.e. the utility's share) for the performance incentive should be based on the level of annual net benefits achieved and verified through Evaluation, Measurement and Verification (EM&V) including the net to gross (NTG) factors verified through EM&V.
  - The performance incentive mechanism should be based upon: (a) a threshold amount of actual achieved annual net benefits below which no incentive is earned, (b) a planned amount equal to the estimated amount of annual net benefits expected to be achieved from the DSM plan, and (c) a cap (based on a high level of performance in achieving net benefits relative to the expected level of annual net benefits in the DSM plan) that places a limit on the total amount of annual shareholder incentive that could be awarded to the Company. If the Company's net benefits turn out to be anywhere between these points, the performance incentive award would be interpolated between them, allowing for a continuous performance incentive based upon the actual amount of net benefits achieved.
  - The Company should establish a separate, transparent lost revenues recovery mechanism designed to recover those lost revenues that are allowed by the DSIM rule, i.e., those lost revenues associated with the utility's demand-side programs that occur when sales turn out to be lower than the sales used to set rates in the most recent rate case.

3. UE'S REQUEST FOR VARIANCES

Q. Please summarize UE's variance requests.

A. UE's Application sorts its variance requests into the following four categories: (1) variances regarding retrospective recovery, (2) variance regarding calculation of utility incentive, (3) variances regarding "rate" and "revenue requirement" definitions, and (4) variances related to net shared benefits. UE requested five variances from the Commission's Rules "regarding retrospective recovery" pursuant to 4 CSR 240-20.093(13) and 4 CSR 240-20.094(9). First, UE requests a variance from 4 C.S.R. 240-20.093(2)(H), which states:

> (H) Any utility incentive component of a DSIM shall be based on the performance of demand-side programs approved by the commission in accordance with 4 CSR 240-20.094 Demand-Side Programs and shall include a methodology for determining the utility's portion of annual net shared benefits achieved and documented through EM&V reports for approved demand-side programs. Each utility incentive component of a DSIM shall define the relationship between the utility's portion of annual net shared benefits achieved and documented through EM&V reports, annual energy savings achieved and documented through EM&V reports as a percentage of annual energy savings targets, and annual demand savings achieved and documented through EM&V reports as a percentage of annual demand savings targets.

UE requests that net shared benefits be calculated based upon the characteristics set out in the TRM and the number of measures as determined by EM&V (Application, 9).

Second, UE requests a variance from 4 C.S.R 240-20.093(2)(H)(3), which states:

> 3. Any utility incentive component of a DSIM shall be implemented on a retrospective basis and all energy and demand savings used to determine a DSIM utility incentive revenue requirement must be measured and verified through EM&V.

UE states that good cause exists to vary the requirement to apply the recovery of net shared benefits on a retrospective basis because allowing prospective recovery in no way diminishes the role of EM&V (Application, 7). UE reasons that, because it is requesting approval of a TRM in this case, which relies largely on recent EM&V reports and therefore embodies the most reasonable approximations of the energy savings and costs of end-use measures, the annual EM&V process will be different than in recent history

(Application, 7). UE argues further that the TRM provides transparency and greatly facilitates understanding of program performance, that UE will still evaluate its programs annually, and that the Commission's EM&V auditor will provide another report of the utility's EM&V efforts (Application, 7). Retrospective recovery, UE contends, heightens recovery risk and does not value demand-side and supply-side resources equally (Application, 8). UE explains that as program costs are spent the effects are immediate, and that delayed recovery has detrimental effects to its financial position (Application, 8). Finally, UE argues that there is no legal basis to unduly relay recovery and the MEEIA statue in no way requires EM&V to be complete before recovery (Application, 9).

In the supplemental direct testimony of William R. Davis, UE further states that it is imperative not to delay recovery of the throughput disincentive, as delaying recovery causes additional financing costs which must be borne by customers and efficiency causes immediate cash losses to the Company (Davis testimony, 2). Delaying recovery of the 15.4% (discussed below) will cost customers an extra 12.5% as compared to UE's proposal (Davis testimony, 3).

Third, UE requests variances from 4 CSR 240-20.093(1)(EE) and 4 CSR 240-20.094(1)(Z), which both state:

> Utility incentive component of a DSIM means the methodology approved by the commission in a utility's demand-side program approval proceeding to allow the utility to receive a portion of annual net shared benefits achieved and documented through EM&V reports.

Fourth, requests variances from 4 CSR 240-3.163(1)(A), 4 CSR 240-20.093(1)(C) and 4 CSR 240-20.094(1)(C), all of which state:

> Annual net shared benefits means the utility's avoided costs measured and documented through evaluation, measurement and verification (E M & V) reports for approved demand-side programs less the sum of the programs costs including design, administration, delivery, and-use measures, incentives, E M & V, utility market potential studies, and technical resource manual on an annual basis.

Finally, UE also requests variances from 4 CSR 240-3.163(1)(F)5, 4 CSR 240-20.093(1)(M)5 and 4 CSR 240-20.094(1)(J)5, all of which state:

> Demand-side program investment mechanism, or DSIM, means a mechanism approved by the commission in a utility's filing for demand-side program approval to encourage investments in demand-side programs. The DSIM may include, in combination and without limitation… utility incentive based on the achieved performance level of approved demand side programs.

Q. Does Public Counsel support the first category of UE's variance requests that it referred to as variances regarding retrospective recovery?

A. No. The Commission made decisions about retrospective recovery in its MEEIA rulemaking that were reasonable and UE has not shown good cause for the requested variances.

Q. Please describe the third category of UE's variance requests that it referred to as variances regarding "rate" and "revenue requirement" definitions.

A. UE notes that 4 CSR 240-20.093(1)(O) and 4 CSR 240-3.163(1)(H) define "DSIM rate" as the charge on customers' bills for the portion of the DSIM revenue requirement assigned by the Commission to a rate class, while 4 CSR 240-20.093(1)(P) and 4 CSR 240-3.163(1)(I) define "DSIM revenue requirement" as the costs associated with the DSIM plan. Taken together and without a variance, UE concludes, these definitions would mean that only charges reflected in a DSIM approved as part of a MEEIA filing could be included on a separate energy efficiency line item on a customer's bill. However, UE continues, the MEEIA statute allows certain customers to opt-out of all energy efficiency charges, which is more than just the costs of UE Missouri's DSIM. Consequently, UE argues that good cause exists to grant a variance for these definitions to the extent necessary to allow the Company to include in that separate line item the costs associated with current and historical energy efficiency cost recovery (i.e., the regulatory asset that under prior rate case orders is currently being amortized over 6 years) in addition to the costs reflected in the DSIM itself. UE says this would allow the Company to effectuate opt-out requests, which MEEIA allows, regardless of whether the cost was incurred under a MEEIA-approved program or "any other authority" (Application, 9-10).

Q. Does Public Counsel support the third category of UE's variance requests that it referred to as variances regarding "rate" and "revenue requirement" definitions?

A. We believe there may be some justification for a variance in this area but that does not mean that opt out customers should be exempted from paying for all of the costs of DSM programs incurred for prior programs. The exemptions in the MEEIA statute and rule for the costs of DSM programs offered "by any other authority" would only apply to programs offered under some other authority when this occurs subsequent to the effective date of the new MEEIA statute.

4. VARIANCES THAT UE REQUIRES BUT FAILED TO REQUEST

Q. Does the OPC have any position on the variances that the Commission Staff (Staff) has argued that the Company should have requested as a part of this DSIM filing?

A. Yes. On February 17, 2012 , the Staff filed a pleading titled "Motion for Variance Determinations and Motion for Expedited Treatment" where the Staff stated that "Ameren Missouri has not requested all the variances the Commission would need to grant before the Commission could approve Ameren Missouri's proposed demand-side programs" including variances from "Rules 4 CSR 240-20.094(3)(D), 4 CSR 240-20.094(4), 4 CSR 240-20.094(2)(A), and 4 CSR 240-3.164(4)" and "Rules 4 CSR 240-3.164(2)(C)9 and 4 CSR 240-20.094(3)(A)" and "Rule 4 CSR 240-20.094(2)." Public Counsel generally agrees with the Staff that approval of the Company's application in this case could not occur without the approval of these additional variances identified by Staff.

Q. Has Public Counsel identified additional variances, beyond those identified by the Staff, that the Company should have requested as a part of this DSIM filing?

A. Yes. First, UE should have requested a variance from 4 CSR 240-20.093(2)(G) because, as shown later in this testimony, UE clearly intends to recover lost revenues through its proposed net shared savings proposal and this proposal does not include a process for using EM&V to measure and verify the level of energy and demand savings actually achieved by the programs approved in accordance with 4 CSR 240-20.094 as required by this provision in the Commission's rule. Second, UE should have requested a variance from 4 CSR 240-20.093(2)(G)1 because, as shown later in this testimony, UE clearly intends to recover lost revenues associated with its proposed programs through its proposed shared savings proposal and its proposal does not include the limitation on the

collection of lost revenues (i.e. revenues can only be recovered to the extent that the utility "does not recover the fixed cost as set in the last general rate case") as required by this provision in the Commission's rule.

5. GENERAL PRINCIPLES IN DESIGNING SHAREHOLDER INCENTIVES

Q. What guidance do the MEEIA statute (MEEIA) and the DSIM Rules provide for designing demand-side shareholder incentives?

A. MEEIA and the Commission's DSIM Rules explicitly allow the Company to earn an incentive for implementing demand-side programs. MEEIA makes three references to shareholder incentives, stating that the Commission: (1) shall ensure that utility financial incentives are aligned with helping customer use energy more efficiently and in a manner that sustains or enhances utility customers' incentives to use energy more efficiently; (2) shall provide timely earnings opportunities associated with cost-effective measureable and verifiable DSM savings; and (3) may allow the utility to retain a portion of the net benefits of a demand-side program for its shareholders. MEEIA, § 3(2)-(3), 5.

The Commission's Rules provide guidance as to how the incentive mechanisms should be structured. Specifically, the Commission's Rules stipulate that any incentive component shall be based on the actual performance of approved demand-side programs and include a methodology for determining the utility's portion of annual net shared benefits achieved and documented through EM&V reports.

Q. Do MEEIA and the DSIM Rules provide a lot of guidance on the details of how the shareholder incentives should be designed?

A. Neither MEEIA nor the Commissions' Rules provide specific guidance on some important issues, such as how much money should be made available for shareholder incentives. While the Commissions' Rules provide a structure for shareholder incentives, they do not indicate a methodology for determining the portion of achieved annual net shared benefits that will be retained by the utility.

The Commission can play an important role in providing further guidance on how demand-side shareholder performance incentives should be structured. Public Counsel recommends that demand-side shareholder incentive mechanisms be designed in such a way as to strike the appropriate balance between promoting effective, successful DSM

programs, and protecting the interests of ratepayers. The Commission can provide such guidance by adopting, in this case, certain principles to apply when reviewing shareholder incentives proposals.

Q. What are the guiding principles for designing shareholder incentives that the OPC recommends?

A. The OPC recommends the following principals be applied when designing demand-side program shareholder performance incentives:

- Shareholder incentive mechanisms should be designed in such a way as to encourage DSM programs that will best achieve the state's energy goals, including the goal of achieving all cost-effective demand-side savings. See MEEIA, § 4.
- The amount of funds available for shareholder incentive mechanisms should be both (1) sufficient to encourage achievement of the desired DSM program outcomes and (2) kept as low as possible in order to minimize the costs to electric customers.
- Shareholder incentives should be explicitly capped and should not exceed a predetermined portion of DSM program budgets.
- Shareholder incentive mechanisms should be based on desired outcomes (e.g., energy savings, net benefits), not program considerations necessary to implement the demand-side program (e.g., expenditure levels).
- Shareholder incentives should be based on clearly-defined outcomes that can be sufficiently monitored, quantified, and verified after the fact.
- Shareholder incentives should be available only for activities where the utility company plays a distinct and clear role in bringing about the desired outcome.
- Shareholder incentives should avoid creating perverse incentives, such as the incentive to increase costs without comparable increases in savings, or the incentive to cream-skim.
- A shareholder incentive mechanism and the rate structure used to recover DSIM incentive revenue requirements should sustain or enhance the utility customer's incentive to use energy more efficiently. See MEEIA, § 3(2) and 4 CSR 240-20.093(2)(C)2.

6. EXPERIENCE IN OTHER STATES

Q. How are demand-side program shareholder incentives designed in other states?

A. A recent report by the American Council for an Energy Efficient Economy (ACEEE) examines state efforts and experiences with financial incentives for encouraging investor-

owned utilities to provide effective energy efficiency programs for their customers.[1] The study found that states have shown a strong preference for mechanisms that award an incentive based on cost-effective achievement of energy savings targets, rather than other metrics such as program spending levels. Further, the study found that when these targets have been established, utilities have tended, thus far, to consistently meet or exceed them. The study categorized incentive mechanisms into three broad categories: shared benefits, performance targets, and rate of return (Hayes, 2011, iii).

The study highlights that most states establish a cap on the total DSM incentive amount available to the utility. This cap (i.e., the maximum dollar amount available for DSM incentives) is often determined by a percentage of the expected program costs, while a few states use savings or a fixed dollar amount to determine the cap. The actual amount awarded to the utility is usually based on the amount of net benefits achieved during program implementation, while a few states rely on program costs to determine the amount awarded. States usually have in place a threshold or trigger amount, below which the utility does not earn an incentive (Hayes, 2011, 11-12).

Q. How does UE's shareholder incentive proposal compare to other states?

A. The Table 1 below summarizes the incentive mechanisms in the 18 states surveyed through the study (Hayes, 2011, 12).

Table 2 below includes a summary of UE's proposed incentive mechanisms for comparison with the ACEEE study results. Note that all of the states in Table 1 except Georgia and Wisconsin have incentive caps that are either fixed or are tied to a portion of the energy efficiency program costs or benefits. Also note that most states determine the amount of incentives awarded to a utility using net benefits, as opposed to total benefits. In addition, UE's shared net benefit mechanism is not subject to any type of cap, unlike the mechanisms in all the other states. Furthermore, UE is proposing two separate incentive mechanisms, unlike other states. For these reasons, UE's incentive mechanism is significantly more generous than the other states in the ACEEE survey, as I will demonstrate below.

[1] Hayes, Nadel, Kushler, York, *Carrots for Utilities: Providing Financial Returns for Utility Investments in Energy Efficiency*, ACEEE, Report U111, January 2011.

Table 1: ACEEE: Overview of Shareholder Performance Incentive in Profiled States

State	Type	Award	Threshold/Trigger	Cap
Arizona	Shared Benefit	10% of net benefits	No. Minimum spending requirement	10% of program costs
California	Shared Benefit	9-12% of net benefits	85% of savings goals	$150 million per year (reward)/$150 per year (penalty)
Colorado	Shared Benefit	0.2-12% of net benefits	81% of savings goals	20% of program costs
Georgia	Shared Benefit	15% of net benefits	50% of projected participation	none
Hawaii	Shared Benefit	1-5% of net benefits	100% of savings goals	5% of net benefits; $4 million
Idaho	Shared Benefit	1-10% of net benefits	7-11.7% of new homes in programs	10% of program benefits
Kentucky	Shared Benefit	10% of net benefits	100% of savings goals	10% of program costs
Minnesota	Shared Benefit	based on spending	90% of savings goals	150% of savings goals/30% of budget
Ohio	Shared Benefit	50-75% of net avoided costs	65% of savings goals	15% of program costs
Oklahoma	Shared Benefit	15% of program costs or 25% of net savings	no	fixed: $2.7 million in 2010
Texas	Shared Benefit	1% of net benefits – up to cap	102% of savings goals	20% of program costs
Massachusetts	Performance Target	3.75-5.5% of program costs	75% of savings goals	5.5% of program costs
New Hampshire	Performance Target	8-12% of program costs	65% of planned savings and 1:1 cost effectiveness	12% of program costs
Rhode Island	Performance Target	4.4% of program costs	60% of savings goals	125% of savings metric; $150,000 for performance metrics
Connecticut	Performance Target	1-8% of program costs	70% of energy efficiency goals	8% of program costs
Washington	Performance Target / Shared Benefit	5-100% of net benefits	100% of savings goals	150% of savings goals
Nevada	Rate of Return	5% of DSM equity	No	5% of program costs
Wisconsin	Rate of Return	Same as other investments	No	No

Table 2: UE's Proposed Shareholder Incentive

State	Type	Award	Threshold/Trigger	Cap
Missouri - UE	Shared Benefit	15.4% of net benefits	None	15.4% of net benefits
Missouri - UE	Performance Target	$2-$16 million	70% of savings goals	130% of savings goals

7. UE'S PROPOSAL

Q. Please provide a summary of UE's proposed DSIM.

A. UE's proposed DSIM includes two components designed to recover three types of costs: (1) a program cost recovery component, and (2) a shared net benefits component that is designed to both make the Company financially whole and provide a performance incentive. UE is requesting that the appropriate amounts be included in the revenue requirement in its upcoming rate case. UE is also requesting an increase in the residential monthly customer charge from $8 to $12 in this case that would become effective at the conclusion of the current UE rate case. The Company's upcoming rate case will request implementation of the DSIM components (Report, 22). I will describe each of these requests in turn below.

Q. What is the program cost recovery component?

A. The Company is proposing to implement an expense tracker to recover program costs. A level of expenditures would be included in the new base rates at the conclusion of the current UE rate case and the Company would monitor DSM program spending and compare it to the amount collected from customers. Any under- or over-collections would be trued up in a future rate case. The tracking will be done by creating regulatory assets or liabilities, and any differences will accrue carrying charges at the Company's AFUDC rate. For the purpose of setting the initial base rates, UE proposes to use an average of the projected DSM expenses across the three years of its DSM plan. The final $/kWh charge would vary by rate class and would be determined based on the final billing units in UE's upcoming rate case (Report, 23).

Q. Why does UE propose to use an expense tracker as opposed to a rider?

A. UE states in its Report that:

> It is worthy to note that the MEEIA rules provide an option for the utility to request the use of a rider; that is, the ability to change rates outside a rate case. Under normal circumstances, a rider would be advantageous because it provides more flexibility to match collections with costs. Unfortunately, the legality of the rider is being challenged in court. If UE were to implement a rider only to have it stripped away by a legal decision after the time of the filing, then it would have no immediate recourse for program cost recovery. The use of an expense tracker will avoid any potential program cost recovery disruption. If the court upholds the use of a rider, then there will be opportunities to use it in the future. (Report, 23)

Q. What is UE's net shared benefit proposal?

A. UE requests recovery of 15.4 percent of the net present value of net benefits, to be collected over a three-year period. This equates to $56 million over the three years and approximately $18 million annually. The Company arrived at 15.4 percent of net benefits by analyzing its income statement both with and without efficiency. UE states that DSM results in reduced non-fuel retail revenues, which reduces its earnings by $56 million in net present value dollars, or $64.7 million in nominal dollars. The Company then divided this value by the net present value of net lifetime benefits ($364 million), which yields the 15.4 percent. Therefore, the Company asserts that 15.4 percent of net benefits is the amount required to make the Company financially whole from efficiency investments for the total lost margins from three years of efficiency investments (Report, 24-28).

Q. What is UE's performance incentive proposal?

A. Between 2013 and 2015, UE's planned demand-side program is expected to achieve incremental annual savings equal to 0.6 percent to 0.8 percent of annual sales (Report, 10). If UE achieves the savings targets in a given year, it proposes to receive $10 million for that year. If UE exceeds the savings targets for a given year by up to 130 percent, it would receive up to $16 million for that year. If UE's actual savings turn out to be only 70 percent of the savings target in a given year, then it would receive $2 million for that year. UE does not propose to earn an additional incentive for savings above 130 percent or any incentive if its performance is below 70 percent of the savings targets.

Q. How did UE determine the $10 million annual incentive amount that it proposes to receive for meeting its savings targets in each year?

A. In UE's 2011 IRP, the preferred resource plan called for the construction of a combined cycle plant to be completed in 2029. Therefore, UE reasons, if it engaged in DSM it

would forfeit the potential equity earnings associated with that rate-based construction investment. UE argues that in order for energy efficiency investments to be on an equivalent economic footing, the earnings opportunities must be equivalent. UE estimates that a long-term annual incentive of $10 million per year would provide a present value of earnings equal to that of constructing a combined cycle plant in 2029 (Report, 27).

Q. How does UE propose to recover the shareholder incentives from ratepayers?

A. UE proposes to include the shared net benefits portion of its incentive in base rates in the Company's upcoming rate case. The Company claims that this is appropriate because it allows it to be made whole for the "immediate financial penalties" that would otherwise be incurred, i.e., it allows the Company to be fully compensated for lost revenues as they occur (Report, 29).

UE proposes to collect the three-year performance incentives once the three-year performance goals are met in 2015. At that time, the Company would request that the performance incentive be included in rate base and amortized over three years. The Company claims that including this amount in rate base effectively accounts for the time value of money associated with the delayed recovery of this portion of the shareholder incentives (Report, 29).

Q. Does Public Counsel take issue with UE's DSIM proposal summarized above?

A. Yes, UE's proposal is not consistent with MEEIA or the Commissions regulations, and the Company is asking for an excessive amount of shareholder incentives. I take issue with many specific aspects of UE's proposal. I will address each of them in turn below.

Q. Does Public Counsel take issue with UE's program cost recovery proposal?

A. No, Public Counsel does not oppose this proposed treatment so long as it applies only to prudently incurred program costs. In the subsequent rate case where the tracker is trued up, parties should have the opportunity to propose excluding DSM expenditures that were not prudently incurred.

Q. Does Public Counsel take issue with the Company's request to increase the residential monthly customer charge from $8 to $12 in the DSIM filing?

A. Yes. This type of rate design decision should only be addressed in the context of a full rate case. Rate design decisions require consideration and balancing of many different

factors, and must consider the entire set of charges and the actual rates that would apply to the relevant customer rate class. One of the important factors to consider is how a fifty per cent increase in the customer charge would impact the charges per kWh and how the price signal associated with the lower charges per kWh would impact customer decisions to conserve energy and decisions to invest in more efficient appliances and building shell improvements. Customer charge and rate design decisions should also consider the implications of the new rate design for different types of customers within a customer class (e.g., low-income customers, high-usage customers, and low-usage customers). Furthermore, it would be inappropriate to single out one customer class (Residential) for a new rate design without considering other customer classes. Finally, this proposed rate design modification cannot be approved in this case because the Commission has not taken the steps necessary to approve such a modification that are required by section 393.1075.5 RsMo which states, in part, that:

> Prior to approving a rate design modification associated with demand-side cost recovery, the commission shall conclude a docket studying the effects thereof and promulgate an appropriate rule.

The Company's request to modify the residential monthly customer charge in this docket is entirely out-of-place for both policy and legal reasons and should be rejected by the Commission.

Q. Does the OPC take issue with UE's shared net benefits proposal?

A. Yes, I have two concerns with the Company's shared net benefits proposal. First, the proposal is clearly designed to allow the Company to recover all of the lost revenues associated with its proposed DSM programs. The DSIM rule explicitly limits the lost revenues that a company can recover to only those lost revenues that arise when DSM program savings cause sales to decline relative to the sales levels used in the most recent rate case (see 4 C.S.R. 240-20-093 (1)(Y), (2)(G)1). The Company's net shared benefits proposal would allow it to recover significantly more than what is allowed by the DSIM regulations.

Second, it would not be good regulatory policy to permit the Company to recover lost revenues through a shared net benefits mechanism. The Company's proposed mechanism conflates the two goals of recovering lost revenues and earning a net shared

benefits incentive. This approach creates a potential for over-recovery (or under-recovery) of either type of cost. For example, if the Company were to set a shared net benefits incentive on certain amount of *forecasted* benefits expected in the DSM plan, but was able to actually achieve benefits greater than those forecasted, and then the shared benefits incentive earned could turn out to be significantly higher than the lost revenues experienced. In my view, there are no circumstances where the Company should be allowed to recover an amount of lost revenues equal to more than its actual amount of total lost revenues. The Company might argue that any over-recovery of lost revenues should not be considered lost revenues, but should instead be considered a shareholder incentive for good performance. My response would be that any shareholder incentive should be covered by a separate performance incentive mechanism, and that the Company, in this example, would be either over-recovering its lost revenues or over-recovering the shareholder incentive it is due. Either outcome is detrimental to customers, and results in providing the Company with more incentive than it is due.

In sum, any lost revenue recovery mechanism should be designed so that it explicitly recovers only the amount of lost revenues that the Company is allowed to recover – nothing more and nothing less. There is no good reason to have the amount of lost revenue recovery tied to a sharing of net benefits achieved by the DSM program. Instead, a sharing of net benefits should be used only for providing utility management and shareholders with an incentive for good DSM program performance.

Q. Does the OPC take issue with UE's "performance incentive" proposal?[2]

A. Yes. This is one of the most outrageous proposals that I have ever seen proposed by a utility – and that is saying a lot. I have two major concerns with this proposal. First, the amount of money associated with the performance incentive is excessive. The Company has proposed three points that define the range of performance incentive allowed: a threshold of $2 million at 70 percent of projected energy savings; a target of $10 million at 100 percent of energy savings; and a cap of $16 million at 130 percent of energy

[2] Throughout this testimony I use the term "performance incentive" to refer to the portion of the Company's shared net benefits proposal that allows it to recover $10 million incentive for achieving 100 percent of the energy savings targets. The $10 million figure was determined to allow for a stream of revenues equal to the present value of shareholder earnings from a future supply-side resource.

savings. These amounts are equivalent to roughly four percent, 21 percent and 33 percent of the energy efficiency program budgets, respectively. These amounts are inconsistent with industry practice and much more generous than the shared benefits proposals identified in the ACEEE study (as indicated in Table 1 above), and represent an extremely large annual incentive relative to the size of the projected annual program expenditures.

Second, the rationale that the Company uses to determine these amounts, especially the target amount of $10 million is misguided, inappropriate, and will result in excessive shareholder earnings at the expense of UE's customers. UE bases this $10 million figure on the present value of earnings that the Company would experience if it were to construct a combined cycle plant in 2029, instead of the energy efficiency programs, as indicated in its 2011 integrated resource plan (Report, 27). This is not a sound basis for determining an energy efficiency performance incentive, and does not make energy efficiency investments comparable to supply-side investments as the Company claims that it does.

Q. Please elaborate on why you believe that the Company's performance incentive proposal should not be based on the potential earnings stream from a future supply-side resource.

A. I have several concerns with the Company's logic here. First, electric and gas utilities have an obligation to provide their customers with safe, reliable, low-cost service, and they have an obligation to plan for and implement resources that will achieve this goal. If the Company were to reject the energy efficiency programs and construct a supply-side resource instead, then it would be explicitly rejecting the best resource option in favor of a second-best resource option. This is clearly inconsistent with utilities' obligation to provide safe and adequate service at just and reasonable rates, and could even be described as an imprudent course of action. There is nothing in Missouri statute or Commission precedent that allows a utility to enjoy earnings equivalent to those it could earn form a second-best resource option, and a utility should not be provided with an incentive equal to the earnings from a second-best resource option.

Second, it should be noted that the earnings that the Company receives through higher rates for investing in a supply-side option would only be included in rates so that the

Company's shareholders would be reasonably compensated for providing the equity needed to help finance the supply-side investment. Without the investment, the additional equity and rates that reflected the increased cost of equity would not be needed to ensure the utility's ability to attract additional capital so there would be no justification for additional compensation to shareholders. If shareholders were compensated through higher rates for providing equity to help finance a phantom plant that never gets built since it is displaced by the DSM investments that are fully funded by ratepayers, this would only increase the return on equity being provided to shareholders for the rest of the Company's investments and increasing that return would lead to rates that are not just and reasonable. It makes no more sense to compensate shareholders for equity that is not necessary than it would be to raise rates to compensate debt holders for money that was never loaned to finance utility operations.

Third, this approach does not make energy efficiency investments comparable to supply-side investments, as the Company claims it does. Imagine, for the sake of argument, that this approach were applied to supply-side investments. If a utility were to build a new combined cycle plant that cost less than the next expensive alternative, for example a wind turbine or a new nuclear plant, should it be allowed to recover the earnings stream that it would have recovered from the alternative resource? Such a proposal would be roundly rejected as nonsense.

Fourth, there is way too much uncertainty regarding the future supply-side resource that might represent the next best option after energy efficiency. The fact that the next supply-side option is not expected to be needed until 2029 provides an indication of the uncertainty associated with the amount, if any, of the actual resource need, the type of supply-side resource that would actually be constructed, and the costs associated with that resource. There are so many factors that could change over the next 17 years, making the Company's estimate of $10 million dollars way too uncertain for the purpose of setting the size of a performance incentive.

Fifth, this is a very unstable figure to use for setting the size of an energy efficiency performance incentive. What should be done in the future, when the assumptions about the next supply-side resource change? What if the IRP in 2015 indicates that the next new resource will not be needed until 2031, resulting in a lower projected earnings

stream than what the Company used to set the size of the 2012 performance incentive, and indicating that the Company's performance incentive was too high for the years 2012 through 2014? Would the excessive performance incentives be returned to customers somehow? What if the timing and costs of the next new supply-side resource changed again in 2017?

Sixth, the 2011 IRP that the Company is basing its $10 million estimate on is plagued with a variety of problems, as indicated in the testimony presented by the Public Counsel and other parties in Case No. EO-2011-0271. The Commission issued its Report and Order in that case on March 28, 2012 wherein it concluded that:

> The Commission finds that the 2011 Integrated Resource Planning filing submitted by Union Electric Company, d/b/a Ameren Missouri, does not demonstrate compliance with the requirements of Commission Rule 4 CSR 240-22 in certain respects described in the body of this order. Union Electric Company, d/b/a Ameren Missouri, shall correct those deficiencies in its 2014 triennial integrated resource planning filing and in upcoming annual updates as appropriate.

This non-compliant IRP cannot be relied upon for making long-term projections of the need for, or cost of, the next supply-side resource needed in the absence of demand-side resources so the foregone earnings associated with a combined cycle generation facility that would not go into service for nearly 20 years is not an appropriate measure of the magnitude of a performance incentive that incentivizes UE while ensuring that consumers are not subject to exorbitant charges for utility service.

I recommend that the Commission completely reject the Company's logic for determining the size of the performance incentive, and require instead that the size of the performance incentive be based on the size of the energy efficiency program budgets. My rationale for this recommendation is further explained in Section 8 below.

Q. Do you have any additional concerns about the Company's performance incentive proposal?

A. Yes. Each of the three tiers of the performance incentive is based on the Company achieving a certain portion of the target energy savings (between 0.6 percent and 0.8 percent of annual sales) in its DSM Plan. The amount of performance incentive awarded to the Company should not be based simply on the achieved energy savings, but should

instead reflect the value that the efficiency programs provide to customers in cost reductions. I believe that the dollar value of net benefits actually achieved is a better basis for incentivizing utility DSM performance. I also believe that this is why MEEIA and the DSIM regulations provide companies with the opportunity to use shared savings as a basis for a shareholder incentive mechanism.

Q. Does Public Counsel have other issues with UE's proposed demand-side incentive mechanism?

A. Yes. I have two additional concerns. First, the models and inputs used by UE through the DSMore model need to be fully vetted to understand the benefit calculations, and to ensure credibility and reliability for savings and benefits that the shareholder incentive proposals relies upon. Public Counsel does not have a license for the DSMore model; we are unable to dig into the details of the model and observe the interactions between the data inputs and model outputs so UE's reliance on this model makes it difficult for OPC to be involving in the vetting that needs to take place.

Second, UE's shared benefit proposal allows the Company to use gross savings as the metric for tracking utility and customer progress toward the Company's efficiency performance incentives (Report, 55). UE states that it makes efforts to design effective programs that minimize free ridership by reviewing studies that indicate certain measures are achieving high market shares and thus high free ridership rates, and carefully setting incentive levels to minimize free ridership (Report, 60). However, by using gross savings, UE is essentially ignoring the impacts of free riders on its programs, which results in an overstatement of energy efficiency savings and a comparable over-recovery of the shared net benefits. The Commission should require the Company to use net savings (i.e., with free-riders subtracted out) for determining the program benefits and therefore the amounts of shareholder incentives that will be awarded to the Company.

Q. What does Public Counsel conclude from UE's proposed demand-side incentive mechanism?

A. By any measure, the Company's shareholder incentive request is excessive. As discussed above, one of the key metrics for assessing the magnitude of a shareholder incentive is the percentage of program costs that the incentive represents. Most states allow for incentives that equal 5 percent to 10 percent of program costs. Some states allow as much

as 15 percent of program costs for outstanding performance. Table 3 below estimates the percentage of program costs that UE is seeking through its proposal, including the shared benefits component, the performance incentive component, and the total effect. As indicated, UE is requesting $98 million in total incentives, which equates to approximately 73 percent of program costs. This is clearly excessive, will place an undue burden on ratepayers, and significantly undermines the net benefits that customers will receive from the DSM programs.

Table 3: Summary of Requested Incentive as a Percentage of Program Costs

	Three Years Total	Percent of Program Cost
Program Costs	134,247,848	
Shared Benefit Incentive	56,101,305	42 percent
Performance Incentive	28,092,720	21 percent
Total Incentive	84,194,025	63 percent

Q. What is UE's position regarding the pending appeal of the Commission's MEEIA Rules?

A. UE states that if the OPC's appeal regarding whether lost revenues are a recoverable cost under Missouri law is successful, it would mean that utility and customer interests could not be aligned (because the throughput disincentive could not be removed), and the Company would not continue to pursue energy efficiency at the levels proposed in its MEEIA filing. The Company's tariff contain language which automatically and without further action by the Company or the Commission terminates the demand-side programs in the event of certain specified occurrences (Application, 5).

Q. Does Public Counsel take issue with this position?

A. Yes. Tariffs should only be terminated based on a date certain or by Commission action which determines that such termination is consistent with the public interest. If the Company believes its tariffs should no longer be effective, then it should file a pleading with the Commission requesting that result and even request expedited treatment from the Commission if that is appropriate under the circumstances.

Q. Does Public Counsel have any other issues with the Company's proposals that you would like to briefly address?

A. Yes. First, OPC opposes the use of demand and energy savings estimates from the proposed Technical Reference Manual (TRM) as the basis for determining program performance in place of EM&V verified estimates of net savings for each program. During one of the technical conferences in this case, DNR cited and explained numerous deficiencies in the TRM and these should be addressed before the TRM can be relied on for planning future programs. While OPC appreciates the efforts that UE has made in its initial attempt to develop a TRM, we do not think it is ready to be relied on as a tool for future planning efforts, and certainly not for establishing the level of incentives that UE should receive for DSM program performance.

Second, the proposed tariffs that UE provided as part of its Report do not contain the level of detail required by the Commission's rule on Filing Requirements for Electric Utility Promotional Practices as they do not adequately describe the availability and terms (e.g. incentive levels and eligibility requirements) associated with the proposed DSM programs. Customers should be able to look at currently effective tariffs and find full descriptions of the DSM services that may be available to them.

Third, the proposed tariffs that UE provided as part of its Report would have the effect of placing the entire burden of paying for low income weatherization programs on residential customers. Up until now, the costs of providing weatherization services to low income electric and gas customers has been shared by all customer classes and OPC believes that this policy should be maintained in this case. For all other DSM program, we support the proposed approach of allocating the cost of DSM programs that serve residential customers to the residential rate class and allocating the cost of DSM programs that serve business customers to the rate classes for business customers.

8. OPC RECOMMENDATION FOR AN ALTERNATIVE MECHANISM

Q. What do you recommend with regard to the recovery of lost revenues?

A. First, I recommend that any recovery of lost revenues be achieved through a separate accounting mechanism, and not be incorporated into a shared benefits incentive or any other performance incentive. Recovery of lost revenues serves a different purpose than shareholder incentives, and the recovery mechanism should be separate in order to avoid

over-compensation or perverse incentives. Furthermore, it is important that lost revenues be recovered through a mechanism that is fully transparent, so that the Commission and other interested parties will know exactly what is being recovered.

Second, I recommend that the Company be allowed to recover only those lost revenues that result from DSM savings that cause sales to be lower than the sales used to set rates in the most recent rate case. This is consistent with the DSIM rule (4 CSR 240-20.093(2)(G)1), and is sound public policy because it ensures that a company will not be overcompensated for lost revenues in times when load is growing steadily.

Q. Is the Company's proposal for lost revenue recovery consistent with your recommendations?

A. No. UE explains that its DSIM tracker will include two separate components; (a) programs costs, and (b) shared net benefits to remove economic disincentives and provide timely earning opportunities (Report, 22). Further, the Company is proposing to collect all lost revenues, not just the lost revenue component from when sales fall below the level determined in the last general rate case. This is inconsistent with my recommendations above for a separate lost revenue recovery mechanism and for recovery of those lost revenues that result from DSM savings that cause sales to be lower than the sales used to set rates in the most recent rate case.

The Company is proposing to recover more of the lost revenues than those that are allowed by 4 CSR 240-20.093(2)(G)1. If lost revenues are recovered through a utility incentive component of an DSIM, then this component must still comply with the limitation on lost revenue recovery required by 4 CSR 240-20.093(2)(G)1.

Q. What do you recommend with regard to the Company's shared net benefit incentive proposal?

A. I recommend that the Commission reject this proposal in its entirety. First, the Company's shared benefits incentive is essentially a means of allowing the Company to recover the full amount of lost revenues from the DSM programs. As described above, this is an inappropriate use of any kind of shareholder incentive.

Second, the shared benefit incentive is redundant with the Company's proposed performance incentive mechanism. Either of these mechanisms should be designed to

provide the Company's management with a clear incentive to implement efficient, successful DSM programs. There is no need to have two mechanisms to achieve this single goal.

Third, the level of benefits expected over the next 15 years should be re-calculated to reflect more realistic values for the cost/kW of avoided capacity costs. UE used fairly high values for avoided transmission and distribution costs that came from its 2011 IRP. While these values were reasonable enough for the purpose of screening DSM resources for consideration of inclusion in alternative resource plans, they have not been supported with evidence in this case to show that they are reasonable for the estimation of benefits that customers will receive from the proposed DSM programs. UE has not provided any evidence in this case to demonstrate the proposed three years of DSM programs will lead to any substantial reductions in the level of transmission and distribution costs incurred in the future. Unless such evidence is provided, the estimated level of benefits associated with the proposed programs should be adjusted to remove speculative benefits from avoided transmission and distribution costs.

I also recommend that UE's proposed shared benefit performance incentive and the additional performance incentive be combined into a single mechanism that incorporates the best elements of each. This will result in a simpler, more transparent approach that will be better suited to achieving the ultimate goals of (1) motivating the Company and (2) protecting it customers. This approach is also consistent with industry practice in other states.

Q. What do you recommend with regard to a performance incentive?

A. Public Counsel agrees that a performance incentive should be provided to the Company to help encourage good performance, and even exemplary performance, in designing and implementing DSM programs. I also agree that the level of shared net benefits achieved should be used as an indicator of program success and as a means of determining how much incentive the Company is awarded. However, I would recommend several important changes to the Company's performance incentive proposal:

- The amount of funds that are made available to the Company for the performance incentive should be determined on the basis of (i.e. as a percentage of) projections of energy efficiency program costs, not on total level of benefits achieved.

- The amount of funds that are awarded to the Company (i.e. the utility's share) for the performance incentive should be based on the level of annual net benefits achieved and verified through Evaluation, Measurement and Verification (EM&V).

- The amount of funds awarded to the Company should be based upon: (a) a threshold amount of actual achieved annual net benefits below which no incentive is earned, (b) a planned amount equal to the estimated amount of annual net benefits from the DSM plan, and (c) a cap (based on a high level of performance in achieving net benefits relative to the expected level of annual net benefits in the DSM plan) that places a limit on the total amount of shareholder incentive that could be awarded to the Company. If the Company's net benefits turn out to be anywhere between these points, the performance incentive award would be interpolated between them, allowing for a continuous performance incentive based upon the actual amount of net benefits achieved.

- The Company should establish a separate, transparent lost revenues recovery mechanism designed to recover those lost revenues that are allowed by MEEIA and the DSIM regulations, i.e., those lost revenues that occur when sales turn out to be lower than the sales used to set rates in the most recent rate case.

Q. Please explain why the amount of funds made available for the performance incentive should be based upon the estimated level of annual DSM program costs.

It is very important that the incentives available be tied to program costs because this helps to ensure that the magnitude of the performance incentive is in line with the magnitude of the demand-side programs. It is important to remember that every dollar that is provided to the Company's shareholders is a dollar that could otherwise have been spent on delivering demand-side programs. This explicit and transparent connection between program budgets and shareholder incentives is important in order to allow the Commission to strike the appropriate balance between shareholders and customers. In addition, the Company and the Commission have much more control over the DSM

program budgets than they do over program benefits; resulting in much more control over the amount of shareholder incentives that are awarded, and allowing for more consistent shareholder incentives from year to year.

Furthermore, the benefits of DSM programs (either total or net) can change significantly between those that are planned and those that are actually achieved, potentially leading to large unanticipated swings in the amount of the performance incentive that is awarded to the Company. The benefits of DSM programs can also fluctuate significantly due to changes in avoided costs, completely unrelated to the DSM programs or the actions of the Company, potentially resulting in unpredictable and volatile shareholder incentives. If the available shareholder incentives are based on shared savings, then several years from now the amount of available shareholder incentives, and consequently earned shareholder incentives, could be significantly different than the range of incentive amounts that were anticipated when the incentive component of a DSIM is approved by the Commission in this case.

Q. Please explain why you distinguish between the basis for the amount of funds made available for incentives and the incentive amount that is awarded based on performance in actually achieving net savings.

A. It is important to recognize that the metric that is used to determine the amount of funds that are made available for the performance incentive (i.e., the threshold, the target and the cap) does not have to be the same metric that is used to determine the amount of funds that is awarded to the Company. The amount of the award could be based on net savings (in dollars), on the basis of energy savings (in kWh), on the basis of capacity savings (in kW), on the basis of some other measure of program success, or on a combination of these measures. This distinction is important because the DSM program budget represents the best metric for determining the amount of funds available for the performance incentive, as described above, but the level of actual DSM program expenditures is not the best metric for determining the amount of funds to award for a performance incentive. A utility that spends a lot of money on DSM programs without achieving an appropriate level of energy or dollar savings should not be rewarded with a shareholder incentive. This would create a perverse incentive to spend a lot of money and achieve little efficiency savings.

Q. Please explain why the amount of money awarded for the performance incentive should be based on the level of net benefits actually achieved.

A. MEEIA and the rule are clear that the Company is entitled to a performance incentive based on the shared net savings approach. The level of net benefits actually achieved is a good metric to use for awarding performance incentives because it provides a dual incentive to both maintain low program costs and maximize benefits. It also incorporates a valuation of the avoided capacity and energy costs so that the amount of capacity and energy load reductions achieved are taken into account and given the value that they contribute to benefitting consumers by decreasing utility revenue requirements.

Q. Please explain why OPC's proposal includes a threshold level, a planned level and a cap.

A. This structure is similar to the three tiers in the Company's proposed performance incentive. The threshold level represents the point below which no incentives will be awarded. This is based on the notion that the Company is not entitled to any performance incentives if the results of its DSM program activities are significantly lower than the planned results. The planned level represents the performance that the Company has planned for and committed to in its DSM program plan approved by the Commission. This level represents the mostly likely outcome of the performance incentive, assuming that the results are close to those in the plan. The cap is set to ensure that customers are protected in case some unanticipated event(s) results in the performance of the DSM programs being significantly higher than planned. It is important that the Company be able to earn incentives for achieving results above the planned level, i.e., to promote exemplary performance, but it is also important to place a cap on these exemplary rewards to protect ratepayers from the impact of unanticipated future events.

Q. Please explain how you would recommend that these aspects of the performance incentive be applied to the Company.

A. The mechanism that I recommend be applied to UE is summarized in Table 4 below. The middle column indicates the annual net benefit targets (subject to adjustment of gross benefit amounts as described above) that should be used to determine the amount of incentive money that is awarded to the Company, for each of the three levels. I recommend that the threshold level be set at 50 percent of annual net benefits, the

planned level be set at 100 percent of net benefits, and the cap be set at 150 percent of net benefits.

The left column indicates the amount of funds that should be made available for the three different achievement levels. I recommend that the Company be eligible to receive five percent of annual program budgets at the threshold level, ten percent of program budgets at the planned level, and up to a cap of 15 percent of the program budgets if it exceeds the planned level.

Table 4: OPC's Proposed Incentive Mechanism

	Annual Net Benefit Targets (percent of planned)	Annual Incentive Earned (percent of budget)
Threshold	50 percent	5 percent
Planned	100 percent	10 percent
Exemplary Cap	150 percent	15 percent

Q. Please explain how this performance incentive would be applied in the context of the Company's current DSM plan.

A. The results of applying this proposal to the Company's current DSM plan are presented in Table 5. For the three-year plan the planned net benefits are $364 million, which means that the threshold level would be $182 million and the cap would be $546 million.[3] Once the Company reaches the threshold level of net benefits it would earn $6.3 million of incentives, and this amount would increase linearly reaching $13.4 million at the planned level and potentially reaching $20.1 million at the cap. Table 5 also presents the annual outcomes for the three levels of performance.[4] Figure 1 presents the results for the three-year total.

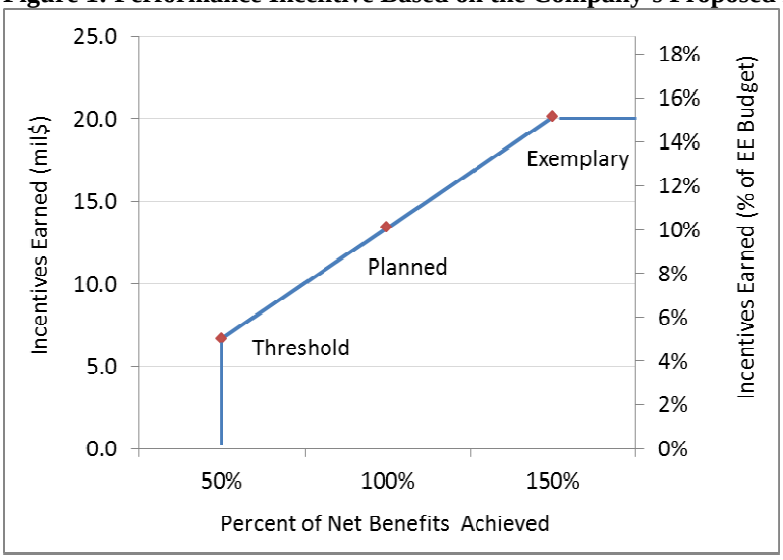
[3] All of the figures presented in Tables 4 and 5 are in 2013 present value dollars.

[4] In order to develop these annual results from the information provided by the Company, I estimated the net benefits for each year by pro-rating the total net benefits by each year's portion of the three year total program costs.

Table 5: Performance Incentive Based on the Company's Proposed DSM Plan (million$)

	2012	2013	2014	Total
Net Benefits				
Threshold (50%)	44.2	57.6	80.3	182.1
Planned (100%)	88.4	115.3	160.7	364.3
Exemplary Cap (150%)	132.5	172.9	241.0	546.4
Incentive Earned				
Threshold (50%)	1.8	2.1	2.8	6.7
Planned (100%)	3.5	4.3	5.6	13.4
Exemplary Cap (150%)	5.3	6.4	8.4	20.1

Figure 1: Performance Incentive Based on the Company's Proposed DSM Plan – Three-Year Totals



Q. How does your proposal for the incentive component of a DSIM compare with the Company's incentive proposal?

A. Table 6 below compares the total amount of shareholder incentive that the Company would be allowed to earn under the UE proposals and the OPC proposal, at different levels of performance.

As indicated, my proposal results in much lower incentive amounts awarded to the Company. The most significant difference between my proposal and the Company's is that I eliminate the shared benefits incentive because it recovers lost revenue and is redundant with the performance incentive. This dramatically reduces the amount of shareholder incentives provided to the Company under my proposal. As noted previously, OPC proposes that the Company use the DSIM lost revenue component

provided in the rule instead of attempting to recover lost revenues through an incentive mechanism.

Secondly my proposed performance incentives are significantly lower than the performance incentive mechanism proposed by the Company because mine is based on a percentage of DSM program budgets. Table 6 does not include additional annual revenues that the Company may receive from the lost revenue component of a DSIM, which OPC proposes in addition to the performance incentive.[5] The UE shared benefits proposal attempted to hold the company harmless from the financial impacts resulting from declines in usage attributable to UE's proposed DSM programs, whereas the OPC proposal addresses the financial impacts of decreased usages solely through the lost revenue component of the DSIM.

[5] I assume that sales growth over the next few years will be sufficient to cover the lost revenues allowed by MEEIA and the DSIM regulations. If this turns out not to be the case, then the Company would be allowed to recover in a separate mechanism those lost revenues associated with the difference between actual sales and the sales used to set rates in the most recent rate case.

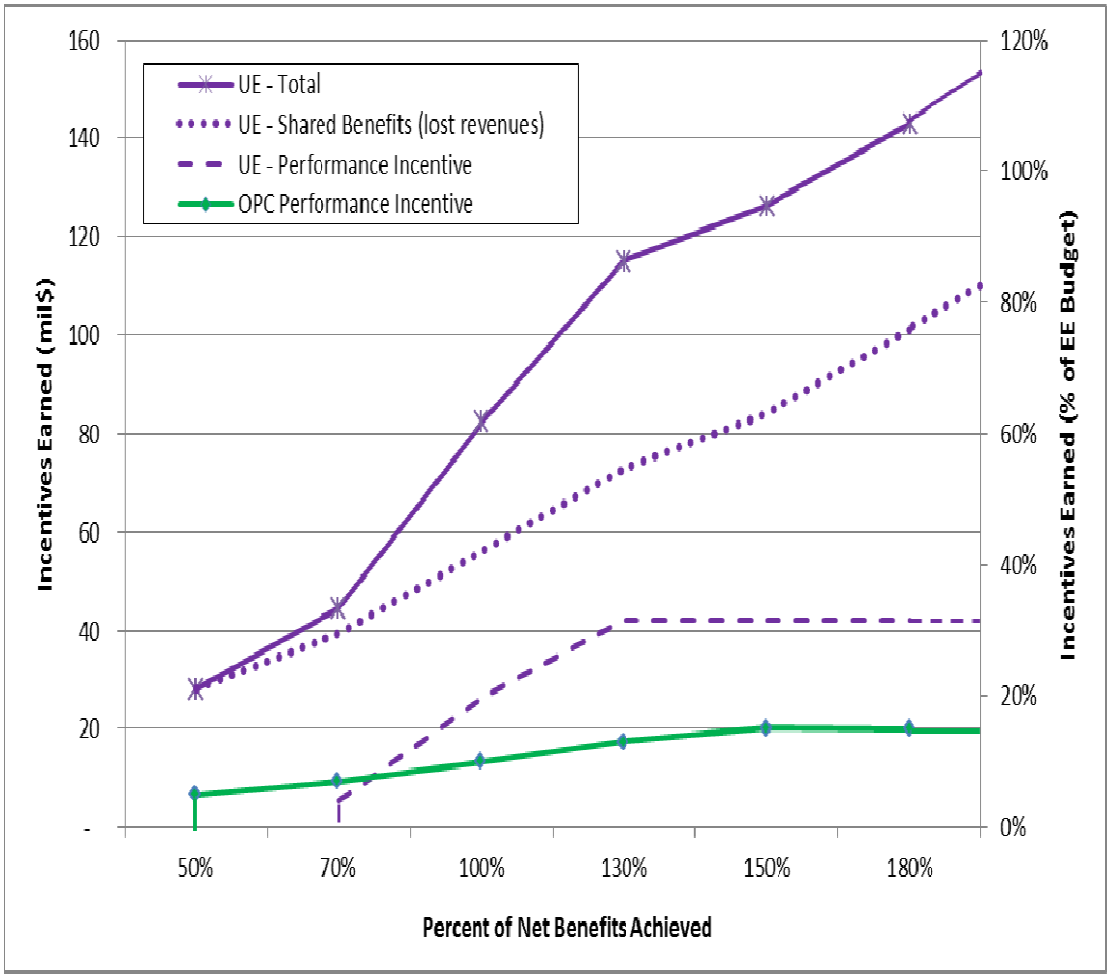
Table 65: Performance Incentives Proposals: UE vs. OPC (million$)

	2012	2013	2014	Total
UE's Shared Benefits Proposal				
Low Net Benefits	9.5	12.4	17.3	39.3
Planned Net Benefits	13.6	17.7	24.7	56.1
High Net Benefits	17.7	23.1	32.2	72.9
UE's Performance Incentive Proposal				
Low Net Benefits	1.9	1.7	1.6	5.3
Planned Net Benefits	9.4	8.7	8.2	26.3
High Net Benefits	15.0	14.0	13.1	42.0
UE's Total Shareholder Incentive Proposal				
Low Net Benefits	11.4	14.2	19.0	44.5
Planned Net Benefits	23.0	26.5	32.9	82.4
High Net Benefits	32.6	37.1	45.2	115.0
OPC's Performance Incentive Proposal				
Low Net Benefits	2.5	3.0	3.9	9.4
Planned Net Benefits	3.5	4.3	5.6	13.4
High Net Benefits	4.6	5.6	7.3	17.5
Difference between UE's and OPC's Incentive Proposals				
Low Net Benefits	(8.9)	(11.2)	(15.0)	(35.1)
Planned Net Benefits	(19.4)	(22.2)	(27.3)	(68.9)
High Net Benefits	(28.1)	(31.5)	(38.0)	(97.5)

Note: In all scenarios above, the low net benefits case is at 70 percent, the planned net benefits case is at 100 percent and the high net benefits case is at 130 percent.

Figure 2 presents a graphic comparison of the OPC proposal with the UE proposal. Note that Figure 2 includes more data points than Table 6 in order to encompass a broader range of potential outcomes; it includes results for when the net benefits equals 50 percent, 70 percent, 100 percent, 130 percent, 150 percent and beyond 150 percent. As indicated by the dashed line, the UE performance incentive is significantly higher than the OPC proposed performance incentive. As indicated by the dotted line, the amount of funds provided to UE through the lost revenue portion of the shared benefits incentive is significantly higher than both the Company's and UE's performance incentive proposals. Note that if the Company were to achieve 150 percent of net benefits, then the total incentive amount earned under UE's proposal ($126 million present value dollars) would be nearly equal to the costs of the DSM programs themselves ($134 million present value dollars).

Figure 2: Performance Incentives Proposals: UE vs. OPC (million$)



Q. Please summarize how you would recommend that the DSM program costs be recovered from customers, and please explain how this differs from UE's proposal.

A. Public Counsel agrees with UE that it is appropriate for the Company to begin receiving funds through the proposed expense tracker once the Commission approves the UE MEEIA application and completes the Company's upcoming rate case.

Q. Please summarize how you would recommend that the performance incentive funds be recovered from customers, and please explain how this differs from UE's proposal.

A. UE is proposing that the lost revenue portion of its shared net benefits mechanism be recovered contemporaneously with the spending of the program costs, through its expense tracker. UE is also proposing to delay the recovery of the performance incentive portion of the shared net benefits mechanism, until after the three year performance goals

are met in 2015. At that time the Company will request that the performance incentive amount be included in its rate base and amortized over three years (Report, 29).

In contrast, I recommend that UE should not receive incentive payments through the expense tracker until the level of net benefits from the UE programs have been calculated and verified through EM&V. This approach complies with the requirement in 4 CSR 240-20.093(2)(H)3 that "any utility incentive component of a DSIM shall be implemented on a retrospective basis and all energy and demand savings used to determine a DSIM utility incentive revenue requirement must be measured and verified through EM&V."

Furthermore, I recommend that the Company not be allowed to place any portion of its performance incentive into rate base. This is could be described as allowing the Company to earn a profit off of its shareholder incentives. If the Commission agrees to compensate the Company for the time value of money associated with any delay in recovering shareholder incentives, then it should do so by applying the low-risk customer interest rate to the delayed incentives, not by placing them in rate base.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.