

**THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

Before Commissioners: Thomas E. Wright, Chairman
Michael C. Moffet
Joseph F. Harkins

In the Matter of a General Investigation)
Regarding Cost Recovery and Incentives For)
Energy Efficiency Programs.) Docket No. 08-GIMX-441-GIV
)
)

Final Order

The above captioned matter comes before the State Corporation Commission of the State of Kansas (Commission) for consideration and decision. Having examined its files and records, and being duly advised in the premises, the Commission makes the following findings:

FINDINGS AND CONCLUSIONS

I. Background

1. In the Commission's Order Initiating Investigation and Assessing Costs opening this docket, the Commission asked for comments from the parties on questions pertaining to the general issues of cost recovery, the throughput incentive, and performance incentives for energy efficiency programs. The parties have provided thoughtful comments, and the Commission has considered the

views expressed.¹ The Commission expresses appreciation to the parties for their insightful perspectives.

2. The Commission held a workshop on these issues on August 26, 2008. The Commission found the workshop very helpful, and wishes to express its gratitude to the presenters and to Mr. Richard Sedano, Director and Principal of the Regulatory Assistance Project (RAP), for moderating the discussion.² The Commission also found helpful Mr. Sedano's selection of "framing papers" for the workshop of the National Action Plan for Energy Efficiency July 2006 Report, Chapter 2, and "Aligning Utility Incentives with Investment in Energy Efficiency" produced by the National Action Plan for Energy Efficiency, June 2007.³

¹ Initial Comments were filed by the Sierra Club, Empire District Electric Company (Empire), Citizens' Utility Ratepayer Board (CURB), Aquila Inc., Midwest Energy, Inc. (Midwest), Kansas City Power & Light (KCPL), Westar Energy and Kansas Gas and Electric Co. (Westar), Kansas Gas Service (KGS), Atmos Energy (Atmos), AARP, and Wal-Mart Stores, Inc. Reply comments were filed by AARP, KCPL, Westar, Empire, Wal-Mart, Aquila, and Atmos. On February 22, 2008, Westar filed notice of service upon the parties of its comprehensive energy plan, *Meeting Our Customers' Energy Needs: A Strategic Plan for Uncertain Times*. Comments on the August 26, 2008 workshop were filed by KCPL and Westar, KGS, CURB (filed as reply comments), Atmos, Black Hills/Kansas Gas Utility Company, LLC, d/b/a Black Hills Energy (Black Hills) (substituted for Aquila per Notice filed July 29, 2008), Empire, Midwest, Wal-Mart. Reply Comments on the workshop were filed by KCPL and Westar, KGS, KCPL, and CURB (See Order Allowing Additional Comment and Granting Motion of KCP&L, filed October 10, 2008).

² The Commission expresses its appreciation to the following presenters: Wayne Shirley, RAP; Chuck Goldman, Lawrence Berkely National Laboratory; Mike Youngblood, Idaho Power; John Perkins, Iowa Consumer Advocate; and Steven Wiel, Nevada Representative to SWEEP and former Nevada PUC Commissioner. Their presentations may be viewed on the Commission's website at http://www.kcc.state.ks.us/energy_efficiency/.

³ These documents may be viewed on the Commission's website at http://www.kcc.state.ks.us/energy_efficiency/

3. The Commission also desires to express its appreciation to the Staff team, led by Don Low and Janet Buchanan, for their service as advisors to the Commission in this investigation.⁴

4. Staff filed its Report on October 10, 2008. The following parties filed comments on Staff's Report: CURB, Westar, KCPL, Midwest, KGS, Atmos, and Black Hills.

5. The Commission participated in the workshop, has reviewed all comments submitted by the parties, and has considered Staff's Report. In Docket No. 08-GIMX-442-GIV (442 Docket), the Commission established basic policy guidelines for energy efficiency programs. The Commission views energy efficiency as a resource to be considered in a balanced approach between traditional and alternative energy sources in meeting Kansas energy needs. Docket No. 08-GIMX-442-GIV, Order Setting Energy Efficiency Policy Goals, June 2, 2008 (442 Order), ¶ 26. As a resource, energy efficiency programs should produce "cost-effective, firm energy savings," and should provide "dependable energy savings supplied throughout the relevant lifetime of the program." 442 Order, ¶¶ 26 & 27. The Commission favors programs or a suite of programs that address energy efficiency "in a comprehensive way," and that address the "total home or building utilizing sound building science principles." 442 Order, ¶ 71. The Commission is particularly interested in energy efficiency programs that

⁴ The Commission expresses its gratitude to Chief Economist Robert Glass who assisted in this matter, along with team members Tom Debaun, Jim Sanderson, Michael Mount, and Jaime Stamatson.

target low-income customers, fixed income customers, renters, and customers who reside in residences most in need of energy efficiency upgrades. 442 Order, ¶ 28. This investigation is informed by the policy directives set forth in the 442 Order.

6. That the Commission views energy efficiency as a resource is important to how the Commission views the policy issues before it here. The Commission's duty is to consider all resource options and to ensure all resources are provided at just and reasonable rates. K.S.A. 66-101b. The Commission has stated it intends to do so in a balanced manner. 442 Order, ¶ 26.

7. The Commission has chosen at this time not to require energy efficiency programs from utilities, but has observed that Kansas utilities have been actively involved in energy efficiency. 442 Order, pgs. 4-7. The Commission has chosen to collaborate with utilities as they pursue energy efficiency as a resource. 442 Order, ¶ 18. See Final Order in *In the Matter of a General Investigation Regarding Energy Efficiency Programs*, filed October 10, 2007, Docket No. 07-GIMX-247-GIV. This stance assumes utilities are willing to continue to pursue energy efficiency initiatives, as they have demonstrated in the past, and view such initiatives as valuable for meeting their duties to their customers. The Commission's basis for pursuing a voluntary approach to energy efficiency is not based on the view that energy efficiency can be obtained only by rewarding shareholders. It is based on the belief that state, national, and international forces are combining to make the need for energy efficiency as a resource alternative a shared vision between the Commission, utilities, and the people of Kansas.

8. A third context for this investigation is the fortunate status Kansas experiences at this time of relatively low energy costs and an absence of capacity restraints. Staff's Report, 25. While Kansas utilities have addressed energy efficiency, particularly through Demand Response (DR) programs⁵, and public awareness of energy efficiency and related issues is significant and growing, these circumstances of currently low energy prices can not help but affect the degree of interest and participation in energy efficiency in general and the desire of utilities and the public to be proactive. Yet, energy costs will inevitably rise in the future. The Commission believes it is important that at least the basis and framework to enable a ramp-up of energy efficiency programs be developed now, before energy costs reach high levels.

9. The Commission is examining these issues at time when economic conditions in general are deteriorating. Demand Side Management (DSM) programs⁶ tend to cost more upfront and then reduce costs with energy savings over time. With the national and Kansas economies headed for a recession, the Commission must consider the appropriateness of raising short term costs at this time.

⁵ Demand Response programs are defined in paragraph 9 of the Commission's Order Initiating Investigation and Assessing Costs, filed 11/6/2007.

⁶ Demand Side Management programs are defined in paragraph 8 of the Commission's Order Opening Investigation and Assessing Costs.

10. The Commission's findings below apply to both DR and DSM programs. The Commission believes DR programs can produce results by shaving demand peaks which reduces the need for peaking capacity and therefore helps keep energy costs down. The Commission favors implementation of DR programs as a means of mitigating the need for expensive new power generation. However, the Commission also recognizes that utilities may have more reason to independently pursue DR programs, such as to meet their duty of providing reliable power, for example, without the need for additional incentives or decoupling. Many utilities have already adopted DR programs. Thus, decoupling and performance incentives may be less appropriate for these types of programs, and the Commission will take these differences into consideration when evaluating program proposals.

11. The Commission also observes it is opening two dockets, as required by the Energy Independence and Security Act of 2007, to address standards added to the Public Utility Regulatory Policy Act (PURPA): 09-GIME-360-GIE and 09-GIMG-361-GIG. As part of those investigations, the Commission will reexamine the issue of whether to require integrated resource planning and rate design, among other matters.

II. Cost Recovery

12. In its report, Staff observed that the Commission's voluntary approach to energy efficiency means the Commission should consider addressing

certain risks for utilities such as the risk of cost disallowance and the risks arising from a lengthy lag between expenditure and cost recovery. Staff Report, 4. The method of cost recovery may help alleviate these risks.

13. The Commission agrees with Staff's suggestion that the Commission permit utilities to submit energy efficiency portfolios and budgets for review prior to implementation as a means of mitigating utilities' concern over the potential for Commission disallowance of program expenditures. Staff Report, 4. The Commission urges utilities to work with Staff in developing energy efficiency initiatives to minimize costs and risks for all parties. Of course, the Commission retains at all times its duty to review program costs for prudence.

14. In general, the parties urged flexibility in the Commission's approach and many noted a rider as a reasonable method of cost recovery. CURB advocated for a systems benefit charge and the use of a non-profit third party administrator, but was not opposed to a rider. KCPL urged that a level playing field for generation and energy efficiency resources requires capitalization of energy efficiency program expenses. Westar also preferred deferral of costs in a regulatory asset until the investment would be amortized in rates, but was not opposed to a rider as an alternative. In general, investor-owned utilities desire a return "of" and "on" their investment in energy efficiency programs. AARP is concerned that cost recovery mechanisms not hinder lower ratepayer bills as a result of energy efficiency and supported traditional rate case cost recovery. Wal-

Mart urges the Commission to carefully weigh which option costs least to consumers.

15. Staff has recommended the Commission adopt an annual tariff rider as a cost recovery method. Staff Report, 26. Staff suggests this rider be established after a company showing that it is incurring significant program costs. Staff Report, 25, 26. Staff has also suggested that programs be admitted for preapproval prior to implementation. Staff Report, 25. Staff recommends that programs costs be reviewed through program evaluations or at the time of a rate case. Staff Report, 26.

16. Staff has recommended that utilities bring applications for cost recovery (and incentives) to the Commission on a case-by-case basis, accompanied by a showing that the utility has incurred significant costs for energy efficiency programs, that these expenditures have had a detrimental impact on the finances of the utility, and that the energy efficiency program or programs resulted in measurable energy savings.

17. As noted, most parties do not object, as a general matter, to Staff's recommendation of a rider as the suggested method of cost recovery.

18. In comments to Staff's Report, Westar generally supported a rider, but believes utilities should receive rate base treatment for appropriate programs. Westar argues a return "on" investments is important to utilities.

19. Atmos Energy also supports a tariff rider, but argues for flexibility in the Commission's approach. Atmos believes a rider should be established at the time of program approval.

20. KGS argues that there should be certainty in cost recovery, perhaps provided for at the time of program approval, and a utility should not be required to wait until it has already incurred significant expenses.

21. CURB asserts the Commission should set forth clear criteria for program approval. In general, CURB also supports a rider if a third party administrator system is not adopted, but argues a clear definition of significant costs when a rider would be approved should be provided.

22. KCPL argues for a case-by-case approach to cost recovery and notes that the Commission should provide specific guidance to utilities. KCPL asserts assurance of cost recovery is necessary when a utility applies for approval of a program. KCPL suggests applications for approval and proposed cost recovery and incentive mechanisms be combined in one application. KCPL also believes DR programs should be eligible for equal treatment as DSM programs. KCPL, in contrast to most other utilities, does not support a rider. KCPL favors cost capitalization, arguing that a return "of" and "on" investments in energy efficiency is appropriate and necessary.

23. Black Hills Energy generally favors a tariff rider, but disagrees that a utility should have to wait until it is incurring significant program costs.

24. Midwest notes Staff does not discuss how pre-implementation costs will be recovered, a concern particularly if a program is ultimately not approved. Like many of the other parties with some exceptions such as KCP&L and AARP, Midwest is generally supportive of a rider as a cost-recovery mechanism, but believes the term "significant costs" needs clarification.

25. AARP asserts cost recovery should occur within the context of a traditional rate case, and disfavors the rider mechanism. AARP suggests using riders results in "piece-meal" regulation. In general, AARP is concerned about the effects of programs and costs on low-income and fixed-income individuals.

26. As a general matter, Wal-Mart is concerned that businesses that have made significant efforts toward energy efficiency not be penalized for those efforts due to rate structures or the necessity to pay for programs.

27. The Sierra Club favors providing for cost recovery, decoupling, and incentives as a means of aligning utility incentives with energy efficiency efforts.

28. The Commission notes the experience of Iowa and Florida with a rider mechanism, as reported by Staff. Staff's Report, 7. Both states utilize true-up adjustments to prevent over or under recovery. Staff's Report, 7.

29. The Commission believes a rider recovery mechanism is the best approach to cost recovery, at least at this time. This mechanism is relatively clear and straight-forward, making it a good choice for an initial approach as the Commission gains experience with energy efficiency programs.

30. A rider reduces risk from the utility's point of view because it will provide utilities with a relative rapid and assured recovery of their program costs. Staff Report, 5. A rider may also reduce potential rate shocks for consumers if costs were deferred to the next rate case. Staff Report, 5. This promotes stability of customer rates.

31. Because a rider offers nearly contemporaneous recovery of program costs for utilities, the need for carrying costs, creation of regulatory assets, and a return on such deferred accounts is reduced. See Staff Report, 26. This also serves to lower costs for customers.

32. The Commission believes a rider should be implemented in a manner that maintains the Commission's responsibility to review costs for prudence. The Commission believes a rider, due to the relative speed of cost recovery, the greater certainty of cost recovery, and the absence of regulatory lag, provides an advantage over traditional rate case recovery of costs for utilities. A rider cost-recovery mechanism provides a balanced approach between the positions of simply treating program costs in a traditional manner in a rate case without full cost capitalization, as favored by AARP, for example, and capitalizing all program costs, as favored by KCP&L.

33. The Commission notes several states have combined the traditional rate case approach with a rider. Staff's Report, 6. As explained by Staff, the rate case is used to examine costs and reset the rider as appropriate. The Commission will consider this type of combined approach. Staff's Report, 6. Staff has

recommended that energy efficiency program costs be reviewed in periodic program evaluations or in the context of a rate case. Staff's Report, 26. The Commission finds Staff's recommendation sound. Of course, as discussed in the 442 Order, evaluation, measurement, and verification should be part of initial program design.

34. The Commission believes utilities should make a formal application for energy efficiency program approval through a tariff filing or another form of application. See Staff's Report, 26. A list of items that should be submitted in such an application is set forth in Appendix A, attached hereto and incorporated herein. Of course, the Commission will review applications in light of Commission policy directives including, but not limited to, Commission policy set forth in 08-GIMX-442-GIV and Commission policy arising from the 09-GIMX-160-GIV docket examining fuel switching and related matters.

35. The Commission would expect utilities to provide a proposal for a rider in connection with an application for an energy efficiency program or in connection with existing programs.

36. For a rider to be implemented, program costs destined for recovery should be significant, as suggested by Staff. Staff's Report, 26. By "significant," the Commission simply means a level of expense necessary to justify putting a rider on customers' bills.⁷ A utility may need to consider the unique

characteristics of its customers and how they would respond to an additional rider.

As noted above, the Commission encourages utilities to discuss potential energy efficiency programs with Staff before making applications to minimize any issues.

37. The Commission prefers that program preimplementation costs be handled via traditional rate-making, but will consider applications for recovery of approved program pre-implementation costs in an approved rider. Such costs will be reviewed for reasonableness and prudence before being approved for recovery.

38. Like program costs, preimplementation costs will be reviewed for consistency with Commission policy directives including, but not limited to, Commission policy set forth in 08-GIMX-442-GIV and Commission policy arising from the 09-GIMX-160-GIV docket examining fuel switching and related matters. If presented with prudent preimplementation costs incurred in good faith consistent with Commission policy directives, the Commission anticipates approval of such costs for recovery in the rider.

39. Once approved program costs have been incurred, the rider will take effect.

40. One rider will be utilized to recover all significant program costs. However, each energy efficiency program must maintain separate records for evaluation, measurement, and verification purposes, whether an independent

⁷ The Commission may consider using as a useful measure of this amount the guideline of 1/2 % of base revenue that has been established by the legislature as a minimum expense level for approval of a GSRS in K.S.A. 66-2203. The Commission recognizes this level would be high, and current programs may not involve this level of cost. The Commission views this legislation as simply a useful indication of what the legislature believed was sufficient to justify imposing a rate adjustment in that context.

program or a part of a program suite. If a utility desires a suite of programs to be reviewed together for approval, the suite should be submitted so it may be reviewed as a whole. Obviously, greater Staff time will be required to review a suite of programs submitted together.

41. Programs that have been previously approved by the Commission will be reviewed for prudence and cost-effectiveness, as Staff suggests. Staff's Report, 26.

42. The Commission is opposed to unnecessarily capitalizing program costs in a manner more extensive than normal rate case regulatory principles would provide.⁸ The Commission believes cost capitalization may result in unnecessarily high energy efficiency program costs. As noted by Staff in its report, this view is informed by the experience of numerous other states that have used rate-basing with broad capitalization of program expenses in connection with energy efficiency programs and subsequently rejected this approach. Staff Report, 28.

43. At this time, the Commission has chosen not to pursue a third party approach to energy efficiency program implementation, but is relying on utilities to develop those programs they believe best meet the unique requirements of their customers and their future energy needs. A System benefits charge has most often

⁸ Of course, prudent investments in such capital expenditures as smart-metering technology, in the context of an approved energy efficiency program or suite of programs, which are in the nature of capital expenditures that are traditionally rate based will be favorably considered for such treatment.

been used in the context of a third party administrator approach. Staff's Report, 26. As a result, the Commission believes a case-by-case tariff rider approach based on a specific utility's energy efficiency program is more appropriate than a broad system benefit type charge.

44. The Commission notes Wal-Mart's concern that entities that have already invested significantly in energy efficiency measures should not be assessed the costs of utility energy efficiency programs, or should be allowed to use the funds otherwise for their own energy efficiency measures. The Commission recognizes this concern, but believes that if a program is properly designed and implemented and passes the TRC test, Wal-Mart and other similar entities will receive a benefit from the program. Of course, if a program passes the RIM test, rates for program non-participants, such as Wal-Mart, will not increase at all.

III. The Throughput Incentive

45. The Commission recognizes that addressing the throughput incentive may be necessary to avoid utilities experiencing loss of margin as a result of implementing energy efficiency programs. This potential conflict between energy efficiency and the incentive to increase revenues or maintain revenues from energy sales has been the subject of much discussion. See e.g. National Action Plan for Energy Efficiency (2007), *Aligning Utility Incentives with Investment in Energy Efficiency*, Prepared by Val R. Jensen, ICF International,

(www.epa.gov/eeactionplan), Chapter 5 (hereafter *Aligning Utility Incentives*). As noted by Staff in its Report, Mr. Chuck Goldman's presentation at the energy efficiency workshop indicated implementation of energy efficiency programs may cause utility revenues to decline and weaken the return on equity. Staff Report, 9. Decoupling, and other methods of addressing the throughput incentive, removes the link between sales and margin recovery which should reduce the reluctance of a utility to promote energy efficiency that might otherwise arise from a fear of reduced sales. Staff Report, 11.

46. All utilities that are parties to this investigation support addressing the throughput incentive issue in some manner. Staff's report, 13. Midwest, for example, believes it has already demonstrated significant changes in revenue due to implementation of its EE programs in that it showed declining gas usage per customer, some of which was attributable to EE programs, in the 06-MDWG-1027-RTS docket.

47. Staff has recommended that a throughput incentive should not be established without evidence a utility will experience loss of margin. Staff would consider decoupling as a method if a utility can show that a program will have significant detrimental impact on company finances. Staff has also suggested that the Commission may consider reduction in risk for purposes of setting rates of return for utilities in connection with decoupling. Staff has suggested a straight fixed-variable rate design would not encourage energy efficiency, and

recommended that the lost margin recovery mechanism not be adopted because it may be too administratively burdensome.

48. The Sierra Club advocates for decoupling. As noted by Staff, the Sierra Club suggests a decoupling mechanism should remove the linkage between utility profits and sales, permit utility revenues to be adjusted for factors that might increase or decrease costs, embody transparency in how adjustments are calculated, and avoid deferrals, surcharges, or rebates. Staff Report, 14, citing Sierra Club Comments, pgs 1-2.

49. Westar observes that as a method of addressing the throughput incentive, decoupling may be administratively burdensome and a straight fixed-variable rate design would be simpler. As configured for modest losses of revenue, argues Westar, the volumetric charge component would be sufficient to encourage consumption reduction.

50. Atmos Energy notes fixed cost recovery in some form is essential to properly align energy efficiency promotion resulting in reduced sales with a utility's incentive to provide profit for shareholders and with a rate structure that provides for profits by sales increases.

51. KGS also argues fixed cost recovery in some form is essential. KGS asserts a case-by-case approach requiring a showing of detrimental financial impact creates uncertainty and only furthers the disincentives against implementing programs. KGS also points out that a straight fixed-variable rate design would be appropriate for gas utilities because commodity prices are a

substantial majority of a customer's gas bill and because gas customers receive gas at a price corresponding to its marginal value, among other factors. KGS cites to recent Ohio and Missouri commission decisions discussing straight fixed-variable rate designs for gas utilities.

52. CURB does not favor decoupling, but argues that if some form of decoupling is adopted, a utility should demonstrate the need after programs have been ongoing and a reduction in the return of investment due to the reduction of risk should be implemented. Lost margin recovery, assets CURB, is too difficult and costly.

53. KCP&L suggests utilities should be able to submit a throughput incentive proposal on a case-by-case basis, but should not have to risk a lower return on equity.

54. In general, Black Hills Energy favors decoupling as a method.

55. Midwest, like other utilities (gas utilities in particular), believes addressing the throughput incentive issue is necessary. Midwest argues it would not represent a significant departure from the Commission's ratemaking policy, noting that the Commission has approved cost recovery mechanisms that adjust rates due to changing average costs, such as electric or gas fuel cost adjustments, property tax adjustments, and weather normalization and that adjustments to utility rates for changes in volume would not be different.

56. As expressed by Atmos, KGS, and Midwest, natural gas utilities in particular have concerns about this issue. The Commission recognizes differences

with regard to this issue for natural gas and electric utilities. The Commission is aware that natural gas utilities face a unique situation in that natural gas usage per customer in general has declined over recent years. With regard to electric utilities, the situation is different. Electricity usage per customer has demonstrated a trend of growth, as customers demand more power for various consumer applications, for example. Even the influence of highly successful energy efficiency programs or the impact of a major economic downturn may only be expected to slow the expected growth of electricity usage per customer over time.

57. Because a significant portion of a gas utility's fixed costs are recovered via volumetric charges, the decline in per customer usage has limited gas utilities' ability to recover the revenue necessary to maintain their distribution systems and meet other fixed costs. Because gas utilities have rising costs due to an ageing infrastructure, the lack of revenue presents a serious problem.

58. For this reason, with regard to gas utilities, the issue of decoupling involves broader considerations than the impact of energy efficiency measures. The issue is maintaining revenue stability. Separating fixed cost recovery from the volumetric portion of rates for natural gas utilities is a potential remedy for this problem. This is a different matter than the context in which the throughput incentive is discussed here—where the issue is removing a disincentive to pursuing energy efficiency programs—and involves a different set of considerations. It constitutes a separate policy issue.

59. In response to this situation, many states that have implemented decoupling have done so for natural gas utilities. Staff's Report, 10-11. The Commission recognizes its responsibility to regulate natural gas utilities in a manner that provides them with the ability to maintain their economic vitality.

60. For purposes of this docket, the Commission has decided to focus on the throughput incentive in the context of energy efficiency. However, the Commission wishes to acknowledge that it will consider decoupling proposals from natural gas companies with concerns about revenue stability. Gas companies with such concerns are invited to make an application to the Commission, and the Commission will address each application on a case-by-case basis.

61. The Commission is also mindful that our country may be on the verge of a recession. This potential economic downturn may have a negative effect on energy usage independent of any energy efficiency program. With a decoupling mechanism, declines in energy usage per customer will result in increases in customer rates. The Commission notes decoupling initiatives in at least one state has failed as a result of unacceptable cost increases. Staff Report, 14-15. This is a time when a Kansas experiment with a throughput incentive approach must be carefully considered.

62. Although, like the other methods of addressing the throughput incentive, decoupling has issues that must be addressed, of the various types of throughput mechanisms the Commission believes full decoupling is the best method. Essentially, decoupling comprises an annual analysis to determine if a

utility has failed to reach, met, or has exceeded its revenue requirement as established in a normal rate case. Decoupling has the advantage of being a type of mechanism with which the Commission and Commission Staff are familiar. For example, the Commission has previously approved limited decoupling-type adjustments to a utility's revenue requirement such as weather normalization adjustments. Decoupling appears to be the method most often selected by other jurisdictions as a means of addressing the throughput incentive issue. See Staff Report, 10. The Commission will consider decoupling proposals, made in connection with energy efficiency programs, on a case-by-case basis.

63. Staff observes there are two types of decoupling mechanisms in use by other jurisdictions: one based on revenue per customers, and the other on total allowable revenue. Staff Report, 11. The Commission prefers the calculation based on total allowable revenue because this method does not contain a tie between fixed costs and changes in the number of customers. However, the Commission will consider proposals on a case-by-case basis.

64. The Commission believes decoupling lowers risk for a utility, because utility revenues are stabilized and protected from sales fluctuations. The utility's likelihood of receiving its rate-case established revenue requirement is significantly increased. The Commission will accordingly factor this lowered risk in setting rates of return in rate cases. This will result in a direct benefit to customers. Black Hills has argued that the Commission need not undertake a distinct risk analysis but, since many states have already adopted decoupling,

reduction in risk resulting from decoupling would be addressed by the routine use of the DCF model in setting rates during rate cases. Comments of Black Hills Energy, filed October 17, 2008, pg. 3. The Commission believes this approach merits consideration, but will require further study and may prove difficult. Because there is variation in decoupling that has been implemented for gas companies it may be difficult to make comparisons involving reasonably similar decoupling programs.

65. One of the dangers of decoupling is that rates for utility customers can be more volatile between rate cases since it is the utility that has the “price guarantee” and not the customer. Staff Report, 12. Annual caps are a remedy for this potential problem. Staff Report, 12. The Commission will require any decoupling proposal to include such a safety mechanism.

66. Another potential danger is that if carrying charges are applied to balancing accounts, these accounts can rapidly grow. Staff Report, 12. The Commission will require decoupling proposals to address this issue, as well. As has been noted, the Commission expects utilities to work with Staff to minimize issues, streamline the approval process, and minimize unnecessary costs and delay. Dealing with potential pitfalls is particularly important in light of the uncertain economic times ahead.

67. Although straight fixed-variable rates are attractive for their relative simplicity and lesser administrative burden, the Commission is concerned about their effect on customer inclination to save energy. Staff's Report, 18. The

Commission is also concerned with the potential impact such rate structures may have on lower-income and fixed-income customers. Staff's Report, 18.

68. The Commission does not favor Lost Margin Recovery because of the high premium this method places on accurate evaluation of program impacts and the increased potential for expensive and time-consuming litigation arising from disputes. Staff Report, 16. Furthermore, while Commission staff expertise is growing in this highly technical field, at this time the Commission does not have the depth of experience available to consider this method without reliance on outside firms.

69. Another problem with the Lost Margin Recovery method is dealing with the issue of measuring the effect of "free ridership" when evaluating the impacts of an energy efficiency program. Free riders are a term for customers who take advantage of an energy efficiency program but would have undertaken their energy efficiency efforts whether the utility offered that program or not. The laudable, self-directed efforts of these customers result in overestimation of the decline in energy caused by the energy efficiency program unless accounted for accurately. The full decoupling method avoids this and other difficult issues involved in accurately assessing a decline in usage actually attributable to an energy efficiency program because the reason for a decline in usage is irrelevant. The utility will recover its lost sales no matter whether the reason is weather, the economy, or energy efficiency programs.

70. Within the context of decoupling as means of removing the throughput disincentive for energy efficiency programs at issue in this docket, the Commission is highly unlikely to address a decoupling proposal without a demonstrated connection to an energy efficiency program application or to existing programs. While decoupling addresses the throughput incentive issue, Staff's Report noted it provides the utility with an incentive to cut costs without any regard for energy efficiency. Staff Report, 13. The utility must demonstrate that decoupling makes economic sense in the context of the utility's energy efficiency program or suite of programs.

71. The Commission also believes decoupling should be implemented in the context of measurable and verifiable program performance in meeting Commission-established goals. On a basic level, if the program is not performing, it is unlikely utility margins are being negatively affected by energy efficiency.

72. As Staff has suggested, the utility should provide a comparison of the potential financial impacts of the energy efficiency programs it has received approval for or intends to seek approval for and the expected financial outcome without energy efficiency programs in place. Staff Report, 27. Additionally, the application should address the rate volatility, as discussed above, and the carrying charge treatment of any balancing accounts.

73. Natural gas utilities may, as an alternative to decoupling, propose straight fixed-variable rate structures. The Commission will entertain such

proposals from natural gas utilities because of the inherent differences in rate structure between natural gas and electric utilities.

74. Midwest, for example, has asserted that straight fixed-variable rate designs are appropriate in the context of natural gas service because delivery costs account for about 15 percent of the total bill but provide 100 percent of utility margins. Allowing straight fixed-variable rates for gas delivery service makes sense, suggests Midwest, because volumetric savings customers might achieve through energy efficiency will not be significantly affected. On the other hand, Midwest asserted continuation of current rate designs will increase long term costs because customers will be burdened with unjustifiable large energy efficiency investments that do not result in reductions in gas delivery costs.

75. The Commission acknowledges that natural gas volumetric rates contain a smaller percentage of fixed costs and a higher percentage of fuel costs. Therefore, concerns about the effect on energy efficiency from separating fixed costs from volumetric charges are not as pronounced as with electric rates.

76. As discussed above, however, a remaining issue with straight fixed-variable rates is their potential negative impact on low-income or fixed income customers. Therefore, natural gas utilities must include an estimate of the impact their proposed rate structure will have on these customers, and if negative, how to address any disproportionate impact to those customers. These issues also raise the concern of increases in bad debt which will result in increased rates in general. The Commission strongly prefers an energy efficiency plan be submitted in

connection with such a proposal which targets low-income and fixed-income customers and would provide appropriate relief. The Commission will not approve a rate design proposal that, as a whole, harms low-income and fixed-income customers or disproportionately negatively affects such customers.

77. As with decoupling, the Commission anticipates considering some reduction in rate of return as a result of the decreased risk.

78. Utilities that anticipate submitting a decoupling proposal in connection with an energy efficiency program application, or in connection with existing programs, and also anticipate submitting a proposal for a performance incentive pursuant to the discussion below, should submit the proposals together so the Commission may evaluate the proposal as a whole.

IV. Performance Incentives

79. Performance Incentives have been urged by utilities and commentators as a regulatory measure necessary to nudge utilities towards the demand side resource of energy efficiency to meet their customers' energy needs instead of the traditional supply-side resource of more power plants. See *Aligning Utility Incentives*, 6-1; Staff Report, 21.

80. Westar, for example, asserts that incentives are simply regulation that makes energy efficiency and demand response a sustainable business model for a utility. Westar argues that the lack of capacity constraints and relatively low utility rates in Kansas provide an opportunity to take proactive steps that permit a

utility to realize a profitable business from energy efficiency and demand response while delivering benefits and cost savings to utility customers. Westar believes incentives are appropriate for DR programs as well as for DSM programs.

81. Atmos Energy also suggests that performance targets or shared savings incentives are appropriate and will focus utility efforts in the same manner as other utility endeavors that benefit shareholders. Shared savings incentives, observes Atmos, benefit both customers and shareholders and do not impose additional costs on customers.

82. CURB, however, argues against incentives. If incentives are awarded, CURB asserts, incentives should be tied to demonstrated program performance. CURB contends that, with regard to shared savings incentives, the majority of savings from energy efficiency are reductions in fuel expenses which do not impact the utility's bottom line and therefore shared savings might create an incentive for the utility to increase energy efficiency program expenditures.

83. KCPL agrees with other utilities that incentives, as well as fixed cost recovery, are necessary for utilities to assess energy efficiency programs on the same basis as supply-side investment. KCPL states its DR programs were put in place to reduce need for future generation capacity with the expectation of reasonable rate treatment. Without cost recovery for DR programs, argues KCPL, there is no incentive to pursue them. KCPL favors cost capitalization as a performance incentive mechanism.

84. Black Hills Energy suggests that performance incentives create a win-win situation for both utility shareholders and customers. A properly designed incentive, argues Black Hills Energy, creates additional benefits for customers, not additional costs.

85. AARP argues performance incentives should only be used judiciously and should be tied to verifiable energy savings created by the program.

86. As a cooperative whose members are also the shareholders, Midwest notes additional incentives are not of benefit. Midwest seeks rapid and complete cost recovery for its programs with a minimum regulatory burden.

87. Staff has recommended the Commission consider performance targets or shared savings plans proposed by utilities, but that utilities should show an additional incentive is necessary and desirable to achieve energy efficiency goals. Staff Report, 28. Staff does not recommend full cost capitalization as an incentive mechanism. Staff Report, 28. Since a rider allows fairly immediate recovery of costs, Staff has recommended that there is no need to provide for carrying costs in the form of a return “on” costs. Staff suggests rate base treatment of costs should have the same financial impact on a company as an annual rider. Staff Report, 28.

88. In its order in 07-GIMX-247-GIV, the Commission observed that it did not need to address the issue of whether or not to require utilities to adopt energy efficiency plans because Kansas utilities had demonstrated a desire to work toward energy efficiency. Final Order, filed October 10, 2007, ¶ 14. Kansas

utilities have recognized the value of energy efficiency as, for example, a means of shaving peak loads and therefore reducing the need for additional power capacity.

89. The Commission has stated it views energy efficiency as an energy resource. The Commission has an obligation to steer utilities toward resources, whether demand side or supply side, in a manner that results in just and reasonable prices. And because the Commission is in the energy regulation business, the Commission views energy efficiency as a means to an end – energy at a low cost to consumers within the context of a balanced energy resource portfolio -- not an end in itself that must be rewarded. Although the Commission has not chosen to specifically incorporate externalities, except carbon regulation estimates, directly in its cost analysis, the Commission has recognized that there are significant costs to supply-side generation that may not yet be reflected in energy rates and these costs benefit the side of alternative energy and energy efficiency resource options in a net benefit analysis. See Final Order, Docket No. 08-WSEE-309-PRE, ¶ 51. Our society is increasingly coming to recognize the significance of these costs not reflected in the price of electricity. All this makes energy efficiency an important part of a balanced approach to energy resources.

90. As noted above, the Commission is aware that economic conditions may be on a downward trend. This means the Commission must be judicious in approving energy efficiency programs, and must view adding costs to such programs via incentives with care.

91. As Staff noted in its Report, Mr. Goldman's presentation at the energy efficiency conference provided support for a view that providing incentives will lead to increased utility earnings. Staff's Report, 20. The Commission's responsibility, however, is not to optimize utility profits, but seek an appropriate balance between utility customer and shareholder interests in the context of moving toward the Commission's objective of meeting public power needs through balanced resource means while mitigating rate increases. The Commission has not approved traditional supply-side energy resources in the past solely because they would result in rate-basing and a benefit to shareholders. These resources were approved because they have been deemed a necessary and cost-effective means to meet energy needs.

92. In the balancing the Commission must undertake between the interests of customers and shareholders, the Commission believes the legislature has provided a cue in recently passed legislation. K.S.A. 66-1239, passed by the legislature in 2003, provides that utilities may seek a predetermination of rate-making principles and treatment that will apply to recovery in rates of the cost to be incurred by the public utility to construct or participate in an electric generating plant or an improvement to an existing plant. K.S.A. 66-1239(c). However, the legislature specified that a utility seeking such a pre-determination must file a description of its conservation measures, a description of its demand side management efforts, its ten-year generation and load forecasts, and a description of all power supply alternatives considered to meet its load requirements. K.S.A.

66-1239(c)(2). In addition, the legislature specified that, in considering the utility's supply plan, the Commission may consider if the utility issued a request for a proposal from a "wide audience of participants willing and able to meet the needs identified," and "if the plan selected by the public utility is reasonable, reliable, and efficient." K.S.A. 66-1239(c)(3).

93. In enacting this recent legislation, the legislature has directed the Commission to specifically consider a utility's energy efficiency efforts in analyzing the utility's proposals. The Commission is directed to consider whether the plan proposed is "efficient." The Commission believes this constitutes a signal from the legislature that the Commission should weigh energy efficiency in at least equal terms to other potential energy resources, and, in fact, that there is an expectation that a utility has explored energy efficiency as an alternative that may be more cost-effective. This legislation is not, in the Commission's view, an indication from the legislature that utilities must be rewarded for pursuing energy efficiency.

94. For these reasons, the Commission is reluctant to provide additional incentives, resulting in increased costs to customers, for energy efficiency programs. If energy efficiency inherently does not result in the same amount of ratebasing, or capitalized costs, that is simply reflective of the nature of the resource. Energy efficiency is only part of a balanced course the Commission seeks to chart. The Commission is confident that energy efficiency is unlikely to replace generation as the primary means of providing new power. On the

contrary, energy efficiency, along with other alternative sources of energy, must provide a bridge over waters troubled by such matters as carbon regulation uncertainties and rising coal plant costs (both costs reflected in rates and “external” costs to society not reflected in rates), until technology provides a better long term solution to energy needs.

95. The Commission also recognizes that utilities must attract shareholders and capital investment, and that it has a duty to ensure utilities are able to attract the investment they may require. Utilities such as Westar argue they require a sustainable business model to remain financially strong, and that incentives are important to maintaining that model and to encouraging utility investment in energy efficiency.

96. The Commission believes the best manner in which to balance these considerations is to allow for incentives, but limit them to specific energy efficiency programs the Commission has determined are the most beneficial for Kansas energy customers and the long-term energy efficiency goals of the Commission.

97. Specifically, the Commission will consider performance benefits for an application involving energy efficiency program proposals that meet either or both of the following goals:

1. Proposals for programs that target low and fixed-income customers, and renters. The Commission believes these groups are vulnerable, particularly in the

face of an economic downturn, and may be unable to undertake energy efficiency measures on their own for various reasons.

2. Proposals that target new and existing residential housing and demonstrate a potential for long-term energy savings utilizing a comprehensive whole house concept, pursuant to Commission policy as expressed in the 442 Order.

98. An example of the type of program that would meet these requirements at present is Midwest's How\$martsm program.

99. Among the three types of performance incentives generally considered, performance target incentives, shared savings incentives, and rate of return (cost capitalization) incentives,⁹ the Commission favors the shared benefit approach to performance incentives. This incentive mechanism provides for the sharing of some percentage of the net benefits of an energy efficiency program with the utility. Staff's Report, 20, 28. This method of incentive naturally encourages utilities to achieve the best possible results, and is in keeping with the collaborative approach the Commission favors at this time. Net benefits generally

⁹ Staff Report, 20.

include avoided energy and capacity costs and transmission and distribution savings. Staff's Report, 20.

100. The Commission believes this approach will recognize the relationship between the amount of money invested in a program, the successful administration of a program, and a return on the investment in the program. In fact it may be viewed as a return on a utility's investment that benefits both the utility and the customer.

101. In favoring shared benefits as a means of promoting energy efficiency as a matter of policy, the Commission is aware that as a practical matter the time may not yet be right for this method. As the description of the shared benefit approach makes clear, this approach can only provide a viable incentive if the net benefit of an energy efficiency program is significant. If the Total Resource Cost Test is just slightly above one, then the shared benefit approach may not provide a significant incentive to the utilities because the net benefit may be small.

102. Frankly, because Kansas energy prices remain relatively low, it may be difficult for energy efficiency programs to achieve a large benefit. However, as a policy matter, the Commission favors this approach, and as energy costs rise, benefits from energy efficiency will increase and benefit sharing will become more advantageous.

103. The Commission appreciates the focus on performance provided by performance target incentives. Under this type of incentive plan, a utility may

recover some of the net benefits associated with an energy efficiency program if the program achieves set target levels of savings. Staff Report, 20. However, as noted in Staff's Report, this form of incentive mechanism demands careful program evaluation. Staff Report, 20. Not only can this be expensive, it demands a high level of expertise. Shared savings incentive plans also, of course, focus attention on the measure of savings and on evaluation, measurement and verification procedures in general. Staff Report, 28.

104. As discussed above, as a matter of policy the Commission prefers shared savings over performance target incentives. The Commission believes shared savings may better align utility and customer interests. While the Commission is not inclined to approve a performance target incentive plan at this time, the Commission may reconsider this method of incentive as Commission Staff continue to develop expertise in the area of program evaluation, measurement, and verification.

105. The Commission believes the shared savings approach or the performance target mechanism provide a better means of providing a performance incentive than full cost capitalization, because of the high cost to consumers of that option even if the net benefits of the energy efficiency program are small. Staff Report, 21, 28.

106. The Commission does not believe full cost capitalization is a good option for Kansas energy customers. With cost capitalization a utility capitalizes or ratebases energy efficiency costs, including items which would normally not be

capitalized for a supply-side resource asset, and then earns a return on the unamortized portion of those costs. Staff states in its Report that capitalization is now used infrequently as a performance incentive in other states and that rapidly rising costs for customers have been a significant reason for the rejection of this incentive mechanism. Staff's Report, 21. Because it is a method that has failed the test of experience in other jurisdictions, and because of its high potential for greater costs to consumers, the Commission will not consider cost capitalization as a performance incentive mechanism.

107. The Commission believes the essentially contemporaneous cost recovery provided by the rider cost-recovery mechanism alleviates carrying cost issues and mitigates any need to capitalize such costs. See Staff Report, 28.

108. In keeping with the principles discussed above, the Commission does not favor providing an additional rate of return to such energy efficiency assets that are rate-based in accordance with traditional rate case principles. However, the Commission will not rule out doing so as provided by K.S.A. 66-117(e) on a case-by-case basis.

109. The Commission agrees with AARP's suggestion that incentives should be used "judiciously" and should be tied to attainment of energy savings performance goals. Staff's Report, 22. The Commission favors linking the level of shared savings performance incentive to the performance achievement level of the utility in meeting the Commission's energy efficiency goals for the approved program.

110. In evaluating utility programs for a shared-benefit incentive, the Commission will consider whether the incentive plan is likely to increase the utility's investment in the energy efficiency program; whether the incentive plan is compatible with the interests of utility ratepayers and other interested parties; and, whether the incentive plan ties the incentive to the utility's performance in achieving Commission-set goals. Staff's Report, 23.

111. As noted above, utilities that wish to make both a decoupling proposal and a shared-benefit incentive plan in connection with approved energy efficiency programs or an application for an energy efficiency programs should submit the proposals together, along with complete information about the energy efficiency programs, such that the Commission may fully evaluate the proposals as a whole.

IT IS, THEREFORE, BY THE COMMISSION ORDERED THAT:

A. The Commission's policy shall be to consider proposals from utilities for riders to recover costs for energy efficiency programs, as discussed above.

B. The Commission's policy shall be to consider proposals from utilities for the decoupling method of addressing the throughput incentive issue, made in connection with energy efficiency programs, as discussed above.

C. The Commission's policy shall be to consider decoupling or straight fixed-variable rate proposals from natural gas utilities for purposes of addressing

the separate policy issue of dealing with potential revenue stability issues for such utilities. As discussed, this issue involves different considerations than decoupling as a means of addressing the throughput incentive in the context of energy efficiency programs and is outside the scope of this docket. Here, the Commission simply desires to signal its recognition of the issue and openness to consider decoupling as a remedy. Such proposals will be considered on a case by case basis.

D. The Commission's policy shall be to consider proposals for shared savings performance incentive plans where tied to specific energy efficiency programs the Commission believes most desirable, as discussed above.

E. Applications for energy efficiency programs shall follow the content guidelines set forth in Appendix A, incorporated herein.

F. A party may file a petition for reconsideration of this order within 15 days of the service of this order. If this order is mailed, service is complete upon mailing and 3 days may be added to the above time frame.

G. The Commission retains jurisdiction over the subject matter and parties for the purpose of entering such further orders as it may deem necessary.

BY THE COMMISSION IT IS SO ORDERED.

Wright, Chmn; Moffet, Com.; Harkins, Com.

Dated: NOV 14 2008

ORDERED MAILED

NOV 17 2008

 EXECUTIVE
DIRECTOR

Susan K. Duffy
Executive Director

crr

APPENDIX A

Content of Energy Efficiency Program Application

1. Program Description
2. Program Goal
 - A. Expected energy and demand savings – time horizon
3. Program Framework/Strategy
 - A. Relationship to other programs
 - B. Marketing Strategy
 - C. Program Delivery (In House/Third Party)
 - D. Partners
4. Program Budget (5-Year)
 - A. Start-up Cost
 - B. Administrative Cost
 - C. Incentives (if any)
 - D. Marketing

E. Evaluation

5. Program Beneficiaries

- A. Expected number of participants by customer class or subclass
- B. Other beneficiaries

6. Program Benefit-Cost Analysis

- A. All five benefit-cost tests and supporting documentation

7. Program Evaluation, Measurement and Verification Plan

8. Program Specific Tariff Schedule

(For programs involving monetary transactions or the provision of articles of value (e.g. free thermostats or CFLs).)