(Decision No. C93-38)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

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THE JOINT APPLICATION OF PUBLIC SERVICE COMPANY OF COLORADO; THE OFFICE OF CONSUMER COUNSEL; THE OFFICE OF ENERGY CONSERVATION; AND THE LAND AND WATER FUND OF THE ROCKIES FOR COMMISSION CONSIDERATION OF DECOUPLING REVENUES FROM SALES AND THE ESTABLISHMENT OF REGULATORY INCENTIVES TO ENCOURAGE THE IMPLEMENTATION OF DSM PROGRAMS.	DOCKET NO. 91A-480EG

COMMISSION DECISION AND ORDER
(1) ADOPTING PORTIONS OF A SETTLEMENT AGREEMENT TO BE THE BASIS FOR COST RECOVERY FOR DSM PROGRAMS THAT STEM FROM THE DSM COLLABORATIVE PROCESS (DOCKET NO. 91A-481EG), AND (2) GIVING DIRECTIONS CONCERNING FURTHER TREATMENT OF CERTAIN ISSUES

Mailed Date: January 14, 1993
Adopted Date: January 13, 1993

BY THE COMMISSION:

Background

By application dated July 15, 1991, Public Service Company of Colorado ("PSCo" or "company"), the Colorado Office of Consumer Counsel ("OCC"), the Land and Water Fund of the Rockies ("LAW Fund"), and the Colorado Office of Energy Conservation ("OEC") filed a Joint Application which asked the Colorado Public Utilities Commission ("commission") to consider the decoupling of PSCo's revenues from its electricity sales, the most efficient and fair method by which regulatory incentives to acquire all cost-effective demand side management ("DSM") resources could be implemented, including, incentives for DSM in PSCo's Electric Cost

Adjustment Clause ("ECA"), and other regulatory incentives for PSCo.

On July 17, 1991, we adopted Decision No. C91-918 in which, among other things, we approved "Revised Settlement II" in Docket Nos. 91S-091EG and 90F-226E. As we recognized in that decision, the purpose of Revised Settlement II was to build a "framework for responsible and sustainable energy planning for years to come." Towards this end, Revised Settlement II contemplated joint applications to the commission to open several interrelated dockets, including this one.

Parties filed initial testimony in this matter in November 1991. PSCo, LAW Fund, OEC, and the City and County of Denver ("Denver") favored decoupling mechanisms and DSM incentives. No parties sponsored any other mechanism to compensate PSCo for DSM-induced lost revenues. Staff, OCC, Multiple Intervenors ("MI"), Climax Molybdenum Company ("Climax"), and CF&I Steel Corporation ("CF&I") opposed a decoupling mechanism, and favored varying degrees of DSM incentives.

Electric Cost Adjustment, Future Test Year, and Attrition Adjustment

A Settlement Agreement on PSCo's ECA was filed by PSCo, Staff, and the OCC on May 12, 1992. The ECA was discussed at the May 20, 1992 prehearing conference in this case. We decided that the ECA would be addressed in the Decoupling/DSM Incentives hearing. The Settlement Agreement was not approved at the May 20, 1992 prehearing conference as the settling parties had requested, nor was a decision rendered at that time regarding questions related to use of a future test year and attrition adjustments.

A Revised Settlement Agreement was submitted on May 29, 1992 by PSCo, Staff, and the OCC concerning PSCo's ECA.

Public Witness Hearing Held

A public witness hearing was held in this case on May 28, 1992. Fifty people presented testimony on DSM incentives, decoupling, low income energy efficiency assistance programs, and Integrated Resource Planning ("IRP").

Interim Order Issued

We issued an interim order on May 29, 1992 that adopted a hearing schedule for this docket that had been proposed by the parties.

Evidentiary Hearing Held

The Commission held an evidentiary hearing on June 2, 3, 4, 5, 8, 9, and 10, 1992. Extensive evidence was presented by the parties. The parties' positions at the hearings are generally characterized as follows:

- PSCo favored a decoupling mechanism with what it termed a "B" factor, to compensate the company for load growth. PSCo's proposed "B" factor is a fixed multiplier--to apply to non-ECA revenues--that would serve as a proxy for likely increases in customer use of electricity that would have occurred under traditional regulation. This "B" factor could be based on either historical data or forecasted information. Additionally, the company favored a Customer Activity Bonus System to serve as an incentive for its participation in DSM activities.

° <u>LAW Fund and OEC</u> favored a revenue per customer decoupling mechanism, and agreed with PSCo that a type of "B" factor is appropriate. As an incentive, LAW Fund and OEC proposed setting DSM megawatt ("mw") goals and the creation of a bounty system of rewards for achieving the DSM mw goals, and penalties for failure to achieve the DSM mw goals.

° <u>Staff</u> opposed the establishment of a decoupling mechanism and also opposed an explicit lost revenue adjustment. Staff proposed that the commission delay new regulatory incentives for DSM until after the filing of electric integrated resource plans ("IRP"),[1] in order to determine the size of the DSM resource in the service territory served by Colorado jurisdictional utilities. Staff proposed a recovery mechanism that represents a slight modification of the existing Demand Side Management

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[1] Electric IRP Rules were adopted on December 30, 1992. At the time of Staff's filing, a docket regarding IRP had been opened, but rules had not yet been adopted.

Cost Adjustment ("DSMCA") that was created in 1990, in Docket No. 90A-147E.

- OCC opposed the establishment of a decoupling mechanism. Like Staff, the OCC proposed a modification of the existing DSMCA as an alternative.

- MI opposed a decoupling mechanism, but proposed an increased financial incentive in the DSMCA. Further, MI contended that increased commission attention to DSM and the issuance of policy statements would satisfactorily resolve questions related to regulatory treatment of DSM.

- Climax opposed a decoupling mechanism, contending that if the commission were to approve decoupling, shareholder risk would decrease, and the Commission, therefore, should lower PSCo's authorized rate of return in the next rate case.

Summary of Supplemental Pleadings

Following the hearing, statements of position and draft orders were filed on July 29, 1992. The parties' positions at that date are generally characterized as follows:

- A Joint Supplemental Brief filed by the OCC, Staff, CF&I, and Climax rejected revenue per customer decoupling and proposed that the commission adopt a modified DSMCA illustrated in their Attachments A and B. The Joint Supplemental Brief did not recommend an alternative means to recover DSM-induced lost revenue. These parties jointly stated that their modified DSMCA created a greater incentive for PSCo to engage in DSM activities than presently exists. The Joint Statement of Position did not attempt to quantify the extent of PSCo's exposure to DSM-induced lost revenues.

- LAW Fund and OEC continued to request commission approval of a decoupling mechanism and a DSM incentive for PSCo. The Energy Conservation Association and Denver also continued to support a decoupling mechanism. The Energy Conservation Association and Denver did not state a preference for any specific DSM incentive beyond that incentive that may be accomplished simply by decoupling profits from sales.

- PSCo's statement of position proposed a new, two-part recovery mechanism for commission consideration, *i.e.*, a lost revenue adjustment and an incentive, as illustrated in its Attachment A. PSCo attached a two-page spread sheet detailing its proposed recovery mechanism and incentive.

Five parties--PSCo, OEC, LAW Fund, the Energy Conservation Association, and Denver--proposed some form of lost revenue adjustment, accomplished through either decoupling profits from sales or through a lost revenue adjustment to recover revenues lost as a result of DSM. None of the other parties--Staff, OCC, MI, Climax, or CF&I--proposed mechanisms for the recovery of PSCo's DSM-induced lost revenues.

Special Working Sessions

We conducted two special working sessions to deliberate in this docket. These were held on July 31, 1992 and August 12, 1992. On July 31, 1992 the two participating commissioners (Christine Alvarez and Gary Nakarado) were unable to reach an agreement on a decision. Instead, we structured a response to PSCo's new position and the positions of the other parties at the August 12, 1992 special working session.

Interim Order

As a result of the August 12, 1992 special working session, we issued an interim order on August 17, 1992. In that order we stated our understanding of the evidence that we cannot expect to overcome regulatory barriers to PSCo's adoption of meaningful amounts of DSM resources unless the company is compensated for DSM-induced lost revenue. However, at that time, only two lost revenue mechanisms were offered by parties--a lost revenue adjustment offered by PSCo, and a revenue-per-customer decoupling mechanism offered by the LAW Fund, OEC, the Energy Conservation Association, and Denver.

The supplemental briefs filed on July 29, 1992 by several parties contained new information which was entered into the record. We found that additional evidence on the financial issues in this docket was advisable and, therefore, we reopened the hearing and narrowed the scope of issues to be discussed at rehearing. To accomplish this, we established several general principles in our Decision No. C92-1057, dated August 21, 1992.

1. We stated that an adequate record exists with respect to a revenue per customer decoupling mechanism. We reserved judgment on whether to adopt that particular decoupling mechanism and, therefore, requested not to hear additional evidence on revenue per customer decoupling at the upcoming hearing.

2. We stated an interest in specific non-decoupling proposals from all parties on a recovery structure that either: (a) combines DSM-induced lost revenues and an incentive to engage in DSM activities; (b) compensates for DSM-induced lost revenues only; or (c) provides for a DSM (such as a modified DSMCA) incentive only.

3. We stated an interest in receiving from parties quantitative evaluation of different recovery options, using certain supplied assumptions. Specifically, we asked to receive numeric and analytic responses to certain defined scenarios.

In addition, parties were asked to analyze and discuss certain approaches to dealing with disincentives imposed by traditional regulation.

We asked parties to economize on hearing time by asking them to accept the supplied assumptions, for illustrative purposes only. We stated that the assumptions could be changed or corrected only if the submitted materials state in a detailed fashion how and why they are changed.

In the ordering paragraphs of our Decision No. C92-1057, we made the following decisions:

1. The Revised Settlement Agreement submitted by PSCo, Staff, and the OCC concerning PSCo's ECA, filed on May 29, 1992 was accepted and approved. This approval was subject to possible revision if the commission adopts a modification or elimination of the ECA as a result of an alternative approach.

2. We re-opened the record in this case for the limited purpose of reviewing recovery mechanisms other than revenue-per-customer decoupling. We asked to hear proposals for recovery based on any combination of demand side management-induced lost revenue adjustments and, or, incentives to engage in demand side management, and, or, an alternative approach described. In addition, we stated an interest in receiving evidence or proposals responding to supplied scenarios.

3. We set hearings for September 10 and 11, 1992. A subsequent order [Decision No. C92-1106-I] granted parties' motions for

extensions of time, and reset the hearing to September 24, 25, and 29, 1992.

Supplemental Testimony Filed

On September 8, 1992 the parties filed testimony. Their positions can be characterized as follows:

- PSCo stated that it favors adoption of a lost revenue adjustment ("LRA") mechanism plus an incentive.

- Staff opted to adopt OCC-developed financial data, stated that it favors a modified DSMCA, and rejected LRAs. Staff reiterated its opposition to changing traditional regulatory practices until such time that IRP reveals, in greater detail, the opportunity for DSM in PSCo's resource portfolio.

- OCC restated its preference for a modified DSMCA and rejected the notion that the company would experience lost revenues attributable to DSM, characterizing the alleged lost revenues as "phantom."

- MI stated its support to the jointly proposed, modified DSMCA.

- LAW Fund and OEC described LRAs as too contentious, and demonstrated how by using LRAs PSCo will lose revenue whenever PSCo's customers deploy demand side measures, whether they be utility-sponsored DSM programs or otherwise. LAW Fund and OEC stated their belief that even with a modified DSMCA that provides PSCo with more revenue than the existing DSMCA, PSCo still will elect the more profitable course of encouraging electricity sales over engaging in DSM efforts. This choice of incentives (sales or efficiency) is referred to as dueling incentives.

Rebuttal testimony was filed on September 14, 1992.

The Settlement Agreement

The re-opened hearing was held as scheduled commencing on September 24, 1992. At the beginning of the hearing, a Settlement Agreement was filed by PSCo, Staff, OCC, MI, CF&I, and Climax, and was entered into evidence as Exhibit 85 (See the Appendix to this decision). The Settlement Agreement proposes a recovery and incentive mechanism for DSM programs to apply to the DSM programs that are planned to be filed before the commission as a result of the Demand Side Management Collaborative Process (Docket No. 91A-481EG). The Settlement Agreement does not apply to the DSM bidding programs covered under the existing DSMCA, nor to any programs resulting from the Low Income Energy Efficiency Assistance Docket (No. 91A-783EG). The settling parties submitted that their recovery and incentive mechanism provides adequate financial incentives for PSCo to aggressively pursue DSM programs and to motivate PSCo to acquire cost effective, reliable DSM resources. In addition, the parties stated that the Settlement Agreement was designed to be used as the framework for establishing the appropriate incentive mechanism to be utilized with respect to any future DSM programs, including any DSM program for CF&I which may be proposed by the DSM Collaborative Process or the company. The Settlement Agreement states that the parties also may consider whether an adjustment factor related to the project life of the particular DSM program under review is appropriate for inclusion and, if so, the specific factor to be included. The settling parties stated that the Settlement Agreement is intended to resolve finally the issues of decoupling and DSM incentives with respect to PSCo.

The filing of the Settlement Agreement and its presentation resulted in a significant departure from the purpose of the hearing, as articulated in our August 12, 1992 interim order. The focus of the testimony offered by the settling parties did not address the merits and problems of LRAs but rather focused on the merits and problems of the Settlement Agreement. The LAW Fund and OEC were not parties to the negotiation that resulted in the Settlement Agreement and were unaware of the terms and conditions of the agreement until it was presented at the hearing. LAW Fund and OEC disputed whether the terms and conditions of the Settlement Agreement are fair, just, and reasonable, and asked us to summarily dismiss the Settlement Agreement. We did not.

The Second Round of Hearings

MI continued to state their belief that the utility will act to implement adequate DSM measures if the commissioners simply continue to focus their policy attention on an expectation that utilities engage in DSM.

Staff and OCC stated that the Settlement Agreement represented a compromise of their initial positions in favor of the company, since the financial package contained therein was of greater financial benefit to the company. Staff and OCC stated that the Settlement Agreement represented an effort to ensure the creation of a mutually agreeable recovery mechanism for the DSM Collaborative Process applications.

PSCo stated that it entered into the Settlement Agreement in order to ensure the movement of the Collaborative Process applications and to resolve disagreements among many parties in the docket.

LAW Fund and OEC witness Sam Swanson, of the staff of the New York Public Service Commission, discouraged the adoption of LRAs as being too contentious and extremely difficult to implement. LAW Fund witness Eric Hirst critiqued the Settlement Agreement as an attempt to divert the commission from its primary responsibility to craft a long-term DSM recovery approach. Hirst also voiced concern that the proposed, modified DSMCA in the Settlement

Agreement may encourage PSCo to design programs that do not provide incentives for customer energy efficiency and bill reduction.

The company stated that although the Settlement Agreement does not explicitly compensate it for lost revenues, the Settlement Agreement meets its financial goals implicitly.

Statements of Position and Proposed Orders Filed

Final Statements of Position were filed on October 16, 1992.

- Staff filed a motion on October 9, 1992 to take administrative notice of recent developments at the Washington Utilities and Transportation Commission.

- Climax filed a pleading on October 16, 1992, with an implicit motion to take administrative notice of matters related to Consolidated Edison (New York). LAW Fund and OEC filed a response, moving to strike Climax's pleading from the record.

- PSCo filed a Motion for Administrative Notice on October 30, 1992 concerning certain matters at the Maine Public Utilities Commission. LAW Fund and OEC filed a response on November 3, 1992.

Discussion

As a result of these hearings, we recognize that a better regulatory structure can be achieved if PSCo's profits are in some manner linked to the company's success in delivering energy services efficiently, including incorporating DSM into the resources used. A regulatory framework which primarily couples PSCo's profits to simply selling more electricity, regardless of the economic, health, or safety consequences, is not in the best interest of Colorado and its citizens.

The record in this case establishes that:

1. Under traditional regulation, PSCo's profits are partially dependent upon its kilowatt-hour ("kwh") sales. As a result, PSCo's profits go down whenever utility DSM programs are successfully implemented.

2. Under traditional regulation, PSCo often has a financial incentive to simply and continuously increase electricity sales whether or not those sales gains are a result of cost-effective use of electricity.

3. PSCo's electric customers and the citizens of Colorado want reliable energy services, *e.g.*, lighting, temperature control, electronic capabilities, and motor drive devices--provided at the least total cost and in a manner that is sustainable over a

long period of time. But they also are willing to pay more for energy if conservation and efficiency are the result.

4. Traditional regulation provides financial incentives to PSCo which may be inconsistent with the provision of least-cost energy services, and are inconsistent with the company's implementation of cost-effective DSM.

Overcoming Regulatory Barriers to DSM

We recognize the importance of having a commission decision on these fundamental and pivotal policy questions.

The Problem. As stated above, under traditional regulation, PSCo's revenues and profits increase whenever it sells an additional kwh. For similar reasons, PSCo's revenues and profits decline whenever a kwh is conserved, even if the savings is accomplished at no cost.

The financial incentives under which PSCo operates will logically act to hinder the ongoing IRP process. For example, the record of this case shows that utilities in other states have developed load-building marketing programs even though new resource needs were imminent, and have underestimated the long-run DSM potential. One solution to this problem would be increased oversight with greater reliance on command and control regulation. Given the limited resources available to monitor utility behavior in Colorado, as well as our preference to adopt a solution that positively reinforces the desired utility behavior without the imposition of constant regulatory oversight, this commission prefers to address the problem through regulatory reform. However, such regulatory reform requires that the Commission be satisfied that it can adopt a mechanism that does not contain elements or incentives that run contrary to regulatory goals.

Potential Solutions. There are several potential approaches available to help remedy the problem of the disincentive to invest in DSM among which are LRAs and Annual Revenue Reconciliation Mechanisms ("ARRM"), or some other form of mechanism which eliminates the dependence of the utility's profits on sales.

1. LRAs provide a potential solution to the lost-revenue problem. LRAs are narrowly crafted mechanisms that attempt to identify the revenues a utility loses when it engages in energy efficiency programs. By restoring these "lost revenues," the adjustments seek to remove the existing disincentives to DSM. In fact, PSCo's position suggests that LRAs may be an acceptable way to encourage the development of cost-effective utility-sponsored DSM programs. Conceptually, the benefit of LRAs is that they attempt to deal specifically with those revenues that are lost directly as a result of the utility's investments in DSM. During the pendency of this docket, only PSCo suggested support for LRAs. PSCo made clear that it needs compensation for DSM-induced lost revenue. For example, PSCo witness

James F. Gilliam states on page 9 of his supplemental testimony, filed on September 8, 1992: "Compensation of this type is necessary for the company to be kept whole while it sponsors DSM programs which reduce its sales volumes. Reductions in sales volumes lead directly to reductions in revenue recovery. Presuming the revenue level before DSM was proper and adequate for the company to recover its cost of providing utility service, then the revenue level after DSM would clearly be inadequate. DSM programs sponsored and promoted by the company should not negatively impact the earnings of the company."

However, we also heard testimony that there are a number of problems associated with LRAs. LRAs do not help promote important activities such as improved rate design or informational programs that encourage customer investment in energy efficiency. They present opportunities for "gaming" of the system. Public utility commissions have had to scrutinize carefully utility DSM program designs when LRAs are involved, usually through some resource-intensive review process, which may become very litigious and drawn out.

2. Some sort of ARRM might provide another potential solution to the lost-revenue problem. Decoupling is a generic term that has been used throughout this docket, which is a term that we believe may cause confusion and disagreement where none actually exists. Decoupling is a term bestowed upon different mechanisms

that render utility revenues and profits independent of sales levels. Thus, higher sales due to marketing efforts or lower sales due to DSM theoretically have no net impact on profits. Given the problems with the Settlement Agreement and LRAs, an ARRM may be appropriate if one can be designed to achieve the outcome of making DSM a desirable investment, without entirely, or forever, removing all business risks for PSCo. In other words, an ARRM method should be devised that breaks the link between sales and profits, but that is not subject to many criticisms leveled at revenue-per-customer decoupling in this docket.

Choosing an Appropriate Mechanism. As a matter of general policy, the Commission is seeking a mechanism that is fair to PSCo and its customers. To accomplish this goal, its implementation should not result in any "windfall" gains or losses when compared with the status quo. In our view, this means that the revenues under an acceptable mechanism should reasonably match the expected revenues that PSCo would otherwise have recovered under existing energy services circumstances, and existing regulation. Under the current system, PSCo's revenues vary not only with the number of customers, but also with the intensity with which customer's use electricity. As a result, it may be appropriate that the amount of revenues PSCo obtains under a reformed system take account of customer intensity of use. Accounting for customer intensity of use should be in place at least until such time as utilities can realign their corporate perspective and efforts from mere purveyors of electricity to energy services coordinators.

<u>The Adequacy of Existing DSM Programs</u>. A principal argument made by many of the parties who oppose decoupling is that PSCo's current efforts at DSM are more than adequate relative to current resource needs and, therefore, decoupling is not needed. To support this position, these parties point to PSCo's pilot programs, the two DSM bidding programs, the low-income DSM program application, and the DSM Collaborative Process.

The record indicates that there remains a much larger untapped DSM resource in PSCo's service territory. PSCo's witnesses testified that an aggressive utility-sponsored DSM program had the potential to reduce utility revenue requirements by over $500 million. They also indicated that these estimates may be conservative. The record also clearly indicates that PSCo will need significant additional resources in the future. In fact, evidence propounded by PSCo showed that PSCo may begin spending money on over 700 mw of additional new capacity in the next three or four years. While the IRP process will shed more light on this issue, we can conclude that, at some point in the not-too-distant-future, PSCo will need new resources to meet the growth in demand for energy.

Decoupling as proposed in this docket, is neutral by itself concerning the encouragement of DSM. PSCo's DSM efforts are in transition. PSCo's initial DSM programs were developed primarily as a learning experience to explore whether DSM could offer significant benefits to its customers. As the results of this initial phase have become more widely known, as well as experience garnered from other jurisdictions, it is clear that DSM can be a very cost-effective resource in Colorado. To enable DSM to compete as a meaningful resource alternative, there needs to be a change so that it is an attractive investment. PSCo must gain hands-on experience with DSM technologies, alter its relationships with its customers, and further develop DSM capability within the company. PSCo's DSM efforts must focus on both capacity and energy savings if expensive new resources are truly expected to be deferred. Decoupling, as proposed in this docket, does not really address these problems.

Furthermore, PSCo ultimately should develop comprehensive DSM programs which avoid cream skimming and should avoid the loss of one-time opportunities, such as new construction. These problems arise when only the most cost-effective DSM opportunities are taken advantage of, making it uneconomic to come back later to a site to pursue remaining opportunities.

Based on the above, we believe that changes in PSCo's financial incentives are necessary to ensure a successful transition (*i.e.*, a transition away from efforts that focus on showing the cost and availability of the DSM resource, and toward efforts designed to systematically acquire that resource). Decoupling, as proposed in this docket, does not accomplish this transition.

The Effect of DSM on Customer Rates and Bills. A concern developed in this record is that, by removing the disincentives to DSM investment, PSCo may pursue DSM in a fashion that leads to unacceptable rate increases. We believe that the rate impacts potentially associated with DSM expenditures have been overstated. A reading of the information provided by PSCo (in Exhibit 63) would indicate that the total rate impact in the year 2011 of PSCo's Aggressive DSM Scenario is slightly over two percent.[2] In addition, PSCo shows that rates will be lower than they otherwise would have been in some years under some DSM scenarios. The record evidence indicates that there are methods, such as the energy service charge, which could greatly ameliorate any rate impact concerns. A review of the energy service charge will take place in the next PSCo general rate case. Finally, participants in a utility's DSM program will have lower bills over the long run as a result of utility-sponsored energy efficiency programs. If PSCo structures its DSM programs to be widely available to all customer classes, as we have clearly required, many customers can benefit from utility-sponsored DSM, even if rates increase modestly.

[2] In some years, such as 2007, the rate impact will be almost zero (.7 percent) when compared to the rates that would have been in the supply-only scenario.

Of course, we are concerned about the rate impact issue. The evidence supports a conclusion that the level and pace of DSM investment and the methods of DSM cost recovery should have a rate impact cap established to protect non-participants. Unfortunately, a rate impact cap was not established in the record of this case. The lack of such a cap is a contributing reason for our reluctance to order any of the proposals <u>at this time</u>. Parties are hereby put on notice that we expect a rate impact cap to be an issue in Phase 1 of the next PSCo general rate case. The parties should provide evidence upon which the commission can determine the appropriate level for such a cap.

<u>Other Concerns</u>. A criticism of decoupling is that it will discourage economic development. We disagree. Economic growth does not necessarily require or imply increased kwh sales. Rather, the best way for this commission and PSCo to foster economic growth is to meet the need for energy services at the lowest possible cost, which includes increasing the efficiency of generation, transmission, distribution, and end-use.

It was suggested that we refer the question of the proper structure of DSM incentives to the Collaborative Process. We decline the invitation. It is the role of the commission to decide important policy questions.

Finally, as proposed in this docket, decoupling may unnecessarily shift or unreasonably shift PSCo's business risks to its ratepayers. Revenue-per-customer decoupling provides revenue guarantees that can adversely affect ratepayers irrespective of PSCo's DSM investment. It authorizes rate surcharges to recover revenues that are lost not only from utility-financed DSM investments, but also revenue lost through customer-financed DSM, third-party-financed DSM, downturns in the economy, unusual weather, utility outages, bypass, population changes, and other risks that traditionally have been borne by the utility. Shareholders are in a much better position to hedge against these risks than are the captive ratepayers of PSCo. Further, it appears that the risks may not be symmetrical--excess profits may go unnoticed, while rate increases will be sought to offset mild weather or an economic slump. Also, of concern to us is the question of quality of service. From the evidence presented, it appears that limiting utility revenues through revenue-per-customer decoupling could potentially lead to deteriorating service quality. Since revenues are fixed but costs are not, the utility may be encouraged to cut back on maintenance. Ultimately, this may reduce the quality of service provided. Again, as with other identified disincentives connected with implementation of decoupling, regulatory fixes are necessary to correct the problems that some decoupling mechanisms appear to create. Any mechanism we adopt should not have these problems.

A concern also has been raised with respect to the "B" factor. PSCo, the OEC, and the LAW Fund support the "B" factor and point out that there is a "B" factor in the traditional system of regulation. But it was argued by others that the use of a "B" factor inadvertently could recouple PSCo's profits and sales. We are sensitive to this viewpoint and expect it to be addressed in Phase 1 of the next PSCo general rate case for any mechanism proposed.

Concerns with Fixed and Variable costs. Another concern about the decoupling proposal was the need to distinguish between fixed and variable costs. We agree with the notion that cost recovery is improved if variable costs track sales, capacity costs track capacity, and so on. Indeed this is one of the guiding principles of rate design. The mechanism to be proposed should take this regulatory principle into account.

The foregoing discussion leads us to conclude that the adoption of a mechanism to address the disincentive to invest in cost-effective DSM should be an issue in the upcoming PSCo general rate case. We therefore order that the Staff's filing in the PSCo general rate case shall include all necessary data to provide us with substantial evidence on the record to form the basis of a reasoned decision to adopt a mechanism that will do that without having the problems of the mechanisms advanced in this docket.

DSM Program Cost Recovery and Incentives. DSM program cost recovery was also an element of the various filings. The record evidence clearly indicates that cost-recovery mechanisms much like the DSMCA are associated with almost all of PSCo's supply-side options. DSM must have an opportunity to compete on an equal basis with these alternative resources. In the area of DSM incentives, we are guided by our policy of providing regulatory signals which cause the utility to act in a manner consistent with the interests of its customers. This approach is in accord with the National Association of Regulatory Utility Commissioners' resolution that a utility's least-cost plan should be its most profitable plan.

Implementing these broad policy statements, while bearing in mind the other principles articulated at the outset of this order, means that simple, performance-based incentives for the successful implementation of DSM programs should be adopted. We recognize that a DSM incentive plan cannot be a substitute for good planning and program design. However, a properly designed incentive plan can be a substantial aid.

DSM incentive plans should have the following characteristics:

1. They should be simple, understandable, and easy to administer.

2. They should be performance-based so that the utility is rewarded for saving capacity and energy, and not for spending money.

3. Over time, once the utility gains experience with DSM, the incentives should be symmetrical, with higher payments for exceptional behavior and penalties for performance below minimum standards.

4. The incentives should be large enough to capture the attention of management and the financial community, but small enough that the entire DSM package remains cost-effective.

5. They should be designed to reasonably control costs.

The Settlement Agreement proposed by the majority of parties in this case satisfies the interest of establishing a recovery mechanism that will permit PSCo to proceed with DSM programs that stem from the Collaborative Process. We will adopt the terms and conditions of the Settlement Agreement that establish a short-term recovery mechanism to be applied to the applications expected to be filed with us by the company on behalf of the DSM Collaborative Process. However, we are not embracing here, as requested by the parties to the Settlement Agreement, that document's terms as the framework for other PSCo DSM programs. The Settlement Agreement may contain flaws, that can better be addressed by a different recovery mechanism. Since we are not prepared <u>at this time</u> to specify a long-term DSM cost recovery mechanism, but do not want to delay the Collaborative Process programs until we are prepared to finally resolve this issue, we will accept the proposed recovery mechanism for the limited purpose described above.

To develop an incentive plan for implementation requires the benefit of more detail, particularly in regard to setting savings and costs targets. We believe Staff's proposal awarding PSCo some percentage of the savings arising from DSM has some merit and requires further elucidation. For example, Staff's proposal pegs the total incentive package to an avoided cost calculation that can be derived based on evidence in the next PSCo general rate case. For purposes of providing guidance to the parties, we state now that we are inclined to favor a mechanism that gives PSCo a total incentive, to be paid in any one year. Both for simplicity of administration, and to avoid any incentive to engage in cream skimming, we believe the payments could be made to PSCo on the basis of kw and kwh savings. To determine the total avoided cost savings arising from utility DSM, actual kw and kwh targets could be implicitly calculated. From these targets, rough dollars/kw and cents/kwh bounty payments could be established.

We tend to favor an approach that half of PSCo's payment would depend on capacity savings, while the other half would reflect reductions in energy usage. This type of bounty structure would tend to encourage PSCo to acquire as much cost-effective DSM as possible, while reducing the incentive to "cream skim."

We also tend to favor an approach that enables PSCo to receive a reasonable percent of its incentive up front. This still provides a significant incentive for PSCo to pursue aggressive monitoring and evaluation.

Discussion from the Special Working Session

On November 4, 1992, we held a special working session to deliberate in this case. We stated that the primary purpose of this case is to determine what level of incentives are appropriate to ensure that PSCo will engage aggressively and genuinely in DSM activities. The present regulatory framework must be reformed so that this will happen. We will regulate in such a way as to make clear that DSM matters, but not as if it is the only thing that matters. This is necessary to be certain that demand is not met automatically by supply side resources, which could be a burden to PSCo's consumers, and so that appropriate consideration is given to DSM.

We put all parties on notice that we are inclined to adopt a mechanism at the conclusion of Phase 1 of the next PSCo general rate case that will correct the problems we have discussed in this decision. We direct our Staff and PSCo to develop a mechanism based on a sufficient record that will become the basis for us to make a reasoned decision in this matter. Parties should recognize that in the event that parties do not establish a mutually agreeable resolution to the problem that ensures PSCo's DSM regulatory barriers have been removed, we will resolve the problem at the conclusion of Phase 1 of the PSCo general rate case.

We believe the settlement agreement as filed would place PSCo's DSM programs in a straight-jacket which might limit PSCo's DSM programs over the next three years to the stipulated applications that arise out of the current Collaborative Process. Simply stated, this is inadequate in our view. We would hope that PSCo would pursue other DSM opportunities in that period of time. The settlement agreement also places the commission in a command and control role that we do not desire. This is of particular concern where recent history suggests that commission involvement in even small DSM programs is likely to result in significant delay and discouragement among the parties. We prefer that the resolution to DSM cost recovery and incentives provide wide latitude to PSCo to ensure that DSM is not dragged down by the regulatory process.

We have confidence that PSCo can exert much creativity in the area of DSM. We are committed to the creation of a regulatory structure and environment that encourages, and thus achieves, that result.

With respect to the Settlement Agreement, we accept it concerning the applicability of the agreement to the Collaborative Process. We specifically reject the Settlement Agreement as a framework for the long-term resolution of DSM recovery for PSCo. We have further work to do to make sure that DSM remains an option that PSCo will want to pursue. We are eager to resolve the regulatory flaws that stand in the way of PSCo's pursuit of DSM. However, we recognize that our strong interest in resolving this should be moderated by an insistence that we be satisfied that our adopted resolution does not initiate unforeseen or unwanted negative side effects that were ignored or inadequately addressed.

We are particularly interested in crafting a long-term framework that minimizes the level and opportunities for contention between PSCo and parties in the regulatory process. Our experience leads us to insist upon the formulation of a framework that minimizes controversy.

THEREFORE THE COMMISSION ORDERS THAT:

1. The Commission accepts the demand side management proposals and the cost recovery mechanism contained in the Settlement Agreement filed on September 24, 1992 for the applications to be filed as a result of the collaborative docket, but not as a framework or long-term model for solving the lost revenue problem, which is specifically rejected.

2. The Commission directs its Staff to prepare proposals for reform of traditional regulation to be filed in Phase 1 of the 1993 Public Service Company of Colorado Rate Case. Reform should accomplish the objective of permanently aligning shareholder and public interest in favor of energy conservation and efficiency as discussed on pages 24, 28, and elsewhere. All other parties may file proposals as well, for consideration by the Commission in Phase 1 of the 1993 Public Service Company of Colorado Rate Case.

3. The foregoing discussion leads us to conclude that the adoption of a mechanism to address the disincentive to invest in cost-effective demand side management should be an issue in Phase 1 of the 1993 Public Service Company of Colorado General Rate Case. We therefore order that the Staff's filing in that Rate Case shall include all necessary data to provide us with substantial evidence on the record to form the basis of a reasoned decision to adopt a mechanism that will do that without having the problems of the mechanisms advanced in this docket.

4. The Commission will take administrative notice of the September 1992 Washington Utilities and Transportation Commission order concerning Puget Sound Power & Light and the Maine Commission Order concerning Central Maine Power, but will not take notice or consider the incomplete New York Public Service Commission decisions concerning Consolidated Edison, and will strike all

references to the Consolidated Edison proceedings from the parties' pleadings.

4. The 20-day time period provided for by § 40-6-114(1), C.R.S., to file an application for rehearing, reargument, or reconsideration begins on the first day after the mailing or serving of this Decision and Order.

This Order is effective on its Mailed Date.

ADOPTED IN OPEN MEETING January 13, 1993.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

ROBERT E. TEMMER

CHRISTINE E. M. ALVAREZ

Commissioners

COMMISSIONER GARY L. NAKARADO
NOT PARTICIPATING.

(S E A L)

ATTEST: A TRUE COPY

Bruce N. Smith
Executive Secretary

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

IN THE MATTER OF THE JOINT APPLICATION OF PUBLIC SERVICE COMPANY OF COLORADO; THE OFFICE OF CONSUMER COUNSEL; THE OFFICE OF ENERGY CONSERVATION; AND THE LAND AND WATER FUND OF THE ROCKIES FOR COMMISSION CONSIDERATION OF DECOUPLING REVENUES FROM SALES AND THE ESTABLISHMENT OF REGULATORY INCENTIVES TO ENCOURAGE THE IMPLEMENTATION OF DSM PROGRAMS.	DOCKET NO. 91A-480EG

SETTLEMENT AGREEMENT ADDRESSING (NON-DECOUPLING) INCENTIVE MECHANISM

Public Service Company of Colorado ("Public Service" or "Company"), the Staff of the Public Utilities Commission ("Staff"), the Office of Consumer Counsel ("OCC"), Multiple Intervenors, Climax Molybdenum Company ("Climax") and CF&I Steel Corporation ("CF&I") enter into the following Settlement Agreement Addressing (Non-Decoupling) Incentive Mechanism.

I. BACKGROUND

1. On August 12, 1992, the Commission adopted Decision No. C92-1057 which set forth various filing requirements and scheduled additional hearings for the limited purpose of reviewing recovery mechanisms other than revenue per customer decoupling. The various filing requirements and the hearing dates were subsequently amended in Decision No. C92-1106-I.

2. Direct testimony has been filed by: J.F. Gilliam and J.L. Finleon on behalf of Public Service; Terry L. Murray on behalf of

Witness 83
Date 9-24-93
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Multiple Intervenors; Robert J. Hix on behalf of the OCC; Gary E. Schmitz on behalf of the Commission Staff; and Eric Hirst and Sam Swanson on behalf of Land and Water Fund ("LAW Fund"). Witnesses Gilliam, Finleon, Murray and Hirst also submitted rebuttal testimony. Public Service, Staff, the OCC, Multiple Intervenors, Climax and CF&I have addressed recovery and incentive mechanisms other than revenue per customer decoupling. LAW Fund takes the position that there is no viable alternative to decoupling.

3. Public Service Company, Staff, the OCC, Multiple Intervenors, Climax and CF&I have entered into the instant Settlement Agreement which sets forth a recovery and incentive mechanism (other than revenue per customer decoupling) for DSM programs, which mechanism is deemed appropriate by said parties.

II. PROVISIONS

4. As a result of the Collaborative Process, eight DSM programs have been identified and are set forth in Exhibit A. This Settlement Agreement shall apply to the DSM programs set forth in Exhibit A which are approved by the Commission and implemented during the three year period commencing with approval of the instant Settlement Agreement.

5. This Settlement Agreement does not apply to the two 50-MW DSM bidding programs covered under the DSMCA clause (Docket No. 90A-147EG), any previously stipulated pilot programs or any programs resulting from the Low Income Docket (Docket No. 91A-783EG).

6. The present DSMCA clause shall be applicable to the DSM programs described in paragraph no. 4, with the exception of the Company's DSM incentive. The incentive mechanism set forth in paragraph no. 7 shall be applicable to the programs contained in Exhibit A. Subject to changes made by the Commission in response to the issues raised by Multiple Intervenors that are referenced in paragraph 11, the cost recovery and incentives shall continue to be recovered through a Rider on all base rate revenues.

7. The incentive mechanism to be applied to the DSM programs is calculated by starting with a bounty payment of $200 per kw and subtracting a certain percentage of the rebate, loan, or other financial payments to customers to undertake DSM activities, described as rebate for the remainder of the document. The DSM project to arrive at a net bounty payment as follows:

REBATE COST OF DSM PROJECT	% SUBTRACTED FROM BOUNTY PAYMENT
$0 - $300	10% of cost
$301 - $600	10% of $300, plus 15% of remainder
> $600	10% of $300, plus 15% of next $300, plus 20% of remainder

For illustrative purposes, a project which costs $250 per kw will result in a net bounty amount of $175 per kw, derived as follows: $200 - (10% x $250); a project which costs $500 per kw will result in a net bounty amount of $140 per kw, derived as follows: $200 - (10% x $300, + 15% x $200); and a project which costs $750 per kw will result in a net bounty amount of $95 per kw, derived as follows: $200 - (10% x $300, + 15% x $300, + 20% x $150). The kw shall be defined as the average of the maximum customer kw reduction occurring in the winter and summer.

75% of the net bounty amount shall be paid after installation of the project; and 25% will be held for four years and recoverable through the DSMCA by Public Service upon verification of the savings through monitoring. In addition, Public Service shall assess the impacts on its system resulting from the implementation of those DSM projects prior to recovery of the 25% payment after four (4) years. The 25% payment shall be paid upon verification of customer savings, but is not dependent on the outcome of this system impacts study.

The parties submit that the above recovery and incentive mechanism provides adequate financial incentives for Public Service to aggressively pursue DSM programs and to motivate Public Service to acquire cost effective, reliable DSM resources.

8. The terms and conditions set forth in the instant Settlement Agreement shall be used as the framework for establishing the appropriate incentive mechanism utilized with respect to any future DSM programs, including any DSM program for CF&I which may be proposed by the DSM Collaborative or the Company. The parties acknowledge that some adjustment to the numbers in the incentive formula agreed to in this Settlement Agreement may be necessary for any such future DSM program. The parties may also

consider whether an adjustment factor related to the project life of the particular DSM program under review is appropriate for inclusion and, if so, the specific factor to be included.

9. The issue of DSM recovery and incentives, in conjunction with and in the absence of decoupling, shall be subject to review following the three year period commencing with approval of the instant Settlement Agreement. The three year period is meant to allow sufficient time for: the Integrated Resource Planning process for Public Service to be completed; experience to be gained from the various DSM programs being implemented; and experience to be gained with respect to various revenue recovery mechanisms which have been, or are being, implemented elsewhere in the country.

10. During the decoupling stage of this proceeding, Public Service was pursuing the Customer Activity Bonus System (CABS) and had proposed general rate cases to be filed at least every three years. Neither CABS nor three-year rate cycles are being pursued by Public Service at this stage of the proceedings and neither is incorporated in the instant Settlement Agreement.

11. This Settlement is intended to resolve the issues of decoupling and DSM incentives with respect to Public Service. However, unresolved by this Settlement Agreement are the DSM rate design and ratepayer safeguard policy issue raised by Multiple Intervenors, both in the hearing testimony of Terry Murray and summarized in paragraphs 7(a) through 7(j) on pages 26-28 of the June 29, 1992 Post Hearing Statement of Position of Multiple

Intervenors. Multiple Intervenors maintain its original position on these issues and requests that the Commission render a decision on these issues.

12. This Settlement Agreement is an integrated agreement, and any of the parties may withdraw if, but no party shall be deemed automatically to have withdrawn simply because, the Commission materially changes any of its terms and conditions. Public Service, Staff, the OCC, Multiple Intervenors, Climax and CF&I agree to take all reasonable steps to support and defend this Settlement Agreement before the Commission.

13. The parties agree that the Settlement Agreement represents a compromise of disputed issues. As such, evidence of conduct or statements made in negotiations and discussions in connection with the Agreement shall not be admissible. The parties agree that nothing contained in the Agreement, unless otherwise expressly provided therein, shall constitute any precedent, admission, concession, acknowledgement or agreement which may be used by or against any of the parties in any subsequent proceeding before the Commission or otherwise.

14. The parties agree that this Settlement Agreement is in the public interest and that all of its terms and conditions are fair, just and reasonable.

DATE: September 24, 1992

Respectfully submitted,

PUBLIC SERVICE COMPANY OF COLORADO

As to Form:

By: ______________________
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As to Substance:

By: ______________________
James F. Gilliam

OFFICE OF CONSUMER COUNSEL

As to Form:

By: ______________________
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Assistant Attorney General
1525 Sherman St., 4th Floor
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As to Substance:

By: ______________________
Robert J. Hix

STAFF OF THE PUBLIC UTILITIES COMMISSION

As to Form:

By: ______________________
Mana L. Jennings-Fader, #15773
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As to Substance:

By: ______________________
Gary E. Schmitz

MULTIPLE INTERVENORS

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As to Substance:

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Robert M. Pomeroy, Jr.

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As to Form:

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As to Substance:

By: Richard L. Fanyo
Richard L. Fanyo

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Docket No. 91A-480EG
EXHIBIT A

DSM PROGRAM	ESTIMATED REBATE COST per KW	ESTIMATED MW REDUCTION BY 1995 (1)
Non-Res Lighting	$300	7.0
Res Direct Install	400	4.5
Res New Const	400	0.7
Non-Res Motors	475	1.3
Res Equipment Replace	550	8.3
Non-Res Process Eff	600	5.9
Non-Res Chillers & Custom	650	3.8
Non-Res New Const	700	2.3
		33.8

(1) Average of maximum customer demand reduction occurring in winter and summer

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