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Delivered by E-mail

Doreen Friis
Regulatory Affairs Officer/Clerk
Nova Scotia Utility and Review Board
3rd Floor 1601 Lower Water Street
PO Box 1692 Unit "M"
Halifax NS B3J 3S3

Dear Ms. Friis:

Re: M07151 – DSM Cost Allocation and Recovery

In accordance with the Board's timetable, these comments are filed on behalf of the Industrial Group.

On October 30, 2015, NSPI set out its position respecting DSM cost *allocation*, having regard to input received from the DSM Advisory Group. NSPI addressed DSM cost *recovery* in its letter of November 30, 2015, requesting approval to expense 2016 DSM costs and defer application on 2017 and 2018 DSM cost recovery until it files for a GRA in April, 2016 or, if not by June 30, 2016.

Thereafter, in response to the Board's directive, NSPI filed additional details regarding its proposed cost allocation and cost recovery for various DSM components. We have organized our comments generally in the same fashion as NSPI's December submission.

2015 AND 2016 DSM AMOUNTS

NSPI has indicated that it will be able to absorb the 1/8 share of the 2015 DSM spending and the 2016 DSM budget in its general rates and so, asks for approval to expense these in its 2016 operating costs. 2015 DSM spending was deferred and amortized over eight years in accordance with legislative requirements; the annual amount is $6,144,785[1]. NSPI earns a return on these deferred amounts at 7.78%, its Weighted Average Cost of Capital ("WACC"), consistent with its other regulatory deferrals[2]. EfficiencyOne ("E1") has enquired whether NSPI would be prepared to enter into agreement with E1 with respect to repayment of these amounts, which would presumably allow E1 to finance at a lower rate. NSPI indicated it would be willing to have these discussions once greater clarity can be provided. If the 2015 DSM spending were

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[1] NSPI (IG) IR-6 and partially confidential Att.1.
[2] NSPI (E1) IR-1.

financed at a 3% rate, NSPI calculated the annual amount to be $5,007,213 – a cumulative savings over the eight years of over $9 million.[3]

The Industrial Group would support any and all means to reduce the carrying costs of the deferred DSM expense from 2015, including entering into an agreement with E1.

NSPI has indicated that it can absorb the first year of 2015 DSM costs and all of 2016 DSM costs in existing rates i.e., as of the end of 2016, the first year of DSM costs associated with the 2015 DSM expenditure (~$6.15 Million) and all 2016 DSM costs will have been recovered from customers in NSPI's existing rates. Accordingly, the Industrial Group recommends Board approval as proposed. Further, the Industrial Group recommends that NSPI and E1 be directed to undertake discussions toward an agreement with the goal to reduce the carrying costs to less than 7.8%. If and when such an agreement is reached, then the balance of the deferred 2015 DSM costs (net of what is expensed in 2016) can be re-amortized over the next seven years at the lower rate.

2017-2019 DSM Expense Recovery

NSPI has requested that any determination on cost recovery of the 2017-2019 DSM expenses be deferred to the general rate application ("GRA") filing *or June 30, 2016*, if there is no GRA application. It has offered no particular basis for selection of the June 30 date (other than it is six months before the start of 2017), nor provided details of what additional information it would have or seek to secure by June 30 that it would not otherwise have by April 30, 2016[4].

NSPI takes the position that it is unable to determine cost recovery beyond 2016 by April 30 because of its uncertainty in forecasting revenue requirement and utility costs prior to that date, since the Board may defer recovery of DSM costs incurred by NSPI.[5]

Under the various legislative amendments, DSM costs are part of general rates and NSPI is required to file for any changes to its general rates for the next three years by April 30, 2016. Unlike other cost inputs over the three year period, NSPI has certainty respecting the DSM amounts for 2016, 2017 and 2018 as they are the subject of a Board order[6] and 2019 has been capped by legislation at $34.05 Million[7]. NSPI is required to evaluate by the end of April what its non-fuel revenues and expenses will be for the next three years and this would include DSM.

While the Board is permitted to defer some portion of DSM costs (and indeed, having regard to rate shock considerations, the Board always has the discretion to amortize some expenses) but this does not change the analysis that must be undertaken by NSPI regarding its GRA application. NSPI was offered the opportunity but failed to articulate what decision presently before the Board would require an additional two months after the decision to file or not to file for a GRA.

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[3] NSPI (Multeese) IR-14.

[4] NSPI (IG) IR-7.

[5] NSPI (Multeese) IR-4.

[6] Board Order of October 7, 2015 in M06733 approving DSM for 2016-2016 at $102.150 Million.

[7] ***Electricity Plan (Implementation) Act***, s. 20(1).

What is troubling to the Industrial Group is that the legislative amendments prohibit any changes in rates during the three year "rate stability period." If NSPI does not file for a GRA to change rates, but on June 30, decides it cannot expense the annual DSM amounts within the existing rate envelope, then it appears that the only alternative for NSPI is to apply to defer and amortize the DSM amounts to be recovered *after* the rate stability period. Unless otherwise ordered, NSPI will earn a return on this deferred regulatory asset at a rate of 7.78% (or its current WACC) over the three years.[8]

NSPI was offered the opportunity to explain the process it contemplated for recovery of DSM costs beyond 2016 and the timing thereof in light of the legislated rate stability period should it not make its decision until June 2016 but it failed to answer the question.[9]

In the absence of a good reason to delay, and the prospect of accumulating additional interest charges over the three year rate stability period, the Industrial Group respectfully suggests that NSPI should be in a position to seek cost recovery in respect of DSM for years beyond 2016 coincidental with the deadline for filing of a three-year GRA i.e., by April 30, 2016. It may be that DSM is the only cost driver for NSPI that warrants a rate change (or a request for deferral) but that decision and the timing thereof should be made in accordance with the legislation. In this fashion, the Board will have all the cost inputs before it and can make a decision on deferrals having regard to all the information, not simply DSM in isolation.

The Industrial Group recommends the Board not approve the requested conditional extension to June 30, 2016, regarding determination on DSM recovery.

2014 RATE SMOOTHING ADJUSTMENT

Appendix B to NSPI's October 30, 2015 letter sets out the outstanding amounts owing and to be repaid as of the end of 2015. There were two "borrowing" classes (Small General and Large General) and four "lending" classes (General, Small Industrial, Medium Industrial and Unmetered). None of the Residential class, the Large Industrial or Municipal classes was either a borrower or lender.

NSPI has stated that because this is an inter-class issue, it is largely indifferent. It has suggested three options:

1) Reallocate DSM services during the 2016-2018 Plan period;

2) True-up in the next GRA; or

3) True-up as part of the 2017-2019 Base Cost of Fuel ("BCF").

NSPI has indicated it has not had discussions with E1 regarding the feasibility of the first option or how it could affect E1's ability to achieve its targets; NSPI stated it would not support this option if it affected E1's costs.[10] The Industrial Group is concerned that E1 already has enough challenges to achieve its targets, within its planned Programs, all the while monitoring customer

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[8] And subject to any financing agreement which may be secured by E1.

[9] NSPI (IG) IR-7.

[10] NSPI (Multeese) IR-5 and NSPI (IG) IR-8(c).

class rate impacts. Further, the original lending/borrowing was accomplished by way of rate adjustments. The Industrial Group does not believe that converting those dollars to efficiency services is appropriate.

Should NSPI apply for a GRA, the Industrial Group recommends that the true-up be included in the rates, to be recovered over the three year period. If NSPI does not apply for a GRA, it seems possible that the true-up could be accomplished using the BCF as a procedural vehicle. In both of those scenarios, the Industrial Group agrees that recovery should be over the three year period, with interest, as previously agreed and approved.

2013 AND 2014 BA AMOUNTS

NSPI has indicated that the 2013 variance was applied to DSM funding in 2015 i.e., ENSC had underspent by approximately $4 Million and these amounts were added to the legislated $35 million for the 2015 time period.[11] NSPI confirmed in response to E1 that it will deal with the 2014 BA of approximately $8.5 Million by expensing the Net Contract Price of approximately $24.7 Million in 2016 as provided in Schedule B of the Compliance Filing Supply Agreement of September 15, 2015.[12]

For the 2014 variance allocation (approximately $8.5 Million), NSPI notes that the 2014 DSM costs were collected through the DSM rider in accordance with the ENSC budget for 2014. It provided an estimated variance analysis by class i.e., it has calculated the difference in spending versus what was budgeted for the customer classes, in Appendix B of its December filing. NSPI goes on to suggest that the variance could be allocated to customer classes in various ways including modification of DSM program delivery, true-up in the next contract period and true-up at the time of the next GRA.

Again, NSPI has taken the position that as this is primarily an issue among customer classes it will look to those classes for a preferred resolution.[13]

The Industrial Group agrees with NSPI's conceptual calculation of the variance. The true-up is discussed below.

COST ALLOCATION AND TRUE UP

The issues of allocation and true-up are related.

- **Allocation**

In its October 30, 2015 filing, NSPI supported continuation of the current direct/system method of allocating the costs:

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[11] December 18, 2015, letter, page 2, and Footnote 2 referencing ***Electricity Efficiency and Conservation Restructuring (2014) Act***, s.79-1(a).

[12] NSPI (E1) IR-2; and see October 30, 2015, letter, page 9.

[13] NSPI (CA) IR-10.

> *3.0 NS POWER'S POSITION*
>
> *The current 25/75 per cent split between system cost and participant cost was agreed to by stakeholders to the 2009 Settlement Agreement. It appropriately recognizes that rate class benefits from DSM programs are higher if the class participates in the program. The direct assignment of 75 per cent of DSM expenses to those classes who caused them aligns with a cost of service principle that to the extent possible, and correct to do so, costs should be assigned to rate classes directly. To the extent there are external benefits that accrue to non-participating classes they should pay for the costs of these benefits, too. Since the nature of DSM programs is such that they primarily benefit participating customers through reduced energy bills, logic dictates that directly assigned costs should represent the majority of the total DSM spent. The current methodology assigns 75 per cent of costs to the participating classes.*[14]

This was reiterated in NSPI (IG) IR-2:

> *NS Power recommends maintaining the 25% - 75% breakdown of DSM costs between system benefits and customer benefits for the cost allocation purposes among rate classes.*

NSPI explained how the DSM cost allocation relates to NSPI's Cost of Service Methodology in response to Multeese IR-1:

> *NS Power sees the DSM cost allocation as an algorithm operating within the cost of service framework. All of the DSM costs, whether prospective DSM plan costs or actual true-up amounts, would be subject to a R/C ratio adjustment and would be recovered through prospective base cost rates. The DSM cost calculations, performed using the previous DSM rider spreadsheets would provide DSM cost inputs into the main COS model. In that sense, treatment of prospective DSM Plan costs would be similar to those of base cost of fuel (BCF) under the FAM. Contrary to the rider-based true-up of fuel costs, however, the actual imbalances in recovery of DSM costs would be recovered through prospective rates.*

When NSPI files its next cost-of-service study (COSS) - presumably at the time of its next GRA - the DSM allocation process can be accomplished by inserting a DSM algorithm in the approved COS framework. Assuming that the GRA is filed by April 2016, the true-up process can be done at the end of the rate stability period.

The rationale for both class allocation and subsequent true-up is based on the unique nature of DSM investment. DSM is unlike other costs that the utility incurs in providing service. When new generation supply is added to a utility system, all customers share in the cost in proportion to their usage. However, when the utility adds DSM in order to reduce the need for generation, the recipients of DSM measures have their usage reduced. As a result, part of the cost of the DSM, along with the effect of reduced fixed cost recovery, is added to the bills of others. To illustrate the principle, if utility-financed DSM reduced a customer's usage to zero, that customer

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[14] At page 6, footnote omitted.

would not pay anything for the "service" (also called "negawatthours") provided. All other customers would pay for the service provided to that customer.

This is the rationale for directly assigning 75% of the cost of DSM to the classes in proportion to their DSM program participation. Recognizing that the DSM is expected to have some effect in reducing system costs, 25% of the cost is allocated among the classes in proportion to their demand and energy usage.

The fact that most of the benefit accrues to the recipients of utility-funded DSM leads to a policy of trying to "spread the DSM around" to all classes.[15] This, in turn, leads to the need for tracking DSM spending not only in total, but also by class, and truing-up any class over- and under-spending relative to the budget.

- **True-Up**

As regards the true-up, NSPI outlines three possible approaches:

1) Traditional method (also called "actual DSM alignment");

2) Cost of Service; and

3) No Allocation.

NSPI stated that it supports the manner in which true-ups were managed when DSM was recovered through a rate rider but proposes the relevant period going forward would be the three year contract period (i.e., 2016-2018 etc.) rather than rebalancing annually.[16] The Industrial Group agrees with NSPI that a true-up at the end of the contract period would be appropriate. It aligns with E1's targets and allows E1 the flexibility to modify programs or service delivery over the three years having regard to budgets and targets.

With respect to the three options, the "Traditional" approach allocates the initial (forecast) budget amount among classes and subsequently allocates the actual. In the past, variances between the two were charged or refunded to each class through the DSM rider. Since there is no longer a DSM rider, this still leaves the question of what to do with the class variances. The Industrial Group suggests that the variances be accrued over the period until the next GRA after the rate stability period.

The "Cost of Service" approach allocates the total DSM cost among classes in proportion to the allocated rate base in the most recent (currently, 2014) COS study. NSPI says that:

[15] From a cost-effectiveness standpoint, it might make sense to devote most or all of the DSM budget to the commercial or industrial classes. However, despite this being a less expensive approach, it is generally perceived as unfair to the class(es) that receive little DSM investment.

[16] December 18, 2015, letter, page 4 and NSPI (IG) IR-12.

> *This option would allocate DSM funds among customer classes in the same manner that NS Power allocates earnings above its approved range of return – allocate based on NS Power's cost of service.* ***Any true ups would be based on this allocation as compared to actual class expenditures (subject to the 75% class cost / 25% system cost allocation)***[17]

NSPI clarified its "Cost of Service" allocation option in response to CA IR-1:

> *The DSM cost collections by rate classes are proposed to be trued up against actual DSM costs apportioned among rate classes using the same costing methodology as approved for DSM Rider calculations. This methodology consists in splitting actual DSM costs of each class between direct and system categories at a ratio of 75 to 25 and then reapportioning the system cost category among rate classes using the COSS-based treatment of fixed generation costs.*

And in response to Industrial Group IR-3; NSPI further clarified that the Cost of Service allocation is specific to the year 2016:

> *The proposed allocation based on Cost of Service is specific to how costs are attributed to customers for the purpose of the 2016DSM expense … For the purpose of attributing 2016 costs recovered from customers on a per class basis used to finance the DSM budget, NS Power first apportions the excess earnings to customer classes based on the Cost of Service method used in the 2014 FAM Deferral, based on the revenue requirement without DSM included. This allocation enables the Company to calculate earnings beyond the allowed range of return on a per class basis according to their relative share of rate base in the Cost of Service. DSM budget costs are then allocated to the classes based on the established 25% system benefit, 75% participant benefit methodology. Subsequent true-ups between the budget and actuals would be carried out against the DSM budget using the DSM cost allocation methodology which was used for the true-up purposes of DSM rider calculations.*

The application of the "Cost-of-Service approach" to true-ups is not clear. Would the same COS study be used to allocate the budget and actual DSM spending? In this case, there would be no variances resulting from differences between forecast and actual class spending, only from a difference in total DSM spending.

Further, the most recent COSS comes from the 2013 Cost of Service proceeding and is based on cost inputs from the 2013 GRA.[18] Using the 2013 COSS to allocate 2016 costs ignores changes in class loads. If NSPI does not file a new COS study, the allocation based on a 2014 study becomes further and further out of date.

For these reasons, the Industrial Group does not believe the Cost-of-Service approach for 2016 (or going forward) is desirable.

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[17] December 18, 2015, letter, page 5.
[18] NSPI (IG) IR-5.

The "No Allocation" approach is explained by NSPI:

> *The "absorption" of the 2016 DSM expenses into the Company's 2016 cost structure without a rate increase means that the cost of the DSM program is being funded by savings in other areas of NS Power's revenue requirement and changes in sales levels from the assumptions applied in the 2013-2014 GRA Decision. The effect of this is that until another GRA is completed, it is not possible to actually segregate bundled customer rates into their DSM and non-DSM components by class. Given this, there is merit in considering that, for 2016 forward until the next GRA, DSM variances by class not be tracked and trued-up.*[19]

NSPI confirmed that "this period" includes 2015 through to the next GRA.[20] By not tracking and truing up, if E1's class spending does not align with how funds are deemed to be collected in the existing rates (based on COSS), as NSPI points out, it creates a potential inequity.[21] NSPI suggests that as E1 is limited to 25% adjustments at the Program level (rather than at the Sector level), this will mitigate against these potential inequities. However, as demonstrated by the 2014 variance between budget and actuals[22], the potential impact on individual customer classes is still material.

In the no allocation approach, there will be winners and losers. It is not unlikely that E1 may maximize its BNI Program spend to most economically achieve its target energy and demand savings. A no allocation approach therefore may favour the Industrials but is not a principled approach.

Further, if NSPI does not file a GRA in 2016, then the next opportunity is not until 2020 rates. The Industrial Group does not have sufficient confidence in the accuracy of the budget and spending to simply ignore any potential mismatch over such a lengthy period of time. The consideration may be different if we knew NSPI would be filing in 2016. For all these reasons, the Industrial Group does not support the "no-allocation and no true-up" approach.

ENABLING STRATEGIES

As outlined in its October 30, 2015, letter, NSPI proposes to maintain the current cost allocation methodology but proposes a change to the methodology for Enabling Strategies that would limit the need for tracking by rate class.

Specifically, NSPI proposes that Enabling Strategies be allocated along the same 25/75 split, except in the following two cases:

[19] December 18, 2015, letter, page 6.
[20] NSPI (Multeese) IR-11.
[21] NSPI (IG) IR-14.
[22] Appendix B to December 18, 2015, letter.

> *(i) where the benefit of a particular Enabling Strategy clearly benefits a rate class(es) and the cost exceeds $100,000 CDN, the costs shall be fully allocated to that rate class (for example, the Small Business study currently contemplated in E1's 2016 plan will be allocated to the SBA if the cost of such study exceeds $100,000); and*
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> *(ii) where the cost of a particular Enabling Strategy can be attributed to a particular rate class(es) based on historical average(s), up to 2014, such cost will be allocated to that rate class(es) without ongoing tracking.*[23]

"Enabling strategies" include certain marketing, promotional and educational programs as well as research and development, innovative financing and regulatory costs. The Board may recall that using the 25/75 allocation was a change from allocation based on customer accounts.[24] The tracking and coding of Enabling Strategies to particular classes carries a cost and there are still a number of programs which are coded to "all classes". NSPI has recommended a simplified method to allocate the share of participant costs based on historical experience. It proposes that where the benefit of a particular Enabling Strategy clearly benefits a rate class and the costs exceed $100,000, costs should be fully allocated to that rate class, offering by way of example, the Small Business Study currently contemplated in the E1 2016-2018 Plan.

NSPI provided a table showing the allocation of Enabling Strategies as per its recommendation and that of Elenchus (as modified in 2014). Both of these are a change from the current tracking to allocate participant costs. The CA implies in IR-7 that E1 erroneously coded the Bright Business Conference to all rate classes but that the Conference does not benefit the residential class. This assertion is made without any support. In fact, the Elenchus memorandum of May 7, 2014, reviewed the direct allocation of Enabling Strategies invoices and confirmed the appropriateness of the allocation:

> *The sample turned up many invoices assigned to All Rate Classes. Costs observed included development-related IT costs, DSM planning, the website, and other organizational marketing and promotional activities. Every entry coded as all rate classes could be expected to impact more than one rate class, and appeared to have the potential to impact all rate classes.*
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> *Where invoices were assigned to individual rate classes, or where an apportionment was made between rate classes, all invoices reviewed appear to have been assigned to the appropriate rate classes, and in reasonable proportions where apportioned.*

Furthermore, the memorandum of Elenchus is supportive of the approach of NSPI, with its "first choice" being direct allocation:

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[23] NSPI October 30, 2015, letter, pages 6-7.

[24] Order approving ENSC 2013-2014 DSM Plan, NSUARB-E-ENSC-R-12.

> *Elenchus has not seen any information to question the validity of the system/participant benefit approach for enabling strategies given the approved cost allocation methodology for Nova Scotia, and believes that it remains appropriate for the reasons set out in February 2012.*
>
> *When performing an allocation of Participant Benefit, our first choice would be to perform a direction allocation if one is available. If a direct allocation does not exist, or is not practical, then we would consider an appropriate allocator to use as a proxy for the benefit derived by the rate class.*

Where Elenchus and NSPI appear to differ is on the "appropriate allocator to use as a proxy". NSPI suggests the use of historical averages; Elenchus suggests allocation on the basis of program benefits.

The Industrial Group supports the proposal of NSPI respecting Enabling Strategies as most aligned with cost causation based on direct experience in Nova Scotia. It also reflects the costs of tracking and minimizes this. Where matters can be directly assigned, they should.

A threshold level of $100,000 is a fairly significant figure for some classes. The Industrial Group would wish to review this threshold in future to see if it continues to be appropriate.

CONCLUSION

To summarize, the Industrial Group recommends:

1. the Board acknowledge NSPI may properly expense the first year of 2015 DSM costs and all of 2016 DSM costs as operating expenses in 2016;

2. the Board direct NSPI and E1 to undertake discussion toward an agreement with the goal to reduce carrying costs to less than 7.8% (NSPI's current WACC);

3. if and when such an agreement is reached, then the balance of the deferred 2015 DSM costs are to be re-amortized over the remaining years at the lower rate;

4. as 2017-2019 DSM costs are properly part of rates, NSPI should be directed to include its plan to expense or request deferral within the time for filing of the 2017-2019 GRA application i.e., by April 30, 2015, and not, as a standalone application on June 30, 2016, should a GRA not be filed;

5. should a GRA be filed, the RSA should be trued-up within this application over the three year period or, alternatively, the RSA true-up could be accomplished using the BCF as a procedural vehicle;

6. the current 25% system cost/75% participant cost methodology to allocate DSM continues to be appropriate. It should be done using a DSM algorithm in the COS framework. The rationale for subsequent true-up should follow the traditional approach, with variances accruing over the three year DSM contract term; and

7. NSPI's proposal to refine the allocation of participant benefits of Enabling Strategies should be accepted, with the $100,000 threshold to be reviewed in future.

Thank you for the opportunity to submit these comments.

Yours truly,

Nancy G. Rubin

NGR/lmc

cc David Landrigan
Bruce Outhouse, Q.C.
Participants in M07151/E-R-15