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The Department appreciates the thorough and insightful evaluation of the Conservation Improvement Program (CIP) undertaken by the Office of the Legislative Auditor (OLA). The report is an excellent resource that the Department, Legislature, and interested parties can use to understand how CIP operates. We are pleased that the OLA's study has borne out our belief that the Department oversees a cost-effective program that provides hundreds of millions of dollars of benefits to the state of Minnesota. The report identifies many areas that deserve our attention. The Department has already begun addressing many of them; some we shall begin addressing soon; and others we will have to thoroughly examine to ensure that the benefits of any changes outweigh any potential costs.

Attached is a brief response of the Department to some of the recommendations of the report. We look forward to working with the Legislature and interested parties to ensure that the CIP program continues its critically important role in providing reliable, cost-effective and environmentally friendly energy conservation services to Minnesota.

Sincerely,

A handwritten signature in black ink that reads "Edward A. Garvey". The signature is written in a cursive, slightly slanted style.

EDWARD A. GARVEY
Deputy Commissioner

EAG/ja

RESPONSE OF THE MINNESOTA DEPARTMENT OF COMMERCE
TO THE OFFICE OF THE LEGISLATIVE AUDITOR'S REPORT ON
THE CONSERVATION IMPROVEMENT PROGRAM

The Department believes the CIP program has greatly benefited from the independent, professional, and thorough analysis conducted by the OLA. The Department wholeheartedly agrees with the six major findings of the OLA report:

- The benefits of the Conservation Improvement Program (CIP) are greater than its costs, and the program has the potential to provide cost-effective energy conservation in the future (pp. 22 and 41 of full report).
- On balance, the methods and assumptions used by investor-owned utilities to calculate the benefits and costs of their 2003 conservation activities tended to understate CIP's cost effectiveness (p. 25-27).
- While cost-effective energy conservation is a primary goal of CIP, some Minnesota laws, rules and procedures reduce the cost-effectiveness of the program to achieve a desired distribution of program benefits (p. 57).
- Utilities, low-income advocates, environmental groups, and the Department of Commerce have concerns about how conservation projects for low-income households are being carried out and evaluated (p. 59).
- The Department of Commerce conducts relatively thorough reviews of investor-owned utilities' conservation plans and activities, but the review process has some deficiencies (pp. 46 and 50).
- A Department of Commerce policy that limits communication within the department about CIP plans makes the department's review process inefficient and creates confusion (p. 55).

Rather than comment on each finding, the Department will focus its response on the Report's four key recommendations.

I. Key Recommendation 1: The Legislature should give the Department of Commerce the authority to switch CIP from a two-year to a four-year program, and the department should increase the level of scrutiny that each CIP plan receives (p. 51).

The OLA Report found that the Department reviews utility filings thoroughly, but that it may be able to increase its scrutiny if utilities are allowed to file their CIP plans once every four years instead of once every two years. The Department notes that this recommendation has been suggested in the past. Some of the utilities favor the longer time between filings, while others have stated that they prefer to file once every two years. Although this change is recommended

in order to save time resources and to enable a standardization and increased level of review, the end result could be the same amount of time being expended over a longer timeframe with the same or less standardization. This could be the outcome because utilities are likely to have to update their filings before the end of the four-year period due to changes in standards, etc. and to update avoided cost assumptions. In addition, most of the electric CIPs are currently reviewed at the same time as the other electric CIPs. The same is true for the gas CIPs. If the CIPs were spread out over more years, there would be less opportunity to compare electric CIPs or gas CIPs side by side. Having said this, the Department is agreeable to the longer time between filings. Amending the CIP statute to allow, at the Commissioner's discretion, a utility to file its CIP plans up to four years apart is a good way to handle this suggestion.

II. Key Recommendation 2: The utilities and Department of Commerce should correct the methodological problems in the utilities' benefit-cost estimates (p.38).

Preceding this recommendation, the OLA identified the following issues with the Department's CIP cost-effectiveness evaluation:

- The use of out-of-date natural gas prices resulted in a significant understatement of the 2003 benefit-cost ratios for the natural gas utilities (p. 27).
- The use of out-of-date discount rates also resulted in an understatement of the 2003 benefit-cost ratios (p. 28).
- In 2003, electric utilities did not use the same discount rate to calculate the value of benefits received in future years under the societal test (p. 29).
- Electric utilities do not use the same methods and assumptions as each other to estimate the energy, power plant, transmission line, and distribution system costs that were avoided through conservation, which led to widely varying estimates (p. 29).
- The electric utilities used different methods to estimate the value of health and environmental damages that energy conservation voids, which has led to widely varying estimates (p. 30).
- Minnesota's benefit-cost model for natural gas projects generally understated the utilities' 2003 reported benefit-cost ratios because of structural problems in the model (p. 33).

The Department and the utilities have been working on modifying the natural gas cost-effectiveness model (BenCost) and are nearing completion of that process. As part of that process, it became apparent that some of the electric and natural gas assumptions could be revised or made consistent. Nevertheless, the Report provides a solid foundation for all parties to consider on how to standardize cost-effectiveness analysis. We address the identified issues below.