

## Assessment of Alternative DSM Cost Recovery Strategies for Midwest Utility Client

### Industry & Client Situation

Legislative statutes and regulatory mechanisms continue to evolve in various states as utilities, regulators, and policymakers strive to eliminate barriers to furthering Demand Side Management (DSM). Many utilities are currently facing the risk of earnings erosion due to conventional cost recovery schemes applied to DSM investments that do not address the revenue degradation impacts of these investments

Some utilities are not earning their approved ROE on capitalized DSM expenses due to regulatory time lags that result in delays between time when they incur DSM costs and recovery of costs from retail customers. Innovative DSM cost recovery/incentive structures are necessary to better align utility financial incentives with the overall mission to achieve greater energy savings and reduce GHG emissions

Our client, a mid-sized utility company, was looking at ramping up its investment in Energy Efficiency programs. However, before additional investments could be made, the client wanted to fully understand the implications of the program on its overall financial and operating metrics. It further wanted to identify the appropriate recovery mechanism that would be amiable to shareholders, regulators and its customers.

### Approach

Bridge Strategy Group formed a small working team with the client composed of members from the finance, DSM and regulatory functions. Some of the key issues that were identified included:

1. What are the guiding principles for a DSM regulatory framework?
2. What is the magnitude and implications of EE on MW, MWh, revenue, EPS, etc.?
3. What are the various recovery options? What are the pros and cons?

A thorough analysis of all current state-wide regulatory compacts was completed to understand the different recovery mechanisms that had been successfully (and unsuccessfully) employed by various utilities. The team developed a detailed financial and operational model that analyzed various cost recovery options based on the planned EE programs. Several factors that influenced performance metrics were considered (free-rider, adoption rate, T&D cost, etc) to highlight appropriateness of EE investments and their recovery.

The team provided the client scenarios that allowed the ability to earn a total return commensurate with the risk/reward profile presented by DSM. Engaging with the regulatory team, we were able to break away from the traditional ROE mindset and the need to "not be harmed", instead, focusing on creating incentives to make DSM a profitable business that competes internally for resources (eg, capital, people).

### Results

Based on Bridge's analysis and insight, our client engaged with regulators to promote a new approach that optimized DSM opportunities while providing a more effective cost recovery model.