STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard.	:	Case 07-M-0548

RESPONSE ON BEHALF OF
CENTRAL HUDSON GAS & ELECTRIC CORPORATION
TO NOTICE SOLICITING COMMENTS DATED MAY 30, 2008

Preliminary Statement

Central Hudson Gas & Electric Corporation ("Central Hudson") welcomes this opportunity to submit comments to the Commission regarding incentives for utility energy efficiency.

Central Hudson has been active in all phases and aspects of this proceeding, which is so important to the State's energy, economic and environmental future, including submitting for the Commission's consideration Central Hudson's Statewide Plan for achieving the goals of the 15x15 policy in a cost-effective way that fully utilizes the respective capabilities of the utilities, NYSERDA, LIPA and NYPA and other State agencies and authorities.

Following the Commission's Session on June 18, 2008 a Press Release emphasizing the importance of energy efficiency was issued, in which Chairman Brown said:

> "Never before have we faced such significant energy challenges," said Commission Chairman Garry Brown. "The unprecedented rise in energy prices we are experiencing puts to

> rest any doubts the market is changing. To confront this new and unpleasant reality, we must immediately take bold steps to improve energy efficiency and reduce consumption of ever-more costly fossil fuels that we have come to depend on. Doing nothing should not be considered as an option."
>
> Chairman Brown added: "The unprecedented energy efficiency program we are approving today will be critically important for the State's future energy policy. Without doubt, energy efficiency is the most cost-effective, and most immediate, way to reduce the burden of rising energy and environmental costs on residential and business customers. The steps we are taking will establish a framework for ensuring energy efficiency becomes an integral part of the New York energy industry. This initiative is squarely in context of broader State policies designed to develop a clean energy industry and economy."[1]

These statements and the initial actions taken by the Commission at its June 18 Session demonstrate the importance and value of energy efficiency and, by implication, of the incentives that are required to make the energy efficiency part of the 15x15 policy a reality. As recognized in the Commission's Notice, "[a]lthough the question of utility incentives has been discussed in this proceeding, the parties have not [yet] submitted comprehensive briefs on this topic."[2] The "incentives"

[1] The Order reflecting the Commission's decisions had not been issued as of the time these Comments were completed.

[2] Case 07-M-0548, Notice Soliciting Comments (issued May 30, 2008) ("Notice") at 1. Offering the public the opportunity to comment at this point does, however, have limitation usefulness because specific attributes or

discussed in the Notice are "performance-related incentives;" defined as "financial incentives based on the extent to which performance exceeds or falls short of targets."[3]

The scope of comments set forth in the Notice, is:

> Parties are encouraged to comment on: a) whether incentives are necessary; b) the reasonableness of the Guidelines, and any recommended modifications; c) any other specific issues not encompassed within the Guidelines; (d) the strengths and weaknesses of the three incentive models identified above, and any recommended modifications; and (e) the range of incentive levels that will accomplish the objectives identified in the guidelines.[4]

I. Summary of Central Hudson's Comments

The absence of the specific information needed to address the proposals advanced in the Notice in a quantitative fashion indicates that the Commission must necessarily limit its consideration at this time to general principles, which would then be applied in individual utility contexts where the needed empirical information will be available.

---

characteristics of the anticipated EEPS program, as referred to in the proposed "incentive" formulations, are not known at this time. Parties are able to comment generally and abstractly, but not specifically at this time. Central Hudson reserves the right to provide additional comments after those parameters are developed.

[3] Notice at 1.

[4] Notice at 2.

The "performance-related incentives" explicitly addressed in the Notice, or some variants of them, while potentially useful as part of a broader approach to compensation to utilities, are practically and legally insufficient in and of themselves. The three "performance-related incentive" examples explicitly addressed in the Notice, through focusing exclusively on concepts of "performance," do not recognize either the effort expended or the value of the products and services provided by the utility that produce energy efficiency or demand savings. The value attained by the utility begins with the first unit of energy or demand savings it produces.

Central Hudson believes that utilities are entitled to earn a profit from the first efforts they make and the first units of savings they produce. If the utility's performance is "imprudent," the utility would be subject to loss of profits it had earned or, in extreme circumstances, to further penalties. It may be possible to include a "performance" component in addition to providing compensation to the utility for all savings produced, but it is not proper or desirable to impose only "performance" metrics of the nature described in the notice.

The proposed "incentives" formulations would not provide any earnings to the utility unless and until the utility demonstrates superior performance through achieving lofty "floor" percentage of savings criteria, thereby incorrectly eliminating the presumption of prudence that exists in New York as a matter of law. Central Hudson submits that those formulations are incorrect applications of established legal principles in New York.

The importance and social value of energy efficiency has not been recognized in the performance incentives identified in the Notice. No empirical basis has been offered for the numerical performance criteria that have been proposed by Advisory Staff or Trial Staff.[5]

Furthermore, it is not proper to pre-define presumed levels of performance by reference to a specified level of achieved savings without clear knowledge of the degree of difficulty in achieving those levels and a compelling demonstration, if the performance levels are uniform across the state, that the degree of difficulty in achieving them is likewise uniform across the state, or a compelling demonstration that each utility faces comparable risks in relation to achieving energy efficiency targets if each is to have the potential to gain comparable rewards. No such demonstrations have been provided.

[5] The discussion of "incentives" by Trial Staff at 22-32 of its April 10, 2008 Initial Brief was beyond the scope of briefing authorized by the ALJs. See, Reply Brief on Behalf of Central Hudson Gas & Electric Corporation In Response to Initial Briefs On Four Specified Subjects at 22-23.

Accomplishing the necessary, but currently absent, empirical investigation required to establish the uniformity of risk implicitly assumed in both Staff formulations is no mean undertaking. How, for example, can the difficulties and risks of delivering energy efficiency products and services in the downstate multi-family rental market be objectively related to the various predominantly single-family residential markets mid-state and upstate?

II. Are Incentives Necessary?

One incentive is necessary. It is necessary both practically and legally. Utilities are private, for-profit businesses. The incentive necessary is that utilities committing resources to produce social benefits in response to Commission requirements are entitled to an opportunity to earn the level of profits that could be earned were the products and services provided in a competitive marketplace instead of through a regulatory requirement.[6] However, as noted above, this

[6] Of course here is no competitive marketplace for the products being spoken of in this proceeding. These products have been provided over the last decade through a governmental entity monopoly, not through the unregulated competitors that were originally envisioned as delivering them at the time when the Commission temporarily authorized ratepayer funding to NYSERDA for energy efficiency.

fundamental incentive has been incorrectly omitted in both the Advisory Staff Guidelines ("ASG") and Trial Staff positions.[7]

The "performance-related incentives" in both the ASG and Trial Staff positions have not been discussed in Working Groups or supported by any empirical information. Accordingly, no record basis for them currently exists.

Both would not begin to provide a "performance-related incentive" until after some high "floor" level of performance had been reached. However, neither would provide any compensation to the utility for any part of the utility's effort or savings achievements up to the "floor" of either 85% or 90% of "targeted savings." In contrast, Central Hudson believes that the utility is entitled to receive compensation for its efforts and for its achievements starting from the beginning, and it should not be denied <u>any</u> payment unless it achieves a pre-specified (but not empirically justified) "floor." Furthermore, even though the "performance-related incentives" in both the ASG and Trial Staff positions do not compensate the

[7] The California rule is not discussed extensively herein because there is no basis for assuming that it represents an appropriate outcome for New York utilities. California utilities operate in a different business and regulatory environment than New York utilities, as demonstrated by returns on common equity authorized in California that routinely exceed the ROEs authorized in New York by material amounts on the order of 150 basis points or more. Accordingly, there is no basis for the assumption that policies established in California are directly applicable to New York. Likewise, California has defined resource benefits quite differently than the Commission has done in the past.

utility at all for achieving the "floor," in reality, achieving the floor represents the production of very substantial public benefits. The simple fact is that any kWh or kW saved represents a public benefit and the utility should be compensated for the effort required to produce it and a material portion of the social value it represents.[8]

In addition, it is not appropriate to deny any compensation to the utility unless it achieves 85% or 90% of a "target," because that level of performance is inconsistent with the reasonableness criterion embedded in the prudence rubric.

Central Hudson believes that the basic approach to utility incentives should build upon a sharing of the value of the net benefits between the public and the utility. This is the basic formulation employed by the Commission in the 1980s. It is incongruous, if not plainly inconsistent, for the Commission now to have recognized the increased value and necessity of energy efficiency as a critical element of State policy, yet propose to provide much lower compensation than previously.

The Commission's TRC test assures that specific energy efficiency programs will not be approved unless it is demonstrated that they can be expected to produce social

---

[8] Central Hudson also believes that the social benefits should include all benefits, including the value of carbon reductions and avoided GHG emissions.

benefits.[9] The TRC test also provides the determination of the value of savings, albeit in a fashion that is significantly limited through the Commission's exclusion of the value of certain environmental factors. The actual net benefits should be computed (using stipulated per measure savings to the maximum extent that is reliable), complete quantification of all relevant environmental factors, and the value (net of the costs to achieve) shared between customers and the utility that produced the social value. Notably, the full value of the energy efficiency savings created by the utilities is automatically received by customers through their bill savings and improvements in environmental conditions and it is only through appropriate Commission action that utilities will be permitted to participate in a reasonable share of the important social values that their efforts will have produced.

Central Hudson believes that incentives should be applied to all savings produced. Incentive "floors" or "dead bands" are not appropriate. The public benefits arise from the first kWh savings that are realized and the utility as well should benefit from the first kWh savings.[10] Incentive floors or dead bands do

---

[9] The Commission has previously indicated that it may permit minor deviations from this principle, but the broad concept remains.

[10] For simplicity, it is assumed that all energy efficiency programs are directed towards energy savings and that demand savings may be computed but

not properly address the value of the products and services provided; they are directed towards a different subject - the possibility of imprudent performance by the utility - which they address through incorrectly requiring superior performance as a condition precedent to receipt of any compensation, in other words through a misinterpretation of the prudence standard of reasonableness. It may be feasible to design a "performance" metric as an additional element, but the performance metric should not be the exclusive incentive as it is in the two Staffs' proposals.

III. The Advisory Staff Guidelines and Trial Staff Position

The ASG are very general and provide little information on how each might be applied in specific circumstances. They are not necessarily objectionable in the abstract, but it is not feasible to provide detailed comments pending more specific information.

However, some concerns may be identified at this time. For example, the ASG generally fail to address the significance of actual market conditions. It has seemingly been assumed that all utilities have the same market opportunities or costs to

do not form the basis of the incentives. If a given program is directed towards demand savings, then that program should be evaluated, and the related incentive developed, on the basis of demand savings.

achieve in each service territory in relation to the provisional utility programs identified by the Commission, but this implicit assumption remains to be demonstrated. In addition, the AGS do not properly recognize the benefits that stipulated savings can provide through allowing avoidance of costly M&V (assuming that there will be a full opportunity to audit all claimed numbers of installed measures).

The ASG and Trial Staff positions differ in detail, not in concept. The ASG and the Trial Staff positions do not really "align utilities' financial interests with energy efficiency as a resource option" because both Staffs' positions are based on percentages of program targets.[11] Both Staffs' positions reward "safe" programs, but not innovation (because there are risks of meeting targets through new or untried approaches), not utility cost-savings in implementing programs, and not development of comprehensive energy efficiency portfolios by utilities.

IV. What is the Proper Approach?

A dichotomy exists in the Commission's Notice. On one hand, State policy and the Commission both recognize energy efficiency as socially desirable, in terms of reduced

[11] Notice at 2, Guideline 1(2).

environmental impacts and reduced energy bills. On the other hand, the value of these benefits is ignored or minimized in the Notice, which discusses incentives without quantitative reference to the value of the reductions in environmental impacts and customer bills that utility efforts will produce as discussed above.

Utilities should have the opportunity to develop meaningful energy efficiency businesses and to operate them efficiently for the benefit of their customers and investors so as to contribute to the success of the 15x15 policy. Performance incentives will not operate in a vacuum, but in the context of the EEPS program. At the time of the preparation of these comments, it remains to be seen whether the initial EEPS program elements discussed by the Commission at its June 18 Session will be insightfully implemented. If the opportunities to utilities constrain the potential for success but not the risks, any performance incentives formulation is likely to be insufficient to produce more than compliance and much less than the innovations that Central Hudson believes are required for success of the 15x15 policy.

Success for the 15x15 policy will require affirmative decisions by millions of New Yorkers to purchase energy efficiency goods and services from providers they know and trust, and it will require retail marketing programs that are based on deep knowledge of customers' desires and preferences in the local markets that attentively, if not aggressively, continuously revise and improve program designs and marketing plans. Constraining utility opportunity will constrain the potential for success.

Central Hudson believes that distribution utilities should be authorized to develop and implement their own broad-scale energy efficiency programs if the 15x15 policy goals are to be achieved through the market penetrations and program innovations that are necessary to persuade millions of individual New Yorkers to allocate increasingly tight financial resources to energy efficiency in times of economic slowdown, even as energy prices are rising. Central Hudson's market research shows convincingly that, while customers do believe in energy efficiency, inducements are necessary to convince consumers to part with their own monies to purchase energy efficiency goods and services. Market knowledge, customer trust, fast movement, flexibility and innovation by utilities knowledgeable about their local markets will be essential to be successful in completing the millions of sales transaction that are needed.[12]

---

[12] Central Hudson previously noted that: "We are in a period of consumer caution. Green may be "in," but with the *causa belli* of the housing market

CONCLUSION

Utilities should have the opportunity to establish energy efficiency businesses based on fully and efficiently developing opportunities for energy efficiency in their local retail markets, with corresponding opportunities to produce contributions to the 15x15 goals and meaningful earnings for their investors commencing with the first energy (or demand) savings they produce.

Sharing between customers and the utility of the value of the net benefits produced by the utility has been used in the past and is even more appropriate now, as State policy now more strongly recognizes the value of energy efficiency (and demand) savings. Performance incentives should not be the only incentives, and, if employed, they should be grafted onto the basic compensation formula that compensates the utility for a

---

bust having begun to unmask the broad financial risks of the unregulated "shadow" banking system, and the potential for significant damage to New York's economy in particular given our strong dependence on Wall Street, together with the impending RGGI-driven increases to commodity prices, and the on-going need to repair the damage to New York's energy infrastructure caused by financial limitations over the last decade, energy efficiency is just one of the many demands competing for consumers' energy dollar."

meaningful share of the value of the social benefits its actions produce.

Dated: New York, New York
June 20, 2008

Respectfully submitted,

Robert J. Glasser

Robert J. Glasser
Thompson Hine LLP
Attorneys for
Central Hudson Gas &
Electric Corporation
335 Madison Avenue
New York, N.Y. 10017
(212) 344-5680