STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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

INITIAL COMMENTS OF THE NEW YORK STATE CONSUMER PROTECTION BOARD

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The Public Service Commission ("PSC" or "Commission") commenced this proceeding on May 16, 2007, to develop and implement an Energy Efficiency Portfolio Standard ("EEPS") to help reduce New York's electricity usage 15% from expected levels by 2015.[1] At its June 18, 2008 Public Session, the PSC approved several initiatives to be implemented immediately by the New York State Energy Research and Development Authority ("NYSERDA") and utilities, and established a process for the submittal, review and approval of longer-term energy efficiency programs to be administered by electric utilities. Pursuant to an invitation from the Commission,[2] the Consumer Protection Board ("CPB") submits these comments regarding financial incentives to be applicable to utility-sponsored initiatives.

The CPB has participated actively in all phases of this case, including working groups, technical conferences and submission of written materials. We continue to believe strongly that energy efficiency can be an extremely cost effective means for consumers to immediately reduce the burden of high energy

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1 Case 07-M-0548, Order Instituting Proceeding, May 16, 2007, p. 2.

2 Case 07-M-0548, Notice Soliciting Comments, May 30, 2008 ("May 2008 Notice").

costs. Based on discussion at the PSC's June 18, 2008 Public Session, it appears that many of our recommendations regarding the energy efficiency programs to be implemented immediately, the need for utilities to have responsibility for a portion of the State's energy efficiency goals, and the procedures and criteria to be used to evaluate energy efficiency initiatives, have been adopted by the Commission.

As to the financial incentives that are the subject of this phase of the proceeding, the CPB has testified in rate cases regarding the general framework that should be applied to energy efficiency programs administered by electric utilities. The Agency explained that financial incentives may be appropriate to achieve superior performance, but must not be so large that they jeopardize the long-term sustainability of energy efficiency efforts. They should reflect the specific circumstances of each program, including the degree to which the utility itself is creating and implementing it, the aggressiveness of the targets, and the extent of competition from other energy efficiency initiatives that may make it more difficult for the utility to achieve its goals.[3]

We elaborate on those recommendations below. In Point I, we address several threshold issues regarding the extent to which financial incentives for utility-administered energy efficiency programs should be established independent of specific program parameters, and the degree to which the Commission should retain flexibility to adjust the incentive over time. In Point II, we address each of the five questions identified in the PSC's May 2008 Notice.

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[3] E.g., Case 07-E-0523, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, TR 4699 - 4701.

I. THRESHOLD ISSUES REGARDING POLICIES FOR UTILITY INCENTIVES FOR ENERGY EFFICIENCY PROGRAMS.

The May 2008 Notice states that "the Commission intends to adopt policies related to performance incentives substantially in advance of due dates for utility proposals."[4] The CPB recognizes the importance of providing guidance to utilities in the development of their proposals, and of establishing a general framework regarding utility incentives at this time. We recommend that the Commission establish broad parameters regarding these incentives, but tailor them to specific programs and modify them over time, as warranted.

A. A Framework for Incentives Should be Adopted

The size and structure of utility incentives applicable to any specific utility-administered program for achieving energy efficiency goals, should be calibrated to the "degree of difficulty" of achieving those targets. Larger incentives would generally be appropriate for more aggressive targets, programs competing with other energy efficiency initiatives such as those administered by NYSERDA, new and innovative proposals, and measures that produce permanent, rather than temporary, energy efficiency savings. Larger incentives would also be reasonable for energy efficiency projects that demonstrably obviate the need for ratepayer-funded utility investment in the transmission and distribution network, because of the higher value of such initiatives to consumers.

The extent to which any specific energy efficiency proposal satisfies these criteria, cannot be known until after the specific initiative is identified by the utility.

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[4] May 2008 Notice, p. 1.

Therefore, we recommend that the Commission refrain from fixing rigid or formulaic policies regarding incentives at this time, and instead establish broad parameters permitting incentives to be tailored to fit the unique attributes of each utility proposal.

B. The Incentives Should be Reviewed Periodically and Subject to Revision

The Commission has established a procedure under which specific energy efficiency initiatives would be approved for a three-year period. To help ensure the long-term viability of PSC-authorized energy efficiency programs, the CPB recommends that the Commission review the appropriateness of financial incentives no less frequently than every 18 months.

Financial incentives that are set too low, may jeopardize achievement of energy efficiency goals. If too high, they will unnecessarily increase the price of energy, jeopardize consumer acceptance of utilities' energy efficiency programs, and threaten the long-term viability of the PSC's efforts. It is extremely difficult to design incentives that appropriately balance these factors, particularly since most projects to be conducted by utilities are likely to be new and untested. In addition, there is considerable uncertainty as to the appropriate targets for utility programs, particularly given the potential for consumers to undertake efficiency measures on their own without the incentive of ratepayer-funded programs, referred to as "free-ridership". That uncertainty is particularly acute at this time, because both the price of electricity and consumer awareness of the importance of energy efficiency are at all-time highs, reflecting unprecedented upheaval in

world energy markets. This suggests that historical data on free-ridership likely understates current and future levels.

Given these circumstances, the CPB recommends that the Commission review the appropriate structure and level of financial incentives for utility-administered energy efficiency programs no less frequently than every 18 months, at least during the first three-year cycle of projects.

II. RESPONSE TO QUESTIONS POSED IN THE MAY 2008 NOTICE

A. Are Financial Incentives Necessary?

The State has established a public policy goal of reducing electricity demand by 15% from projected levels by 2015. This policy has been clearly articulated by the Governor and found by the PSC to be in the public interest.[5] Moreover, utilities must provide service at just and reasonable rates,[6] and energy efficiency is a cost effective and immediate tool to fulfill this fundamental requirement. The PSC could thus require utilities to conduct energy efficiency programs without providing financial incentives, as a means to ensure just and reasonable rates.

Notwithstanding this fact, the CPB recommends that utilities be provided reasonable financial incentives to conduct energy efficiency programs. Properly constructed financial incentives can encourage utilities to identify innovative,

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[5] Order Instituting Proceeding, p. 2. ("...we find that realizing the State's energy efficiency potential and reducing New York's electricity usage 15% from expected levels by 2015 are in the public interest.")

[6] New York Public Service Law §65.

cost-effective approaches to achieving the State's energy efficiency goal, and ensure the long-term commitment of utilities to this important objective. Excessive incentives, however, would be counterproductive, since they would unnecessarily increase costs and jeopardize the commitment of ratepayers who fund the utilities' energy efficiency initiatives.

B. The Reasonableness of the Guidelines and Recommended Modifications

The May 2008 Notice includes the following eleven proposed guidelines for financial incentives regarding energy efficiency.

1. Overall Objectives

The Notice identifies two specific overall objectives of performance incentives for energy efficiency: encourage superior performance and "align utilities' financial interests with energy efficiency as a resource option."[7] The CPB has two concerns with these recommendations.

Although we recognize that utilities should be provided a reasonable financial incentive to achieve energy efficiency goals, the CPB is concerned that the proposed wording of the second objective, may lead to excessive payments to utilities. Utilities do not require a return on energy efficiency that is equivalent to the return they earn on other resource options such as new capital projects. That is because funding for energy efficiency programs will be provided entirely from ratepayers on an as-needed basis, unlike funding for massive new

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[7] May 2008 Notice, p. 2.

generation or transmission projects which must be obtained from investors in competitive capital markets. Utilities need only be provided an incentive to achieve energy efficiency goals in a cost effective manner, not an incentive that would equate the return required for other resource options such as new investment.

Additionally, the CPB recommends that a third overall objective of performance incentives in this context be included -- to assure the long-term sustainability of the PSC's ratepayer-funded energy efficiency program. Perhaps the most important lesson learned from the Commission's early 1990's efforts to promote utility-conducted energy efficiency programs, is that excessive incentives jeopardize the overall effort, even if they achieve the two objectives of encouraging superior performance and rewarding utilities. The State cannot afford a repeat of that outcome. Thus, the PSC should establish an explicit objective that its energy efficiency program be sustainable over the long-term.

2. Maximum Amount of Incentive

The May 2008 Notice seeks comment on the proposed guideline that the maximum incentive should account for "the size of the utility program portfolio target" and "should encourage improved utility performance without placing an excessive burden on ratepayers."[8] Although we do not dispute these principles, this should not be construed as the complete list of factors that should be considered in establishing the maximum incentive. As explained further in Point

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[8] Id.

I.A., the maximum incentive should also account for the "degree of difficulty" of achieving energy efficiency targets and the extent to which permanent rather than temporary energy savings are obtained.

3. Avoiding Manipulation

The design of incentives could have unintended consequences that increase program costs or decrease accomplishments. The May 2008 Notice proposes a guideline that incentives should not "induce utilities to increase program costs artificially or manipulate the program design and implementation inappropriately."[9]

The CPB supports this principle. However, the fact that utilities have an inherent incentive to be conservative in estimating both their costs and the likelihood of achieving their targets, supports the need for periodic review of their energy efficiency programs, as proposed in Point I.B. It also demonstrates the need for a thorough review and analysis of proposed programs and supporting information.

4. Positive and Negative Revenue Adjustments

Consistent with the financial incentives adopted in many other states, the May 2008 Notice suggests that the incentive formula should provide for both positive and negative revenue adjustments, the latter in the event that minimum

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[9] Id.

goals are not achieved.[10] The CPB supports this general principle. We disagree, however, with the manner in which the negative revenue adjustment would be calculated, as explained in Point II.C, below.

5. Basis for Financial Incentives

The May 2008 Notice proposes that "the effectiveness of a utility's energy efficiency program portfolio, based on measurement and verification results, should be the basis for determining revenue adjustments."[11] The CPB agrees that this should be the primary determinant of financial incentives. It is of paramount importance that actual, verified energy efficiency results, as opposed to projections, be used to determine the financial incentives applicable to utilities. However, we reiterate our recommendation that factors such as the extent to which capital investments can be avoided should be considered in setting financial incentives.

6. Threshold for Minimum Incentives

As a general matter, the CPB agrees that utilities should not be provided any financial incentive unless they achieve a high percentage, such as 80%, of the target energy savings. Financial awards are not warranted or appropriate for average or mediocre performance.

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[10] Id.

[11] Id., p. 3.

7. Primary Gauge for Incentives

The CPB also supports the premise that the primary criterion for determining the effectiveness of a utility's energy efficiency programs is verified MWH savings, or for programs aimed to reduce peak demand, MW savings. These savings must be verified after the fact, not based on ex-ante projections, and must explicitly exclude "free ridership," or energy savings that would have occurred even in the absence of ratepayer-funded programs.

The Commission should also explicitly encourage initiatives that produce permanent, or long-lived energy efficiency, as opposed to temporary measures that can be easily reversed. For example, measures that replace inefficient heating equipment or add insulation, are difficult to reverse and will produce recurring energy savings. In contrast, changing the setting on a thermostat may only yield temporary savings. The former will yield longer lasting benefits and are more valuable to consumers and the environment than the latter.

8. Applicability of Incentives

The May 2008 Notice states that incentives "should be calculated over aggregated portfolio performance rather than by specific programs."[12] The CPB agrees. This approach will encourage utilities to put more effort into a holistic program rather than focus on a few initiatives.

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[12] Id.

9. Incentives for NYSERDA-Administered Programs

The May 2008 Notice proposes that utilities not be provided incentives for programs in which they transfer funds from ratepayers to NYSERDA.[13] The CPB urges the Commission to adopt this guideline as a presumption that may be rebutted in specific circumstances. Although reasonable as a general rule, it is conceivable that an incentive may be warranted for an outstanding accomplishment of compiling, analyzing and sharing customer-specific information to enhance the effectiveness of energy efficiency programs administered by NYSERDA.

10. Consistency of Principles Statewide

The May 2008 Notice proposes that principles regarding incentives for energy efficiency programs should be applied in a consistent fashion to similarly-situated utilities.[14] Although reasonable as an overall principle, the Commission should recognize that differences in factors including the parameters of energy efficiency proposals, regional electricity prices and impacts on local transmission and distribution investment, may warrant differences in the structure and size of incentives among specific energy efficiency projects.

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[13] Id.

[14] Id.

11. Role of Incentives in Cost Estimates

This guideline would require that the cost estimates for energy efficiency projects to be administered by utilities, include projected financial incentives that assume achievement of program targets. This is a fundamental principle that is required to assure that the most cost-effective energy efficiency programs are selected, and specifically, that utility-administered initiatives are properly assessed and compared with NYSERDA-administered programs, for which financial incentives are generally inapplicable.

C. Other Specific Issues Not Encompassed Within the Guidelines

The CPB recommends that the proposed guidelines in the May 2008 Notice be revised to include two additional provisions to protect ratepayers. First, the PSC should explicitly confirm that financial incentives will not be provided for "free-riders," since those consumers would produce energy savings even without utility-sponsored programs. Spending ratepayer funds to obtain energy savings that would otherwise have been available, is wasteful and jeopardizes the long-term viability of the program.

The CPB also recommends a new principle to reassure ratepayers who will be expected to fund these programs for the foreseeable future that all programs are cost effective. Specifically, we propose that under no conditions, should ratepayers be required to fully fund programs not delivering benefits that are at least equal to their costs. Should the measurement and evaluation results indicate that program costs exceeded benefits, utility shareholders would be

obligated to fund the shortfall. This principle should be reflected in the methodology for determining the negative revenue adjustment that would be applicable in the event that minimum goals are not achieved. It will further increase ratepayer confidence in, and support for, utilities' energy efficiency initiatives.

D. The Strengths and Weaknesses of Three Incentive Models

The May 2008 Notice identified three proposed incentive models and invited comments on each. The CPB's comments and concerns regarding the first of those approaches -- the guidelines identified in the May 2008 Notice -- are explained in Points II.B and C.

1. California Model

Under the "Shareholder Risk/Reward Incentive Mechanism" adopted by the California Public Utility Commission ("CPUC") in 2007, the net benefits of energy efficiency projects are calculated by deducting investment costs from energy savings. If the utility achieves 100% of its energy savings goals, it can retain 12% of the net benefits. Utilities begin to retain net benefits if they meet 85% of energy efficiency goals, and are penalized if they obtain 65% or less of

savings goals. Overall, the financial incentive assuming utilities meet their goals is equivalent to approximately 15% of total program costs.[15]

For the reasons identified below, the California model should not be adopted by the PSC.

a. The Relevance of California vs. Other States

The May 2008 Notice contains no explanation or suggestion as to why the approach to utility incentives for energy efficiency programs taken by the CPUC should be adopted in New York. A study conducted by the American Council for an Energy-Efficient Economy ("ACEEE") found at least 25 states with "serious" utility ratepayer-funded energy efficiency programs -- defined as programs that attempt to achieve measurable energy savings including providing tangible incentives to customers.[16] The Commission should consider the decisions made by utility commissions in all other states, particularly those with similarly structured energy industries.

Of the 25 states discussed in the ACEEE Report, California provides the largest financial incentive, measured as a percentage of program costs. Moreover, according to that Report, of the sixteen states that have energy

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[15] Total program costs in the first cycle are estimated to be $2.2 billion. If utilities achieve 100% of program goals, they can retain $323 million. CPUC Order Instituting Rulemaking to Examine the Commission's post-2005 Energy Efficiency Policies, Programs, Evaluation, measurement and Verification, and Related Issues, Decision 07-09-043, September 20, 2007 ("CPUC Order"), pp. 10 – 11.

[16] Aligning Utility Interests with Energy Efficiency Objectives: A Review of Recent Efforts at Decoupling and Performance Incentives, Report Number U061, October 2006, ("ACEEE Report"), p.7.

efficiency programs administered by the utilities, six have no shareholder incentive mechanisms at all.[17]

We urge the PSC to consider the size of incentives in other states relative to the effectiveness of those energy efficiency programs, before adopting a policy for New York.

b. The California Approach is Inapposite

The cornerstone of the model adopted by the CPUC is that incentives for energy efficiency need to be comparable to the earnings that utilities could obtain from supply-side investments, such as electricity generation, which includes debt service and return on equity. This approach was developed in the early 1990's, consistent with California's 2003 Energy Action Plan, which states that the CPUC should "provide utilities with demand response and energy efficiency investment rewards comparable to the return on investment in new power and transmission projects."[18] The CPUC concluded that this methodology is relevant today, "now that investor-owned utilities have been returned to the role of managing both supply-and demand-side resource procurement on behalf of their ratepayers."[19]

In the CPUC's proceeding on incentive awards for energy efficiency measures, several parties argued that the California Commission should consider the ACEEE Report, which found that many states offered financial

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[17] Id., p. 9. The Report indicates that seven states have no shareholder incentive mechanisms. However, since that Report was issued, California adopted shareholder incentives.

[18] California Energy Action Plan, 2003, action item #6, p. 5, cited by CPUC in Decision 07-09-043, September 20, 2007, p. 65.

[19] CPUC Order, p. 66.

incentives in the range of 5% of program costs, far less than those then being considered, and ultimately adopted, in California. In response, the CPUC stated:

> The ACEEE report...reviewed energy efficiency incentives after electric restructuring, during which time incentive rates for those states that still retained energy efficiency incentive mechanisms were observed to decline considerably....A survey of other state's energy efficiency incentives would have looked much different if [it] had considered the incentive rates in place prior to electric restructuring, when investor-owned utilities across the country managed resource portfolios as our California investor-owned utilities do again today.[20]

Just as the CPUC has found that financial incentives adopted in states in which the energy industry has been restructured are inapplicable in California, the incentives adopted by the CPUC are inapposite in New York, where the utility industry has been restructured with competitive generation and retail markets. Utilities in New York are precluded from investing in new generation under most circumstances. Accordingly, there is no need to adopt financial incentives for energy efficiency in New York, that are equivalent to profits that utilities could earn from investments in generation.

c. Incentives in Other States with Restructured Energy Industries

The financial incentives for ratepayer funded energy efficiency adopted in states where the energy industry has been restructured, provide a relevant point of comparison for the PSC. According to the ACEEE Report, as summarized

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[20] Id., 81.

below, those states provide incentives averaging 5.6% of total program costs.[21] In particular:

- Massachusetts - "provides an opportunity for companies to earn about 5% of program costs as an incentive for meeting established program goals."[22] The Massachusetts Department of Telecommunications and Energy reasoned that an incentive of 5% balances the two objectives of promoting effective programs and protecting the interests of ratepayers.[23]
- Connecticut - "For reaching 100% of goals the incentive would be 5%."[24]
- New Hampshire - "Separate target incentives are set for residential and commercial/industrial sectors -- each set at 8% of the total program and evaluations budgets for each sector."[25]

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[21] It is important to note that some restructured states provide no financial incentives, as explained above.

[22] ACEEE Report, p. 27.

[23] Joint Petition of Massachusetts Electric Company and Nantucket Electric Company, pursuant to F.L. c. 25, § 19, G.L. c. 25 A, § 11G, and G.L. c. 164, § 17A, for approval by the Department of Telecommunications and Energy of its 2003 Energy Efficiency Plan, including a proposal for financial assistance to municipal energy efficiency projects, D.T.E., 03-2, September 16, 2003, p. 16.; Joint Petition of Massachusetts Electric Company and Nantucket Electric Company, pursuant to F.L. c. 25, § 19, G.L. c. 25 A, § 11G, and G.L. c. 164, § 17A, for approval by the Department of Telecommunications and Energy of its 2006 Energy Efficiency Plan, D.T.E./D.P.U. 06-34, May 2, 2007.

[24] ACEEE Report, p. 25.

[25] Id., p. 31.

- Rhode Island – "The target incentive rate for the kWh savings goal is 4.4% of the eligible spending budget."[26]

Two major utility holding companies with New York operations, National Grid and Energy East, currently conduct energy efficiency programs in those New England states. The PSC should take note of the ability of these utilities to provide cost-effective energy efficiency services with incentives in the range of 5% of total program costs.

Overall, the CPB recommends that the PSC consider that according to the ACEEE Report, six states have utility ratepayer-funded energy efficiency programs with no financial incentives, and the incentives in states in which the industry has been restructured, average 5.6%. These facts are much more relevant to New York than the total incentives recently ordered in California.

2. DPS Staff Proposal

The May 2008 Notice invites comment on a DPS Staff proposal that was outlined in a previous submission. Three tiers of incentives would be created, depending on the percentage of program goals that were achieved. Under that approach, 5% of the program budget would be available for achieving energy efficiency targets, and up to 12% for exceeding those goals. Utilities achieving less than 60% of program goals would be subject to a "negative revenue adjustment" of one-third of the maximum incentive.

Although the overall framework of this approach is reasonable, the CPB has concerns with some specific elements. First, although we recommend that a

[26] Id., p. 32.

maximum incentive be specified, the 12% level proposed by DPS Staff, which would be applicable upon achievement of 112% of program goals, is excessive. Permitting a utility to obtain 240% of the 5% target incentive, for achieving only 12% above target levels, appears overly generous to shareholders at the expense of ratepayers. In the CPB's view, the maximum incentive, energy efficiency targets and energy savings at which the maximum incentive would be earned should be determined only in the context of a specific proposal, as explained in Point I.

The CPB also calls for an additional requirement that only utility programs delivering benefits that are at least equal to the costs of the program, are to be fully funded by ratepayers. Any shortfall of the realized benefits from actual costs should be funded by utility shareholders. This recommendation is explained further in Point II.C.

E. The Appropriate Range of Incentive Levels

The CPB recommends that the PSC adopt financial incentives for utilities achieving 100% of their energy efficiency goals, in the range of 5 – 6% of program costs, the level adopted by public utility commissions in other states with restructured energy industries. Utilities achieving superior performance should receive larger awards, based on specific circumstances identified herein.

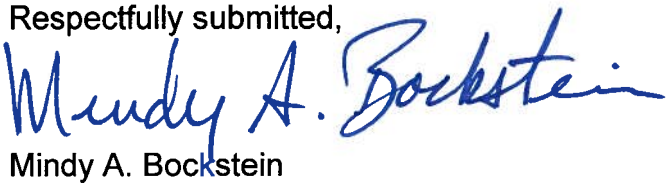
Financial incentives for utility shareholders in this range are reasonable in view of the fact that ratepayers will pay 100% of energy efficiency portfolio costs, including labor costs, administrative overheads, and rebates and/or subsidies

associated with the energy efficiency programs. In addition, ratepayers will make the utility whole for any revenue shortfall resulting from energy efficiency through revenue decoupling mechanisms. Since shareholders do not fund any energy efficiency costs and are insulted from the risk of associated revenue reductions, equity demands that ratepayers obtain the vast majority of the benefits from energy efficiency programs.

CONCLUSION

The Consumer Protection Board urges the Public Service Commission to adopt the recommendations identified herein.

Respectfully submitted,



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Dated: Albany, New York
June 20, 2008