

**STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION**

**Case No. 07-M-0548 – Proceeding on Motion of the Commission  
Regarding an Energy Efficiency Portfolio Standard**

**Comments by the City of New York**

**June 20, 2008**

## **I. Introduction**

The City of New York (“City”) hereby comments on the issue of performance-related incentives for utilities participating in energy efficiency programs. Public comments were solicited in a Commission Notice issued in the above-captioned proceeding on May 30, 2008. The Notice sought views on the advisability of the use of financial incentives based on the degree to which utilities performed in achieving goals to be established by the Commission, and also noted the Commission’s intent to adopt relevant performance incentives substantially in advance of the dates to be established for utility proposals concerning efficiency measures. The Notice set out a number of specific topic areas for comment, and also referenced a series of performance incentive guidelines derived from the views of the Advisory Staff as expressed at various times during the development of the record in the Energy Efficiency Portfolio Standard proceeding.

As the Commission has asserted in its most recent public session, there must be a prominent role for the regulated utilities in the development of any effective and comprehensive efficiency program – a role that is distinct from the parallel NYSERDA programs, but one that also permits and encourages coordination and complementary activities that will best utilize the respective strengths of NYSERDA and those of the investor-owned utilities. There will need to be a concerted effort involving all parties capable of delivering large-scale efficiency programs, and that effort will of necessity mean significant utility participation.

## **II. Form and Structure of Utility Performance Incentives**

The City strongly supports the development of performance incentives for the utilities, and does not join in the view that has been expressed in some quarters that utility-

related incentives are inappropriate or wasteful of efficiency program funds. The City position is that a properly designed incentive structure will markedly enhance the effectiveness and breadth of efficiency program offerings, and for that reason, associated incentive expenses will prove to be money well spent in achieving far greater penetration than that which we have seen in New York across a number of market sectors in recent years. In short, to answer the first question posed in the Notice, whether incentives are necessary, the City reply is a distinct yes. It would clearly be a form of false economy to deny a utility incentive program as a step that would reduce overall expenditures, if such a course also sharply reduced the likelihood of success in any program as far-reaching as that embodied in the State's 15 x 15 goal. Any program cost-effectiveness assessment will need to consider the expenses associated with utility incentives. However, ignoring the potential benefits of vigorous company involvement spurred by an effective incentive mechanism would clearly bias such an analysis.

The principal basis for awarding utility performance incentives should be lifetime net resource benefits. Utility incentives should be developed as a percentage of the expected economic savings associated with an efficiency program portfolio, and projected over the expected lifetime of the measures installed. This approach is the one best calculated to be both equitable and understandable. Moreover, it largely avoids the pitfalls of dealing with elaborate metrics and finely parsed incentive schemes.

### **III. Incentive Guidelines**

Concerning the Incentive Guidelines proffered in the Notice, the City makes the following observations:

Performance incentives should include an opportunity for regulated utilities to earn financial benefits for the successful implementation of programs that meet or exceed targets. In addition, the incentive regime should contain symmetrical or at least roughly proportional disincentives for poor performance in meeting pre-established efficiency goals. This element of balance was cited by Staff in its submission of April 10, 2008, at page 18, and the City agrees with that proposition. A disincentive structure, whether it is characterized as revenue reduction or adjustment, should help focus the attention of program administrators on achieving targets in much the same manner that affirmative incentives will.

The City also agrees with the principles espoused by Staff in the same document concerning ease of program administration, and the need for transparency in program design. In particular, as mentioned above, the City strongly cautions against the use of highly complicated or finely calibrated incentive or disincentive structures. Their very complexity, while perhaps superficially appealing, will in the City's view ultimately prove unworkable, and will give rise to program goals and targets that prove to be illusory, with the accompanying potential to discourage desirable energy saving behavior.

DPS Staff cited an example of such a program structure in California. Aside from appearing to be highly complex, it is also in the City's view is far too rich in incentives to serve as a model for New York.<sup>1</sup> For their three-year administration of California's \$1.9 billion energy efficiency portfolio, that state's investor-owned utilities were eligible for up to

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<sup>1</sup> See Staff Report of November 27, 2007, at p. 19, discussing a 227-page California Public Utilities Commission decision addressing efficiency program incentives and penalties.

\$450 million if they reached 150% of net resource benefit goals set by the PUC. This is some 23% of the entire portfolio budget.<sup>2</sup>

Staff has also made note of the highly detailed evaluation protocols and the high evaluation costs (approximately 8% of the total program budget) in the California program.<sup>3</sup> Those elements are in the City's view a product of an efficiency program that seeks far too much precision – or the impression of precision. An approach such as that taken by California's is not well considered. Whatever the strengths of that state's program – and they are considerable – it should not be replicated in New York.

Clear incentive signals are more important than a very elaborate incentive schedule, especially in the early years of utility DSM programs and shareholder incentives. Once DSM program design and evaluation has become more established, the Commission can consider adding greater complexity to the incentive structure. But in the near term, incentives are far more likely to gain the commitment of utility management to a robust efficiency program if they are simple, readily understood, and not subject to gaming. In addition, as was noted by NRDC/Pace/AEA in their comments herein (at page 3) and also by others, while a sound revenue decoupling mechanism will bring a utility to a position of neutrality concerning DSM measures, it will take a combination of well-designed and clearly articulated efficiency incentives and disincentives to truly focus corporate attention on demand reduction efforts.

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<sup>2</sup> Excluding evaluation, monitoring, and verification (EM&V) Source for \$450 million 3-year incentive award cap: California Public Utilities Commission. Attachment to D 07-09-043. September 20, 2007 <http://docs.cpuc.ca.gov/published/GRAPHICS/73174>. PDF: page 6. Source for 2006-2008 IOU budgets with and without EM&V: California Public Utilities Commission, D0506043 Tables and Attachments, September 22, 2005: <http://docs.cpuc.ca.gov/published/Graphics/49863.PDF>: pages 7-8, 40, 57-59.

<sup>3</sup> Initial Staff Brief on Bridging Programs, at p. 24 (April 10, 2008)

As the Guidelines suggest, there is an inherent degree of tension between generous incentives and the burden placed on ratepayers.<sup>4</sup> Consideration of this topic should not be too short-term in nature – effective energy efficiency programs will reduce the amount of energy and capacity required by participants and also benefit all energy consumers by allowing deferral of utility investments and reducing market prices to the extent that the efficiency programs in question are successful in lowering peak system demand, and thereby realizing a lower ultimate cost to ratepayers.<sup>5</sup>

Concerning Guideline 3 and opportunities for gaming, the City is largely in agreement with the expressed Staff view. One of our concerns mentioned above regarding elaborate incentive schemes is the risk that they will permit parties to manipulate numbers or program expenditures in order to reach a finely tailored result that may not reflect the true benefits of the program in question. We caution, however, that there will be at the outset in any greatly expanded program a necessary period of experimentation. Mature efficiency programs with known or predictable results should therefore not be treated identically to those efforts that are entirely novel or untested. There should be sufficient latitude built into program design to permit the use of innovative approaches to efficiency achievement challenges without giving rise to a legitimate concern that new and untried efforts run the risk of sacrificing valuable incentives.

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<sup>4</sup> The direct costs of the efficiency program result in real and obvious bill savings to participants, while increasing rates. Shareholder incentives increase rates and only decrease ratepayers' costs to the extent the incentives actually encourage additional efficiency.

<sup>5</sup> Due to the large amount of gas used in electric generation, efficiency in electric use will tend to reduce wholesale gas prices and efficiency in gas use will tend to reduce wholesale electric prices, in addition to the direct effect of reduction in either type of energy use on its own price.

It is for this reason that the City believes that Staff scrutiny and oversight, and periodic process and effectiveness checks, will constitute necessary elements of any effective efficiency program. And a distinct role should be established for active participation by various other stakeholders, including the City of New York, to provide their perspective to DPS Staff and to the Commission on actual program design and execution.<sup>6</sup>

Concerning Guidelines 4-6, the City has already noted its agreement on the need for both positive and negative revenue adjustments. While there may well be an appropriate place for broadly scaled incentives and disincentives in order to foster greater efforts to realize goals, we continue to caution against a formula that is too finely drawn. Such an approach creates the risk of protracted debate and potential litigation over precisely where on an elaborate spectrum of incentives/disincentives a particular program administrator should be placed. The likelihood of distraction from the actual underlying purposes of an efficiency program becomes too great under such circumstances, and that prospect should be avoided to the extent possible in program design.

The City would modify Guideline 6 concerning the “high percentage” goal to include such phrasing as: “considering achievable potential, relative size of the DSM responsibility placed on the utility, and the overall maturity of the utility program, before realizing....” These factors, particularly the latter, should be incorporated in the goal setting process, as a new and untried program will as noted above require somewhat more latitude. We are otherwise in accord with the view expressed in Guideline 6 that a relatively high percentage of a utility target result must be achieved before a positive revenue adjustment should apply.

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<sup>6</sup> The New York City Partnership proposal of that was preliminarily accepted with certain modifications in the ALJs’ Straw Proposal is a prime example of a vehicle that is designed for this purpose, and should ultimately receive favorable consideration in this case.

The City suggests that such a number should be at or near 80% of the target achievement level. We also share the Staff view that an assessment of effectiveness is best made on an aggregate basis rather than looking at individual programs, except where the Commission may be concerned that the utility will ignore cost-effective programs that require greater effort, in favor of easy targets from other programs.<sup>7</sup> If close scrutiny by Staff and other parties proves insufficient to avoid these problems, the Commission can reconsider the sole use of aggregate achievements in the incentive structure.

Achievements such as 120% or more of an efficiency program goal should be rewarded with a form of supranormal revenue adjustment, and a deadband mechanism should also be employed to avoid extended microanalysis of results that could prove to be distracting and counterproductive to our larger goals. Moreover, there should be put in place a disincentive mechanism to sanction significant utility failures to reach established efficiency goals, such as at the 70% level, again with the use of a deadband to reduce the likelihood of disputes over relatively small divergences from target numbers.

Based on the discussion held by the Commission at its session in this matter on June 18, it appears that a new and independent M&V program will be established for all efficiency programs to be administered by NYSERDA and by the utilities. To the extent that occurs, the overarching M&V program will presumably address any necessary verification requirements in the utility incentive programs, and importantly will do so in a fashion that permits a fair assessment of the effectiveness of utility programs and NYSERDA programs alike.

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<sup>7</sup> This would be particularly problematic if the neglected programs were those for low-income customers or lost opportunities.

Concerning Guideline 7, the City would suggest consideration of Total Resource Cost (“TRC”) net benefits as a primary gauge, with the MW or MWh savings (or a natural gas analogue in MMBtu) cited in the proposed Guidelines included as a secondary consideration. While the two concepts are of course related, Guideline 7 as presently stated fails to fully incorporate the critical element of cost. Thus, greater MWh savings associated with a particular efficiency measure will materially affect the TRC score associated with that measure – but so too will the costs associated with that measure or program, as well as the load shape and load factor of the savings.

Moreover, as Staff has previously recognized, additional criteria will need to be incorporated for such programs as low income-centered efforts, toward which the Commission has historically shown both solicitude and flexibility, as illustrated in the differential treatment allowed for low income programs under traditional TRC analysis. The same is true for peak reduction measures – simply examining raw numbers of megawatts or megawatt hours saved will fail to capture the real value of an efficiency program that is explicitly intended to effect peak savings. Thus, some form of weighting or the addition of “plus factors” would be needed to fairly measure the additional system benefits that flow from such peak shaving measures. A pure focus on MW or MWh will not be a fully or accurately reflect efficiency program value.

Guideline 8 the City has no quarrel with, but we do differ to some degree on the proposition stated in Guideline 9 that incentives should not be available for utilities that are transferring ratepayer funds to NYSERDA. As a purely straightforward proposition, that principle may suffice, but only if there is truly no utility effort involved in a given program. However, the City suggests a more nuanced approach be employed – one that examines the

actual involvement and effort of the utility in programs even if they are principally managed by NYSERDA. For example, to the extent that the utilities provide NYSERDA with material assistance in the form of marketing, enhancement of public awareness of the program in question, or in facilitating delivery of efficiency measures, such activities should be financially encouraged. The financial inducement to a utility in such a situation may need to be reduced to recognize the primary role of NYSERDA, but the utility incentive applied should not be negligible.

All of the foregoing discussion concerning the need for appropriate incentives is in essence an attempt to recognize that in the inevitable corporate competition for time, effort and diligence in pursuing myriad priorities, efficiency programs will only become the imperative that we need them to be if there are financial inducements established that are commensurate with the utilities' level of involvement in efficiency initiatives, whether serving as the primary provider or in a support role.

#### **IV. Assessment of Advisory Staff Model**

The City has already made note at page 3 herein of its belief that lifetime net resource benefits should be the touchstone for determining the basis for determining the incentives that should be associated with a given efficiency measure.

For this reason, the City's takes exception to the suggestion in the Notice herein that incentive levels should constitute a percentage of program costs.<sup>8</sup> There is no necessary relationship between overall program cost and incentive levels, and the Commission would be well advised not to create one. It is not even clear how one would express a percentage of

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<sup>8</sup> See discussion in Illustration of Advisory Staff Model at pages 3-4 of the Notice herein issued on May 30, 2008.

program costs in the traditional form of equity basis points, particularly if done on a statewide basis. And even if undertaken, such a methodology would by its nature fail to take into account the variability between modest and incremental programs, and more aggressive or far-reaching ones. The latter would presumably be expected to have a higher yield, and on that basis would be justifiable. The mechanical use of program cost basis would permit no such modulation of incentive mechanisms, and should not be adopted.

Similarly, the proffered incentive curve structure appears to contain some unexplained anomalies. Under its terms, moving from a 59.99% to 60% goal achievement would eliminate a significant utility penalty and moving from 79.99% to 80% would result in a significant incentive, which could lead to enormous arguments over estimating the critical \$1,000 or so of benefits.<sup>9</sup> In contrast, there is no additional inducement to make the much larger leap from 61 to 80%, and the incentive appears to be flat in the 100-101% and 110-111% ranges.

This critique is not to suggest that a perfectly articulated incentive scale could be developed by the City or any party. Rather, our contention, as previously discussed herein at page 6, is a more central one: it is a mistake to create, as California evidently has, an elaborate and finely honed spectrum of incentive levels. That approach is far too cumbersome, and too subject to gaming and extended disputes over the exact incentive levels that should apply. Moreover, such a course would give rise to a false aura of precision that cannot be realized in practice, at least not without enormous consumption of time and resources by all parties involved, including both regulatory staff and utility personnel. The mechanism would be much simpler and less contentious if the incentive rises smoothly, such

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<sup>9</sup> The California incentive mechanism has the same problem.

as 5% of TRC benefits from 80% of target to 100%, plus 10% of benefits between 80% and 110%, and 15% over 110%.<sup>10</sup> In this model, if the target is \$100M in TRC benefits, the incentive at 95% would be  $5\% \times (\$95M - \$80M) = \$750,000$ , at 100% it would be  $5\% \times (\$100M - \$80M) = \$1M$ , and at 105% it would be  $\$1M + 10\% \times (\$105M - \$100M) = \$1.5M$ . Any incremental \$1,000 in net benefits would result in an incremental incentive of \$50 to \$150, rather than the millions of dollars at stake in the Advisory and California models.

As the Commission has implicitly recognized in its preliminary EEPS budget announcement of June 18<sup>th</sup>, existing efficiency programs will not be adequate to meet the imperatives of the State's 15 x '15 goal. A prominent position for utility efficiency programs will have to be created in relatively short order to augment and complement parallel NYSERDA efforts.<sup>11</sup> There is thus a recognized need to do far more than has been accomplished to date, and that heightened effort must be made by all concerned parties, including the utilities. An effective utility incentive program is critical to achieving that goal.

## V. Conclusion

The City urges that the positions of the City of New York expressed in the foregoing discussion be adopted in the creation of utility incentives associated with energy efficiency programs.

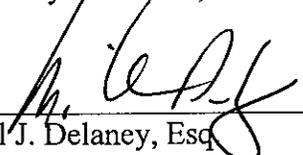
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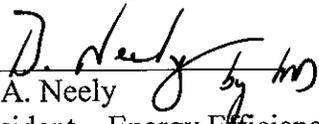
<sup>10</sup> These values are simply illustrative.

<sup>11</sup> This conclusion is reflected both in the announced initial program budget numbers in the latest Commission session, and in the directive to both NYSERDA and the regulated utilities to submit comprehensive plans within 90 days for efficiency programs beyond those apportioned between the two principal program administrators on June 18.

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Respectfully submitted,

  
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Michael J. Delaney, Esq.  
Director – Energy Regulatory Affairs  
NYCEDC  
110 William Street, 4<sup>th</sup> Floor  
New York, New York 10038  
Phone: (212) 312-3787  
E-mail: [mdelaney@nycedc.com](mailto:mdelaney@nycedc.com)

  
\_\_\_\_\_  
Bridgett A. Neely  
Vice President – Energy Efficiency  
NYCEDC  
110 William Street, 4<sup>th</sup> Floor  
New York, New York 10038  
Phone: (212) 312-3938  
E-mail: [bneely@nycedc.com](mailto:bneely@nycedc.com)