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June 20, 2008

VIA HAND DELIVERY

Hon. Jaclyn A. Brilling
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223

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

Dear Secretary Brilling:

Pursuant to the Notice Soliciting Comments ("Notice") issued on May 30, 2008 in the above-referenced proceeding, Multiple Intervenors, an unincorporated association of over 50 large industrial, commercial and institutional energy consumers with manufacturing and other facilities located throughout New York State, hereby submits for filing the original and five copies of the Initial Comments of Multiple Intervenors on Incentive Issues.

In accordance with the Notice, copies of the enclosed Initial Comments are being served electronically on all parties via the "List Serve" established for this proceeding.

Respectfully submitted,

MULTIPLE INTERVENORS

Michael B. Mager

Michael B. Mager

MBM/cgw
Enclosures
cc: ALJ Eleanor Stein (via Hand Delivery & E-Mail; w/enc.)
ALJ Rudy Stegemoeller (via Hand Delivery & E-Mail; w/enc.)
Paul Agresta, Esq. (via Hand Delivery & E-Mail; w/enc.)
Active Parties (via E-Mail; w/encs.)
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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 MULTIPLE INTERVENORS
ON INCENTIVE ISSUES**

Dated: June 20, 2008

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PRELIMINARY STATEMENT

Multiple Intervenors, an unincorporated association of over 50 large industrial, commercial and institutional energy consumers with manufacturing and other facilities located throughout New York State, hereby submits its Initial Comments on Incentive Issues in Case 07-M-0548, which is examining the design and the implementation of an energy efficiency portfolio standard ("EPS") in New York State.[1] Multiple Intervenors' Initial Comments are submitted in response to the Notice Soliciting Comments ("Notice"), which was issued in this proceeding on May 30, 2008 by the New York State Public Service Commission ("Commission").

In the Notice, the Commission indicates that it intends to "initiate a process for the submittal, review and approval of proposed energy efficiency programs to be administered by electric utilities." (Notice at 1.) That process raises issues as to: "Whether, and to what extent, financial incentives based on the extent to which performance exceeds or falls short of targets should be established prior to the submittal of proposals by utilities." (Id.) The Commission intends to provide guidance to utilities with respect to incentive issues prior to the due dates for utility-sponsored efficiency program proposals. (Id.)

To facilitate the consideration of incentive issues, New York State Department of Public Service ("DPS") Advisory Staff prepared a set of general guidelines for incentives ("Guidelines") and a model that would implement the Guidelines ("Model"), both of which are set forth in the Notice. (Id. at 2-4.) The Commission solicits comments from interested

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[1] Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard.

parties on incentive issues, including those raised by: (a) the Advisory Staff Guidelines and Model; (b) proposals advanced previously in this proceeding by DPS Trial Staff; and (c) the "Shareholder Risk/Reward Incentive Mechanism" adopted by the Public Utilities Commission of the State of California ("California PUC") in September, 2007 (hereinafter, the "California Model").[2]

Multiple Intervenors opposes the provision of financial incentives to utilities for implementing energy efficiency programs. Such incentives: (a) are not necessary to induce compliance with Commission policy; (b) would increase further the already-substantial cost of an EPS to customers; and (c) are highly susceptible to "gaming" that, in all likelihood, cannot be regulated effectively, thereby undermining any potential usefulness. If, arguendo, the Commission adopts utility financial incentives over Multiple Intervenors' objections, such incentives should be very limited in magnitude and conform with many – but not all – of Advisory Staff's Guidelines.

Multiple Intervenors' Initial Comments are organized into four sections. In Point I, Multiple Intervenors advocates in opposition to utility financial incentives. In Point II, Multiple Intervenors comments on Advisory Staff's Guidelines and Model. In Point III, Multiple Intervenors comments on Trial Staff's incentive proposals. Finally, in Point IV, Multiple Intervenors comments on the California Model.

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[2] See California PUC Rulemaking 06-04-010, 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, Interim Opinion on Phase 1 Issues: Shareholder Risk/Reward Incentive Mechanism for Energy Efficiency Programs (issued September 25, 2007).

ARGUMENT

POINT I

CUSTOMERS SHOULD NOT BE FORCED TO FUND FINANCIAL INCENTIVES FOR UTILITIES TO ADMINISTER ENERGY EFFICIENCY PROGRAMS IN COMPLIANCE WITH AN EPS

One of the issues identified for resolution in the Notice is: "Whether … financial incentives based on the extent to which performance exceeds or falls short of targets should be established …." (Notice at 1.) For the reasons set forth below, Multiple Intervenors opposes the provision of financial incentives to utilities for implementing energy efficiency programs. Such incentives: (a) are not necessary to induce compliance with Commission policy; (b) would increase further the already-substantial cost of an EPS to customers; and (c) are highly susceptible to "gaming" that, in all likelihood, cannot be regulated effectively, thereby undermining any potential usefulness.

A. Financial Incentives Are Not Necessary to Ensure Utility Compliance with Commission Policy

The Commission possesses broad jurisdiction over utilities. See, e.g., N.Y. Pub. Serv. Law §§ 5, 66. In instituting this proceeding, the Commission determined 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."[3] Given the broad purview of its authority and the above determination, the Commission, if it chooses, simply can direct the State's utilities to administer and/or facilitate efficiency programs. There is no

[3] Case 07-M-0548, supra, Order Instituting Proceeding (issued May 16, 2007) at 2.

compelling reason why utilities must be "bribed" by the promise of financial incentives to ensure compliance with Commission policy.

The Commission's jurisdiction encompasses the sale and the distribution of electricity and gas, as well as the corporations that operate electric and gas plant. N.Y. Pub. Serv. Law § 5(1)(b). In fact, the Commission possesses "general supervision of all gas corporations and electric corporations ...." Id., § 66(1). The Commission also is empowered explicitly to encourage "the conservation of natural resources." Id., § 5(2). Thus, as part of an EPS, the Commission can direct utilities to administer, or facilitate, the implementation of efficiency programs. Indeed, inasmuch as utilities presumably would be authorized to recover program costs and lost revenues (the latter through revenue decoupling or alternate mechanisms), adoption of this approach would not involve a "taking" of property from utilities, nor should there be a financial disincentive to comply with an EPS.

In its regulation of utilities, the Commission evaluates routinely, and modifies periodically, the responsibilities assigned to utilities. For instance, in Case 04-M-0159, the Commission imposed new requirements on utilities to engage in stray voltage testing of electric facilities.[4] In that circumstance, the Commission found that it was in the public interest to direct utility action in furtherance of public safety. The Commission did not find

[4] Case 04-M-0159, Proceeding on Motion of the Commission to Examine the Safety of Electric Transmission and Distribution Systems, Order Instituting Safety Standards (issued January 5, 2005) and Order on Petitions for Rehearing and Waiver (issued July 21, 2005).

it necessary to offer financial rewards for utility compliance with the new requirements.[5] In fact, the Commission established financial penalties to address possible noncompliance.[6]

In Cases 01-E-0680 and 01-E-1628, the Commission directed New York State Electric & Gas Corporation ("NYSEG") to enter into flex-rate contracts with two customers, over the utility's objections.[7] In those circumstances, the Commission found that it was in the public interest to direct utility action in furtherance of economic development. The Commission did not find it necessary to offer financial rewards for utility compliance and, in fact, directed the commencement of an enforcement action against NYSEG to ensure compliance, and also threatened the utility with a penalty action for noncompliance.[8] The

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[5] Id.

[6] Id.

[7] Cases 01-E-0680, Nucor Steel Auburn, Inc. – Complaint Seeking Resolution of a Dispute with New York State Electric & Gas Corporation Regarding Application of Tariff Rates, Order Directing Flex Rate Contract Negotiations and Providing for Interim Relief (issued November 2, 2001), Order Clarifying Mechanism for Recovery of Lost Revenues Associated with a Flexible Rate Contract (issued November 29, 2001), Order Directing Entry Into a Flex Rate Contract (issued March 25, 2002), Order Denying Rehearing and Stay and Authorizing an Enforcement Proceeding (issued May 23, 2002), and 01-E-1628, In the Matter of Electric Service at a Potential Manufacturing Facility to be Constructed in New York by Corning Incorporated, Order on Flex Rate Contract Negotiations (issued October 31, 2001), Order Directing Entry Into a Flex-Rate Contract (issued April 2, 2002), Order Denying Rehearing and Stay and Authorizing an Enforcement Proceeding (issued May 23, 2002).

[8] Cases 01-E-0680, supra, Order Denying Rehearing and Stay and Authorizing an Enforcement Proceeding at 20; 01-E-1628, supra, Order Denying Rehearing and Stay and Authorizing an Enforcement Proceeding at 18.

Commission's rulings in those proceedings were affirmed by the New York State Supreme Court and the Appellate Division.[9]

Thus, the Commission can direct the State's utilities to administer and/or facilitate the implementation of efficiency programs. There is no requirement that financial incentives be made available to utilities for complying with Commission policy.

B. Financial Incentives Would Increase the Cost of the EPS to Customers

Multiple Intervenors is extremely concerned about the possible cost of the EPS to customers. As detailed below, electricity prices in New York already are extremely high and place the State at a substantial competitive disadvantage vis-à-vis other states. The EPS, as proposed, would add substantial, incremental costs to customers' existing burden, even without financial incentives being made available to utilities. Thus, in determining whether to authorize financial incentives as part of an EPS, the Commission must consider the detrimental cost impacts that such incentives would impose on customers.

According to the Energy Information Administration, which publishes the official energy statistics for the United States Government, the average electricity price in the United States for all sectors was 9.14 cents per kWh in 2007.[10] In comparison, the 2007 average electricity price in New York for all sectors was 15.35 cents per kWh, approximately

[9] New York State Elec. & Gas Corp. v. Public Serv. Comm'n, 194 Misc. 2d 467 (Albany Co. 2002), aff'd, 308 A.D.2d 108 (3rd Dep't. 2003).

[10] Energy Information Association, Average Retail Price of Electricity to Ultimate Consumers by End-Use Sector, by State (report released March 13, 2008).

68 percent higher than the national average.[11] For the year, only Connecticut and Hawaii had higher average electricity prices than New York. In fact, 23 states had average electricity prices that were less than half that of New York.[12]

Against this backdrop, proposals have been advanced in this proceeding to increase the annual System Benefits Charge ("SBC") – which already collects $175 million from customers annually – by more $300 million, reflecting a near tripling of the SBC.[13] Such proposals have not reflected, as costs, utility recovery of EPS-related lost revenues or financial incentives from customers. The adoption of utility financial incentives would increase the cost of the EPS to customers and, depending on how such incentives were designed, possibly by a significant amount.[14]

To the extent utility-administered efficiency programs are needed to supplement the ongoing efforts of the New York Energy Research and Development Authority ("NYSERDA"), the Commission is empowered to direct utility compliance with

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[11] Id.

[12] Id.

[13] On March 25, 2008, Trial Staff circulated a report recommending, at page 8, that annual collections from customers to fund the EPS in 2009 (i.e., its first full year) be set at $308.5 million. In a Straw Proposal circulated on February 13, 2008, the presiding administrative law judges proposed, at pages 7-8, annual EPS spending of approximately $327.7 million. The specific EPS program costs approved by the Commission at its June 18, 2008 session were not known to Multiple Intervenors when these Initial Comments were finalized.

[14] For instance, in its Initial Brief filed herein on April 10, 2008, Trial Staff recommended, at pages 23-31, that utilities be authorized to earn incentives of up to 12 percent of program budgets for administering energy efficiency programs in accordance with Commission policy. If, arguendo, utilities were selected to administer all of Trial Staff's recommended programs – at a proposed annual cost of $308.5 million – the potential incentives that customers could be forced to fund would exceed $37 million annually.

the EPS. Authorizing financial incentives for utilities, which are not necessary, would increase the cost of the EPS to customers at a particularly inopportune time.

C. Financial Incentives Are Highly Susceptible to Gaming

The possible creation of financial incentives for utilities to administer energy efficiency programs under the EPS would present numerous opportunities for gaming. Multiple Intervenors is concerned that such gaming opportunities cannot be regulated effectively, thereby undermining any potential usefulness of incentives.

For instance, if financial incentives are linked to the costs of efficiency programs administered by utilities, the Commission will have created a strong inducement for utilities to spend as much money as possible on programs in order to maximize potential incentives. Thus, such a design could prove very costly to customers, who are expected to fund EPS program costs, lost revenue recovery and, possibly, financial incentives.

Alternatively, if financial incentives are linked to consumption reductions, the Commission will have created strong inducements for utilities to: (a) overstate reductions achieved; and (b) understate projected reductions (i.e., to make actual performance appear stronger). The development of projected reductions, and the measurement and verification of actual reductions, is extremely labor-intensive, and relies extensively on numerous assumptions (e.g., the useful lives of all measures installed, projected energy savings resulting from measures installed, estimates of free-ridership).

The Commission should recognize that, even without financial incentives, there likely will be a sizeable bias in favor of overstating the success of efficiency programs implemented under the EPS. Whichever party is administering an efficiency program (e.g., NYSERDA, a utility) possesses a natural incentive to be perceived as having done a competent, if not superior, job. The Commission, having authorized the annual expenditure of possibly hundreds of millions of dollars of customer funds in furtherance of an EPS, likely would not want to report publicly that: (a) the consumption reductions and/or benefits realized were less than projected; or (b) the costs incurred to achieve targeted performance were more than projected. DPS Staff, having supported the design and the implementation of the EPS, and as the party likely to be charged with overseeing its administration, similarly would possess a strong incentive to report program results as favorably as possible. Outside parties, retained for measurement and verification purposes, likely will be influenced somewhat by the motivations of the parties responsible for hiring and compensating them. Thus, even with the purest of intentions, the entities most closely involved with the implementation of an EPS likely would be highly motivated to cast program results in a favorable light. The possible authorization of financial incentives for utilities only would exacerbate this bias, to the detriment of customers.

POINT II

MULTIPLE INTERVENORS' COMMENTS ON DPS ADVISORY STAFF'S GUIDELINES AND MODEL

For the reasons set forth in Point I, supra, Multiple Intervenors opposes the provision of financial incentives to utilities for implementing energy efficiency programs. If, arguendo, the Commission adopts utility financial incentives over Multiple Intervenors' objections, such incentives should be limited in magnitude and conform with many – but not all – of Advisory Staff's Guidelines. Set forth below are Multiple Intervenors' comments on Advisory Staff's Guidelines and Model.

A. Advisory Staff's Guidelines

1. Guideline No. 1

> **The overall objectives of performance incentives in the context of energy efficiency are: (1) Encourage superior performance and deter weak performance; and (2) align utilities' financial interests with energy efficiency as a resource option.**

Multiple Intervenors has no specific objections with respect to Guideline No. 1, except it notes that financial incentives should not be necessary to encourage compliance with the EPS. Additionally, the Commission should be leery about adopting financial incentives that encourage utilities to: (a) spend more money (i.e., customer money) on energy efficiency than warranted; and (b) overstate the benefits of utility-administered efficiency programs.

2. Guideline No. 2

> **The maximum amount of money available to utility stockholders from an energy efficiency incentive should account for the size of the utility program portfolio target relative to the jurisdictional goal for the utility's service territory, and should encourage improved utility performance without placing an excessive burden on ratepayers.**

Initially, it is obvious that financial incentives should not place an excessive burden on customers. What remains to be seen, however, is how such a goal can be accomplished. As detailed in Point I(B), supra, the projected cost of the EPS is likely to be substantial, and imposed on customers at a time when electricity prices in New York are approximately 68 percent above the national average, and almost half the states in the country enjoy prices that are less than half that of New York. On top of EPS program costs, utilities are likely to receive lost revenue recovery, through revenue decoupling or similar mechanisms. Such regulatory treatment almost certainly would increase electricity rates paid by customers. Thus, Multiple Intervenors submits that the impacts of the EPS, even without financial incentives, are likely to be excessive, at least for large commercial and industrial ("C&I") customers.[15] Accordingly, to the extent financial incentives are deemed necessary, they should be very moderate in magnitude.

It is not clear how linking financial incentives with a utility's share of the EPS target for its service territory would work. If the incentives are linked to the size of the utility's efficiency programs, that would encourage utilities to spend as much as possible on efficiency, to the detriment of customers and the State's competitive position. If the incentives are linked to the consumption reductions and/or benefits achieved, that would encourage utilities to overstate the reductions and/or benefits, as well as understate the projected reductions and/or benefits prior to implementation. In either circumstance, it is highly questionable as to whether DPS Staff possesses the resources to prevent such "gaming" from occurring at the expense of customers.

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[15] As Multiple Intervenors pointed out at pages 43-44 of its Initial Brief filed herein on April 10, 2008, there have yet to be any delivery rate impact analyses conducted that segregate large C&I customers from small C&I customers. Inasmuch as proposals have been advanced that would recover EPS costs on a volumetric basis, there can be little doubt that such proposals, if adopted, would have a disproportionate impact on high load factor customers, such as large C&I customers. Accordingly, until the appropriate analyses are conducted that analyze the impact of the EPS on the delivery rates of large C&I customers, the Commission has no way of knowing whether the impacts on those customers are excessive, even without the additional cost of financial incentives.

3. Guideline No. 3

The formula by which a maximum monetary incentive and intermediate monetary incentives and disincentives are calculated should not induce utilities to increase program costs artificially or to manipulate the program design and implementation inappropriately.

Multiple Intervenors agrees with the goal of Guideline No. 3. As alluded to above, however, it is not clear how any incentive mechanism would avoid creating inappropriate inducements. For instance, once the magnitude of financial incentives are linked to program costs, an inducement is created for utilities to spend as much as possible on energy efficiency to increase the potential reward. Similarly, if the magnitude of financial incentives are linked to consumption reductions and/or benefits achieved, inducements are created for utilities to overstate reductions and/or benefits, as well as understate the projected reductions and/or benefits prior to implementation.

4. Guideline No. 4

The incentive formula should provide for both positive and negative revenue adjustments.

If positive financial incentives are approved over Multiple Intervenors' objections, the incentive mechanisms implemented also should provide for possible negative revenue adjustments. Moreover, the maximum amount of potential negative adjustments should at least equal the maximum amount of potential positive adjustments.

5. Guideline No. 5

The effectiveness of a utility's energy efficiency program portfolio, based on measurement and verification results, should be the basis for determining revenue adjustments.

If financial incentives are adopted over Multiple Intervenors' objections, it philosophically makes sense to base revenue adjustments on the "effectiveness of a utility's energy efficiency program portfolio." How that "effectiveness" is measured, however, is not clear from the above guideline. That being said, due to the infinite number of ways in which program performance can be gamed, it would be critically important for any incentives to be modest in amount and calculated following rigorous measurement and verification efforts.

6. Guideline No. 6

The utility must achieve a high percentage of its target before realizing a positive revenue adjustment tied to performance.

If financial incentives are adopted over Multiple Intervenors' objections, this guideline should be adopted. Upon information and belief, utilities will (or should) be competing with NYSERDA and possibly other entities for the right to administer efficiency programs under an EPS.[16] If a utility is authorized to implement a specific program based on a benefit/cost ratio reflective of certain projected consumption reductions, then why should a utility receive customer-funded financial incentives for failing to achieve the projected level of reductions? For this reason, utilities should be required to achieve a high percentage of the targeted level of reductions (e.g., 100 percent) before becoming eligible for positive revenue adjustments.

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[16] Upon information and belief, only utilities are seeking financial incentives for administering energy efficiency programs.

7. Guideline No. 7

The primary gauge for determining the effectiveness of a utility's energy efficiency program portfolio should focus on verified MWH savings. For programs that are approved with a specific peak reduction target, the primary gauge should be MW savings.

If financial incentives are adopted over Multiple Intervenors' objections, MWH savings should not be the sole determinant of the effectiveness of a utility's energy efficiency program portfolio. Rather, savings should be evaluated in light of program costs and the resulting benefit/cost ratio (absent non-quantitative factors). For instance, if savings are the sole criterion, utilities would be induced to increase spending solely for the sake of achieving savings, regardless of the program cost. Thus, program costs must be considered. Additionally, the resulting benefit/cost ratio (following rigorous measurement and verification) also should be considered. Programs that produce high savings at a low cost are far preferable to programs that produce low savings, or high savings at a high cost.

Multiple Intervenors also has a concern with the proposal to base financial incentives on MW savings for programs with a peak reduction target. Although Multiple Intervenors is a strong proponent of demand response, the EPS under consideration is focused solely on consumption reductions and, therefore, financial incentives should not be targeted at demand reductions (absent some change to the EPS goal).

Targeting reductions in statewide demand – as opposed to consumption – may provide equal or greater benefits to customers. As asserted at page 5 of the Initial Comments of Multiple Intervenors in Response to Staff's Questions, filed herein on July 11, 2007, "although the specific goal of the EPS – to reduce New York's electricity usage by 15% from expected levels by 2015 – is laudable, there has been no analysis that this particular goal is more beneficial to possible alternate goals of an EPS." Such absence of analysis of alternate goals for an EPS continues to this day. For instance, reducing electricity consumption by 7.5 percent and demand by 7.5 percent may produce far greater benefits than focusing solely on consumption reductions. Alternately, given the State's precarious position vis-à-vis other states in terms of electricity prices, reducing electricity consumption by 15 percent by 2020 may better address competing interests than a 2015 deadline.

Disappointingly, this proceeding was instituted with a single, predetermined goal in mind – a 15 percent reduction in electricity consumption by 2015 – and, consequently, possible alternative goals (and their costs to customers) have been ignored. Any proposal to target specific reductions in demand – without any modification of the consumption reduction goal – should be rejected because it would increase the burden on customers to achieve a goal that many parties – including Staff – already consider to be extremely (if not overly) aggressive. Accordingly, absent a change to the EPS goal, financial incentives should not be implemented to target specific demand reductions.

8. Guideline No. 8

Incentives should be calculated over aggregated portfolio performance rather than by specific programs; however, a mechanism must be in place to assure that individual program targets are not sacrificed to maximize incentives.

If financial incentives are adopted over Multiple Intervenors' objections, this guideline should be rejected. For several reasons, financial incentives should be evaluated on an individual program basis for purposes of financial incentives. First, the decision as to whether a utility – as supposed to some other entity – should implement an efficiency program presumably will be made on an individual program basis. Thus, the fact that a utility may achieve acceptable or even superior performance on one program should not relieve the utility of the negative consequences associated with poor performance on another program, especially where another entity may have been authorized to implement that program had the Commission known that projected performance would not be achieved.

Second, it is not necessary to develop some sophisticated mechanism to authorize positive and negative revenue adjustments on a portfolio basis. As alluded to in the guideline, adoption of a portfolio approach would require additional mechanisms to ensure that certain programs are not sacrificed for financial reasons (another form of gaming created by the adoption of financial incentives). In many respects, applying incentives on an individual program basis would be equivalent to a portfolio approach because positive revenue adjustments from some programs could be offset by negative revenue adjustments from other programs.

Third, applying financial incentives on an individual program basis also would provide greater transparency regarding a utility's performance. For instance, under the portfolio approach, one successful program could gloss over the fact that a utility may have "earned" a negative revenue adjustment on three of the four programs it implemented.

9. Guideline No. 9

> **Incentives would not be available for programs in which a utility transfers funds from ratepayers to NYSERDA (this principle would not preclude a utility from obtaining incentives for a program that it undertakes that was previously conducted by NYSERDA with ratepayer funds transferred by the utility).**

Multiple Intervenors does not take issue with this guideline. Of course, utilities should not be eligible for financial incentives for an efficiency program that principally is administered by NYSERDA. Over-burdened customers should not be forced to pay financial incentives for utilities merely for facilitating NYSERDA's efforts in administering an energy efficiency program.

10. Guideline No. 10

> **Consistent statewide incentive principles based upon overall program performance are necessary for ease of administration and to prevent confusion among potential market participants.**

If financial incentives are adopted over Multiple Intervenors' objections, this guideline should be adopted. Absent statewide principles, there likely would be utility-specific proposals for – and litigation over – financial incentives on a regular basis. There seems little point in adopting guidelines or establishing other incentive-related policies if utilities are going to be permitted to propose anything they want each time efficiency programs are advanced.

11. Guideline No. 11

Incentives (assuming performance at 100% of the utility's proposed program target) must be included in the cost estimates of program proposals.

If financial incentives are adopted over Multiple Intervenors' objections, this guideline should be adopted. It is very likely that the primary administrators of efficiency programs under an EPS will be NYSERDA and utilities. Upon information and belief, NYSERDA is not seeking financial incentives from customers. Thus, in order to evaluate whether NYSERDA or a utility should be authorized to implement a specific efficiency program, any potential financial incentives that customers may be forced to fund should be reflected in the program costs. Additionally, if financial incentives are to be paid, such payments – along with any recovery of lost revenues – need to be reflected because the public deserves to know the true cost of an EPS.

B. Advisory Staff's Model

The Advisory Staff Model possesses a number of characteristics that warrant comment, provided below.

Initially, the Model attempts to eliminate any relationship between program expenditures and available financial incentives. This aspect of the Model is described as follows:

> Prior to the receipt of any utility filings, the total amount of statewide program costs required to reach the Commission's statewide jurisdictional MWH goal for the year in question would be estimated. A percentage of the statewide program costs would be derived and then expressed in terms of return on equity basis points. The incentive level for all New York State utilities would then be set in advance at that basis point level and

> would therefore be independent of the program cost projections submitted by utilities.

(Notice at 3.)

While Multiple Intervenors applauds Advisory Staff's apparent recognition that financial incentives should not be based on "program cost projections submitted by utilities," the structure proposed in the Model raises several questions. For instance, Multiple Intervenors assumes that utilities will be competing with NYSERDA in terms of which entities can administer efficiency programs more cost-effectively. The Model seemingly would determine the available financial incentives based on a predetermined amount of return on equity ("ROE") basis points. The Model does not identify any relationship between ROE basis points and efficiency programs. Additionally, there is no mention as to how many basis points would be used.[17] Finally, as interpreted by Multiple Intervenors, a utility that implements only a single efficiency program under the Model would be eligible for the same financial incentive (on a proportional basis) as a utility that implements an extensive portfolio of efficiency programs. While Multiple Intervenors appreciates the apparent focus on cost-effectiveness – as opposed to program expenditures – such an approach can create an inducement that utilities seek only to administer isolated programs for which the thresholds for financial rewards appear easy to attain (yet another form of potential gaming).

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[17] For the reasons detailed in Point I, supra, Multiple Intervenors opposes the implementation of customer-funded financial incentives for the administration of efficiency programs under the EPS. If, arguendo, Multiple Intervenors' position is rejected, the maximum amount of incentives that customers would be forced to fund should be extremely moderate. Additionally, if ROE basis points are used, utilities only should be afforded the opportunity to realize a higher ROE, rather than a receiving a guaranteed payment.

Pursuant to Advisory Staff's Model: (a) utilities would be eligible to start receiving positive revenue adjustments at 90 percent of targeted performance, increasing gradually up to a maximum reward at 120 percent of targeted performance; (b) utilities would be eligible to start receiving negative revenue adjustments at 75 percent of targeted performance, increasing gradually to a maximum penalty at 60 percent of targeted performance; and (c) there would be a deadband between 75 and 90 percent of targeted performance for which no revenue adjustments would be made. (Notice at 3-4.) If financial incentives are adopted over Multiple Intervenors' objections, the approach set forth in the Model should be modified in several respects.

Initially, Multiple Intervenors is very concerned with Advisory Staff's apparent decision to establish performance thresholds at "the utility's proposed target." (Notice at 4.) What role, if any, would the Commission and/or DPS Staff play in evaluating whether proposed targets set by utilities are reasonable? Absent strong competition from NYSERDA and/or other entities, the Model's approach would encourage utilities to understate performance targets to make positive revenue adjustments more easily attainable. Multiple Intervenors recommends, at a minimum, that the Commission assume responsibility for establishing performance targets for utility-administered efficiency programs, which targets should be adopted based on a thorough evaluation of proposed programs by DPS Staff. If the Commission and DPS Staff are unwilling to assume such responsibilities, they should refrain from proffering customer-funded financial incentives to utilities.

Additionally, while Multiple Intervenors does not take issue with the proposal for negative revenue adjustments to commence at 75 percent of targeted performance (reaching a maximum penalty at 60 percent of targeted performance), it does object to the commencement of positive revenue adjustments at 90 percent of targeted performance. Where a utility is authorized to administer an efficiency program with a targeted level of savings, customers should not be forced to reward the utility when it fails to achieve the targeted level of performance. Rather, 100 percent of targeted performance should be the minimum threshold for receiving a financial incentive.

For the foregoing reasons, if financial incentives are adopted over Multiple Intervenors' objections, Advisory Staff's Guidelines and Model should be modified in accordance with these Initial Comments.

POINT III

MULTIPLE INTERVENORS' COMMENTS ON DPS TRIAL STAFF'S INCENTIVE PROPOSALS

DPS Trial Staff's proposals seek to limit customer exposure to incentive costs while balancing customer and utility interests. The incentive structure recommended by Trial Staff is relatively straightforward.[18] A utility may earn a percentage of program costs that increases with performance. Under Trial Staff's approach, utilities may earn a positive revenue adjustment up to: (a) 5 percent for achieving between 85 and 100 percent of the savings target; (b) 9.5 for achieving between 101 and 111 percent of the savings target; and

[18] Cases 07-M-0548, supra, Revised Proposal for Energy Efficiency Design and Delivery and Reply Comments of the Staff of the Department of Public Service (November 26, 2007), and Initial Brief of the Staff of the Department of Public Service on Bridging Programs and Issues (April 10, 2008) ("DPS Trial Staff Initial Brief").

(c) 12 percent for achieving between 112 and 122 percent of the savings target.[19] A negative revenue adjustment would be triggered by the failure of a utility to achieve at least 60 percent of its savings target, and a deadband would be established for achieving between 60 and 85 percent of the savings target.[20]

Multiple Intervenors has four objections to Trial Staff's proposals.[21] First, although Multiple Intervenors welcomes the effort to limit customer exposure to incentive costs, it does not believes that the proposals advanced by Trial Staff would achieve this end and, instead, may increase such exposure. The Trial Staff would provide an incentive based on the program costs, up to a cap equal to 12 percent of program costs. This structure would create a strong inducement for utilities to spend as much money as possible in order to maximize potential incentives. Such an inducement, therefore, undermines the goal of limiting rate impacts of financial incentives.

Second, Trial Staff states that "utilities can earn incentives for exemplary performance more generous than offered in several states."[22] Presumably, this refers to the fact that this model would reward achieving up to 122 percent of the consumption reductions target. This "generous" reward, however, would create an inducement for utilities to: (a)

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[19] Case 07-M-0548, supra, DPS Trial Staff Initial Brief at 30.

[20] Id. at 30-31.

[21] Multiple Intervenors responded previously to Trial Staff's incentive proposals in its Reply Brief filed in this proceeding on April 18, 2007, which is incorporated by reference herein.

[22] Id. at 29 (emphasis added).

overstate reductions achieved; and (b) understate projected reductions in order to make actual performance appear stronger.

Third, the proposals advanced by Trial Staff would establish lenient performance benchmarks. Under this model, a utility achieving only 61 percent of its performance target is held completely harmless. By all accounts, the efficiency goals envisioned for the EPS are ambitious and their accomplishment is uncertain; a low threshold that rewards mediocre performance would be inconsistent with such goals. Similarly, among the three approaches under consideration, Trial Staff recommends the broadest deadband. Such deadband should be reduced, with penalties being triggered at 75 percent of targeted savings. If a utility achieves less than three-fourths of the targeted performance, it should be penalized.

Finally, where a utility is authorized to administer an efficiency program with a targeted level of savings, customers should not be forced to reward the utility financially when it fails to achieve the targeted level of performance. Rather, 100 percent of targeted performance should be the minimum threshold for receiving a financial incentive. For this reason, Multiple Intervenors also objects to the proposed commencement of positive revenue adjustments at 85 percent of targeted performance.

For the reasons described above, the proposals by Trial Staff should be modified or rejected.

POINT IV

MULTIPLE INTERVENORS' COMMENTS ON THE CALIFORNIA MODEL

The California Model attempts to align shareholder and customer interests by establishing incentives that result in a "win" for both utility shareholders and customers. This alignment is described as follows:

> [The California Model] creates incentives of sufficient level to ensure that utility investors and managers view energy efficiency as a core part of the utility's regulated operations that can generate meaningful earnings for its shareholders. At the same time our adopted incentive mechanism protects ratepayers' financial investment, ensures that program savings are real and verified, and imposes penalties for substandard performance.[23]

The California Model involves a very complex incentive structure built around a foundation of assumptions, many of which are ripe for manipulation and gaming. According to the Model, the California PUC establishes kW, kWh, and Mtherm reduction targets (collectively, the minimum performance standard, or "MPS") which are assigned a dollar value that reflects their avoided costs (i.e., "the supply-side generation, transmission, distribution and environmental costs avoided by those reductions in demand").[24] After the reductions are verified, the avoided costs are transformed into "resource benefits."[25] A performance earnings basis ("PEB") is established that "represents the net benefits to

[23] California PUC Rulemaking 06-04-010, supra, at 4.

[24] Id.

[25] Id. at 20.

ratepayers (resource benefits minus costs) from their investment in energy efficiency," of which the utility will receive a percentage (the "sharing rate").[26] Utility shareholders, therefore, earn a percentage of the net benefits achieved by the energy efficiency portfolio.[27]

The California Model establishes a sliding scale under which a utility can earn a higher sharing rate with improved performance and, conversely, the utility can incur a penalty that increases as performance decreases.[28] In this manner: (a) utilities are eligible to start receiving a 9 percent sharing rate at 85 percent of targeted performance (i.e., MPS),[29] which would increase to a 12 percent sharing rate if the utility performs at or above 100 percent of its MPS; (b) utilities are eligible to start receiving negative revenue adjustments at 65 percent of its MPS; and (c) there would be a deadband between 65 and 85 percent of targeted performance for which no revenue adjustments would be made.[30] Also, the California PUC established specific earnings and penalty caps for each utility.[31] Accordingly, a utility that meets and exceeds 100 percent of its MPS may continue earning up to the level of its cap. Conversely, a utility that fails to achieve at least 65 percent of its MPS would incur a negative revenue adjustment that increases up to a specific penalty cap.

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[26] Id. at 19.

[27] Id.

[28] Id. at 219-20.

[29] Also, the utility must achieve at least 80 percent of its performance target for each metric (i.e., MW, GWh, and Mtherm) in order to qualify for an incentive. Id. at 219.

[30] Id. at 219-20.

[31] Id. at 220.

Initially, Multiple Intervenors objects to the performance thresholds established by the California Model. Specifically, Multiple Intervenors takes issue with the commencement of negative revenue adjustments at 65 percent of targeted performance. Such a threshold excuses mediocre to poor performance too easily. Additionally, a utility that is authorized to administer an efficiency program with an established performance target should not be rewarded financially for failing to achieve the targeted level of performance. Rather, 100 percent of targeted performance should be the minimum threshold for receiving a financial incentive. For this reason, Multiple Intervenors also objects to the commencement of positive revenue adjustments at 85 percent of targeted performance.

Second, both the resource benefits and the program costs which comprise the PEB are subject to manipulation and gaming. Each element of the avoided costs that comprise the resource benefits is built on numerous assumptions that are difficult, at best, to quantify. For example, placing a value on the environmental costs avoided by an energy efficiency program is a subjective exercise in estimating the value of intangibles and guessing at the level of savings associated with potentially quantifiable impacts (e.g., public health benefits).[32] Similarly, the costs of generation, transmission and distribution can subject to debate, and gaming. It is highly likely that any proceeding that seeks to determine the value of resource benefits would be extremely contentious, and that the resulting amount of resource benefits would reflect a negotiated or Commission-determined number rather than their actual value.

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[32] For instance, due to the imposition of more stringent environmental requirements and programs, certain costs claimed by some to be externalities, in reality, are reflected market electricity prices.

Also, determination of program costs is subject to the same infirmities as discussed above (i.e., susceptibility to utility manipulation). The California Model, therefore, presents many opportunities to maximize the earned incentive by manipulating PEB inputs (i.e., inflating the resource benefits, shrinking the program costs, or both).[33]

Finally, an incentive structure comparable to the California Model would impose an excessive burden on customers. Under the California Model, a utility may earn a sharing rate of 9 or 12 percent of the positive net benefits that accrue from an energy efficiency program portfolio. For example, the California PUC estimates that the utilities would earn, collectively, $323 million if they achieve 100 percent of the California PUC's savings goals during the 2006-2008 period (i.e., about $108 million per year).[34] If the utilities achieve 125 percent of the same savings goals, then the California utilities would earn, collectively, $450 million (i.e., about $150 million per year).[35] Financial incentives of this magnitude would overburden customers that already are paying average electricity rates higher than 47 of the other 49 states.

For the foregoing reasons, if financial incentives are adopted over Multiple Intervenors' objections, the California Model should be rejected, in its entirety, as a template for consideration under the EPS.

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[33] The California Model was developed over a substantial period of time and under a different regulatory regime. New York has not undertaken a similar evaluation of incentive issues and it would be inappropriate – for numerous reasons – for the Commission to simply "copy" the California Model for use in New York.

[34] Id. at 5.

[35] Id. at 9.

CONCLUSION

For the reasons set forth in Point I, supra, Multiple Intervenors urges the Commission to reject the proposed inclusion of utility financial incentives as part of an EPS. If, arguendo, Multiple Intervenors' position on this threshold issue is not adopted, then, for the reasons set forth in Points II through IV, supra, the proposals of Advisory Staff and Trial Staff should be modified in accordance with these Initial Comments and the California Model should be rejected.

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Respectfully submitted,

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