

June 20, 2008

**VIA HAND DELIVERY**

Honorable Jaclyn A. Brillling, Secretary  
New York State Public Service Commission  
Three Empire State Plaza  
Albany, New York 12223-1350

**Re: Case 07-M-0548 – Proceeding on Motion of the Commission Regarding  
An Energy Efficiency Portfolio Standard – Comments of Niagara  
Mohawk Power Corporation d/b/a National Grid on Performance  
Related Utility Incentives**

Dear Secretary Brillling:

Enclosed please find for filing an original and five (5) copies of the comments of Niagara Mohawk Power Corporation d/b/a National Grid regarding performance-related Utility incentives in response to the Commission's Notice Soliciting Comments issued May 30, 2008 in the subject proceeding.

Kindly acknowledge receipt of this filing by date-stamping as received the enclosed Duplicate copy of this letter and returning it in the enclosed, self-addressed envelope Provided for your convenience. Thank you for your attention to this matter.

Respectfully submitted,



Catherine L. Nesser  
Assistant General Counsel

Enc.

cc: Hon. Eleanor Stein, Administrative Law Judge, w/ enclosure  
Hon. Rudy Stegemoeller, Administrative Law Judge, w/ enclosure  
Janet Gail Besser, w/ enclosure  
Timothy Stout, w/ enclosure  
Active Parties via listserv

**STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION**

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

**INITIAL COMMENTS  
OF  
NIAGARA MOHAWK POWER CORPORATION  
d/b/a NATIONAL GRID**

**I. Introduction and General Statement of Position**

The New York Public Service Commission (the “Commission”) has recognized the enormous benefits of improved and expanded energy efficiency program efforts in New York. In its order issued on May 16, 2007 instituting the Energy Efficiency Portfolio Standard (“EEPS”) proceeding, the Commission stated:

The benefits of energy efficiency include forestalling the building of new generation, reducing use of finite fossil fuels, reducing customers’ energy bills, developing independent sources for New York State to reduce energy imports, and mitigating the environmental impacts of burning fossil fuel for energy, including greenhouse gas emissions.<sup>1</sup>

Niagara Mohawk Power Corporation d/b/a National Grid (“National Grid” or the “Company”) strongly supports actions to advance the State’s energy efficiency efforts as well as an increased role for the State’s utilities in the development and administration of electric and natural gas energy efficiency programs. To that end, National Grid stands ready to implement an aggressive set of energy efficiency programs for its customers that

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<sup>1</sup> See Case 07-M-0548, *Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard*, Order Instituting Proceeding (issued May 16, 2007), at pp. 2-3.

will complement and enhance existing New York State Energy Research and Development Authority (“NYSERDA”) programs as well as other state agency and third party energy efficiency efforts.

In this filing, National Grid provides comments on the three incentive models and the eleven elements comprising the Advisory Staff Incentive Guidelines set forth in the May 30, 2008 Notice Soliciting Comments in Case 07-M-0548 (the “Notice”).<sup>2</sup> The Company responds to the issues in the Notice against the backdrop of its own substantial experiences in delivering energy efficiency programs in Massachusetts, Rhode Island and New Hampshire.

The Notice requested comments to assist the Commission in adopting policies related to performance incentives for utilities. To facilitate consideration of the performance incentive issue, the Department of Public Service (“DPS”) Advisory Staff prepared a set of Guidelines (“the Advisory Staff Incentive Guidelines” or the “Guidelines”) and a Model illustrating the implementation of such Guidelines. The Notice seeks comments on the Advisory Staff Incentive Guidelines as well as two other models: (1) the DPS Trial Staff (“Staff”) proposal described on pages 18-21 of Staff’s Revised Proposal dated November 27, 2007 and pages 30-31 of Staff’s Initial Brief dated April 10, 2008 in the EEPS proceeding (“Trial Staff Incentive Proposal”); and (2) the Shareholder Risk/Reward Incentive Mechanism adopted by the Public Utilities Commission of California, Decision 07-09-043 dated September 20, 2007 (the “California PUC Incentive Model”). The Notice requested comments to five specific issues.

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<sup>2</sup> Case 07-M-0548, *Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard*, Notice Soliciting Comments (issued May 30, 2008).

## **II. Responses to Those Issues Set Forth in the Notice**

The Notice requested comments to five specific issues to assist the Commission in the adoption of policies related to performance incentives substantially in advance of due dates for utility proposals in the EEPS proceeding. National Grid's comments on each of those issues are set forth below.

- (a) whether incentives are necessary;
- (b) the reasonableness of the Guidelines, and any recommended modifications to same;
- (c) any other specific issues not encompassed within the Guidelines;
- (d) the strengths and weaknesses of the three incentive models identified above, and any recommended modifications; and
- (e) the range of incentive levels that will accomplish the objectives identified in the Guidelines.

### **A. There is a case for performance-based incentives.**

In a variety of contexts the Commission has recognized the benefits of properly designed incentives in encouraging the attainment of desirable policy goals. The Straw Proposal presented in the EEPS proceeding provided that “[utility] incentives, properly designed, can serve at least four purposes: (1) to align utilities’ financial interests with energy efficiency; (2) to provide through negative performance incentives a mechanism to hold utilities accountable for meeting targets; (3) to encourage control of program costs; and (4) to encourage achievement of increased efficiency gains.”<sup>3</sup>

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<sup>3</sup> See Case 07-M-0548, *Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard*, Corrected Ruling Presenting Straw Proposal (issued February 13, 2008), at p. 16.

National Grid supports the adoption of performance-based incentives in New York. It has been National Grid's experience in other jurisdictions in which it serves customers that when the Company's interests are fairly aligned with energy efficiency and environmental objectives, both customers and the public realize substantial benefits. The Commission, in its directive to the utilities to include a revenue decoupling mechanism ("RDM") in their respective next general rate cases, has already recognized the need to align ratemaking strategies to focus utility efforts on the delivery of energy efficiency to customers in order to achieve public policy objectives related to managing energy costs and protecting the environment. Although a RDM removes the disincentive for utilities to invest in energy efficiency, it does not create an incentive for pursuing energy efficiency over other efforts. Further, eliminating disincentives to invest in energy efficiency through a RDM or the recovery of lost revenues alone is insufficient to ensure that the delivery of aggressive and successful energy efficiency program services is a key business objective for utilities. Aligning utility rate structures and earnings capabilities with public policy objectives through the adoption of a meaningful and well designed performance-based shareholder incentive mechanism, in concert with a RDM, will lead to aggressive, cost-effective energy efficiency implementation efforts by utilities. Moreover, given that New York has identified energy efficiency as a tool that can be used to derive both economic and environmental benefits within the state, the best results will be achieved when incentive mechanisms are in place that make successful energy efficiency efforts the smart business decision.

National Grid believes that a meaningful performance-based shareholder incentive mechanism, in conjunction with a well-designed RDM can best achieve the

desired objective of reducing electricity usage by 15% from expected levels in 2015, as well as an abundance of concomitant economic and environmental benefits. These economic and environmental benefits include: (i) energy bills for customers that are lower than they otherwise would be; (ii) reduced environmental impacts from burning fossil fuels for energy production and over time, reduced need for the construction of new generating facilities; (iii) increased job growth in the green marketplace; (iv) improving the competitive position of businesses in New York compared to others in the global marketplace by helping New York businesses to operate more efficiently; (v) economic development through technological research and advances that assist in the design, implementation and delivery of energy efficiency programs to consumers; (vi) reduced consumption of fossil fuels; (vi) reduced environmental impacts from burning fossil fuels for energy production and over time, reduced need for the construction of new generating facilities; and (vii) reduced reliance on energy imports.

**B. The reasonableness of the Advisory Staff Guidelines and recommended modifications thereto.**

The Advisory Staff Guidelines were described in the Notice as consisting of eleven (11) major elements. For convenience, the Company's comments as follows are grouped in accordance with said elements.

**1. The Advisory Staff Guidelines in regard to performance incentives in the context of energy efficiency are premised on the overall objectives of: (1) encouraging superior performance and deterring weak performance; and (2) aligning utilities' financial interests with energy efficiency as a resource option.**

National Grid agrees with the proposition that performance incentives encourage superior performance in energy efficiency program efforts while aligning utilities' financial interests with energy efficiency as a resource option. An incentive mechanism that provides a meaningful reward to the utility for achieving energy efficiency program objectives along with increasing rewards for exceeding goals can accomplish this. Given the urgency for achieving significant results in a short amount of time and the challenge this presents, the Company suggests that superior energy efficiency efforts should entitle a utility to earn an incentive that is at least as lucrative as other activities it might engage in. The implementation of enhanced energy efficiency measures provides long-term benefits to customers by reducing energy costs while also significantly benefiting the environment. Energy efficiency is the most cost-effective way to reduce greenhouse gas emissions and help mitigate climate change. Taken together, substantial performance merits a corresponding substantial incentive award while superior performance merits a corresponding superior incentive award.

National Grid also supports the inclusion of a financial penalty for poor performance in delivering energy efficiency programs. Penalties should be sufficient to be meaningful but not so punitive as to deter innovation due to a perceived financial risk for trying, and despite best efforts, not succeeding.

- 2. The Guidelines are premised on a maximum incentive payout that takes into account the size of the utility program portfolio target relative to the jurisdictional goal for the utility's service territory in order to encourage improved utility performance without placing an excessive burden on ratepayers.**

As the Company interprets this element of the Guidelines, Advisory Staff is advocating a top-down allocation of overall statewide energy efficiency goals to each utility, not inconsistent with the Straw Proposal and the supporting Technical Appendix thereto, which would effectively cap each utility's incentive payout at the jurisdictional target for that utility irrespective of whether a given utility proposed to deliver energy efficiency programs that would exceed such a jurisdictional target.

Although National Grid agrees that the Commission should establish energy efficiency targets for each utility, such targets should be based on thorough bottom-up studies undertaken by the respective utilities taking into account specific customer mix and service territory attributes, in the manner generally described in the consensus recommendations issued by Working Group III.<sup>4</sup> Such a bottom-up approach to target-setting is "most likely to result in the establishment of achievable goals."<sup>5</sup> Further, such an approach will allow for the tailored consideration of "diverse demographics and economies within the state to assess program design and how best to achieve efficiency savings."<sup>6</sup> The Company supports the approach recommended by Working Group III.

National Grid believes that a top-down approach as suggested by the Straw Proposal and further embodied in the Guidelines would not be good policy as it could lead to unrealistic and therefore unachievable goals. Further, top-down Commission-imposed targets may not allow a given utility to satisfactorily address changing market factors or other unique attributes in its service territory that affect energy savings potential. Each electric and gas utility within New York State should be allowed to

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<sup>4</sup> See Working Group III Final Report, dated December 5, 2007 ("Working Group III Final Report"), at pp. 13-16.

<sup>5</sup> *Id.* at p. 14.

<sup>6</sup> *Id.* at p. 15.

develop energy efficiency programs and corresponding targets to meet the needs of its specific customer mix and service territory attributes. While such an approach may require the Commission to reconcile individual utility goals and those of other program administrators, such as NYSEERDA, with the overall statewide goal and determine the need for program enhancements and adjustments over time, it will lead to program delivery goals informed by those most knowledgeable about the customers who will be served and thus enhance the likelihood of realizing the 15 x 15 goal. Moreover, proposed energy efficiency programs should focus on acquiring all cost-effective energy efficiency in a given residence or business and not simply on the acquisition of the “cheapest” savings available. An approach that focuses only on the “cheapest” savings (also commonly referred to as “cream skimming”) will not be sufficient for achieving the aggressive energy efficiency goals established for New York State.

The Company also suggests that the maximum incentive payout that a utility may earn reflect the net benefits captured through energy efficiency program efforts. This should address what appears to be the Commission’s concern about “placing an excessive burden on ratepayers.” National Grid does support capping the maximum incentive payment that may be made in a given time period, but it does not support capping those payments based on the costs of providing energy efficiency services to customers. The incentive should focus efforts on maximizing benefits for consumers rather than on potentially inflating the costs required to deliver those benefits.

- 3. The Guidelines are premised on a formula by which maximum and intermediate incentive payouts and disincentives are calculated so as not to induce utilities to increase program costs artificially or manipulate program design and implementation inappropriately.**

A shareholder incentive mechanism that results in customers and shareholders sharing in achieved net benefits rather than one based on program costs will ensure that utilities are not induced to increase program costs artificially or manipulate program design and implementation inappropriately. Basing incentives on net benefits encourages utilities to improve the efficiency of program delivery efforts while creating savings, with a focus on maximizing benefits for both customers and shareholders. Providing for a higher reward for exceeding goals will further the objective of efficient program delivery combined with maximization of savings.<sup>7</sup>

**4. The Guidelines advocate for both positive and negative revenue adjustments.**

National Grid agrees in principle that an incentive mechanism that provides both rewards and penalties based on challenging but reasonably achievable thresholds and targets is appropriate. In the Company's experience, these thresholds and targets must be based on a bottom-up approach to achieve the desired energy efficiency objectives. If the Guidelines are proposing to set incentive levels in advance based on a top-down allocation of statewide program costs required to achieve a commensurate savings goal, rather than a funding proposal and goals that are set in recognition of service territory-specific attributes and program delivery costs, the proposed goals and funding to achieve such goals in a given utility's service territory may be off the mark and set either too high

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<sup>7</sup> In Case 08-M-0484, *Petition of Niagara Mohawk Power Corporation d/b/a National Grid for Expedited Approval of Three-Year Energy Efficiency Plan*, dated April 30, 2008 (the "Plan"), National Grid has proposed an incentive mechanism that is focused on a sharing of achieved net benefits. The Plan includes: a penalty provision for achieving less than 50% of targeted net benefits; a deadband over which no penalty would be imposed and no reward would be available when achieving between 50% and 75% of targeted net benefits; a meaningful reward for achieving greater than 75% up to 100% of targeted net benefits; and an enhanced reward for achieving over 100% of targeted net benefits that would be capped at 125% of targeted net benefits. A stepped incentive structure as proposed in the Plan is consistent with the Advisory Staff Guidelines in that it does not encourage the artificial increase of program costs in order to achieve desired results. Rather, it focuses on maximizing benefits for both customers and shareholders.

or too low. This could in turn result in a potential reward being perceived as unattainable and the desired efforts may not be given the appropriate priority by the utility.

**5. The Guidelines advocate that measurement and verification results form the basis for determining effectiveness of a utility's energy efficiency program portfolio and any resulting revenue adjustments.**

National Grid agrees that measurement and verification ("M&V") of program results should be the basis for assessing the effectiveness of a utility's energy efficiency program and any resulting rewards or penalties. The recommendations of Working Group III discussed M&V as a way to determine a pre-evaluation estimate of savings for a given energy efficiency project. The Working Group III Final Report stated:

M&V refers to the efforts employed to develop an initial estimate of savings that is based on expected energy use after completing a Demand Side Management ("DSM") project. These efforts include refinements that may be made as a result of quality assurance efforts but do not include findings from formal impact evaluations. M&V efforts provide information that can be used to verify that program installations are occurring and producing expected savings. M&V provides estimates of gross savings. Gross savings also provide an initial measure of progress toward the goal prior to refining the savings estimates to reflect impact evaluation results.<sup>8</sup>

National Grid suggests that the best estimate of savings from program efforts available at the end of each program year should be the basis for determining performance under a performance-based incentive mechanism. The Company recommends basing the reward, if any, on a preliminary estimate of net savings rather than gross savings. Preliminary net savings estimates would take into account any known impact evaluation findings available at the time goals are established. That is to say, the same impact evaluation findings available when annual goals are established and which

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<sup>8</sup> See Working Group III Final Report, at p. 17.

are reflected in the annual goals should be used to assess results at year-end. Evaluation findings would be used to develop plans for future years.

**6. The Guidelines require that a utility achieve a high percentage of its target before realizing a positive revenue adjustment tied to performance.**

National Grid agrees in principle with this Guideline element. The percentage of target that must be achieved before a utility may earn an incentive should reflect the challenges involved in achieving desired results. Setting the threshold appropriately recognizes that significant effort will be required to achieve the target. If the threshold is set too high, this would discourage sustained program implementation efforts if it appears to the utility that actual performance will fall short of this threshold level. Significant potential benefits may be lost as a result.

**7. The Guidelines advocate that the primary measure of a utility's energy efficiency program be verified MWh savings (or MW savings for such programs with a specified peak reduction target).**

National Grid suggests that the primary measure for determining the effectiveness of a utility's energy efficiency program portfolio should be the creation of net benefits quantified using the preliminary year-end estimate of savings compared to the expected net benefits in the pre-approved energy efficiency plan. Net benefits are defined as the dollar value of benefits (i.e., the value of both the energy and demand savings) over the expected life of installed energy efficiency measures minus the total cost of creating those benefits. Net benefits take into account the efficiency of program efforts while including the value of both energy and demand savings from such efforts.

- 8. The Guidelines advocate that incentives be calculated over aggregate portfolio performance rather than by specific programs with a mechanism in place to assure that individual program targets are not sacrificed to maximize incentives.**

National Grid agrees that incentives should be calculated over aggregated portfolio performance rather than by individual program performance. The Company suggests that budget control mechanisms that focus on customer class rather than program level budgets could be put in place to ensure that all customer classes receive the appropriate focus and there are not inappropriate trade-offs being made between customer classes. Further, National Grid advocates that utilities implementing energy efficiency programs be given sufficient flexibility to shift funds between programs targeted to a given customer class in response to customer demand without requiring Commission approval for such intra-class shifting of funds.

- 9. The Guidelines specify that incentives would not be available for programs in which a utility transfers ratepayer funds to NYSERDA. However, this principle would not preclude a utility from obtaining incentives for a program it undertakes that was previously conducted by NYSERDA with ratepayer funds transferred by the utility.**

National Grid could support such a proposal provided that it applies only to programs where a utility provides funding and nothing more to NYSERDA.

- 10. The Guidelines require consistent statewide incentive principles based on aggregate portfolio performance for ease of administration and to prevent participant confusion.**

National Grid supports a consistent application of incentive principles statewide for all utilities that would be based on each utility's aggregate energy efficiency portfolio performance.

**11. The Guidelines require that incentives (assuming performance at 100% of the utility's proposed program target) be included in the cost estimates of program proposals.**

National Grid agrees that shareholder incentive dollars associated with achieving 100% of the target net benefits should be included as a cost when assessing program cost-effectiveness. However, if an incentive mechanism that is focused on net benefits is adopted as recommended by National Grid, then for the purposes of calculating the shareholder incentive this cost should be excluded. The earned incentive would, itself, be based on net benefits and, therefore, could not be included in the determination of those net benefits.

**C. Additional considerations relative to the illustrative Advisory Staff Model.**

In addition to the element discussed above in regard to the Guidelines, National Grid provides the comments as follows on the accompanying illustrative Advisory Staff Model ("Model").

**1. The total amount of statewide program costs required to reach the Commission's statewide jurisdictional MWh goal for any given year would be estimated.**

The process of establishing budgets and goals by utility service territory should be a collaborative process informed by a bottom-up assessment that takes into account unique service territory and customer attributes. The resulting goals should be challenging but achievable and supported by sufficient funding to attain desired outcomes. In addition, the proposed funding levels and goals by year must take into account the ramp-up period when new programs are initiated. The process described in the Guidelines and accompanying Model is a top-down approach that is not collaborative.

National Grid supports the findings of Working Group III which recommended a bottom-up approach to target-setting.

**2. A percentage of the statewide program costs would be derived and then expressed in terms of return on equity basis points.**

National Grid recommends that the incentive mechanism adopted for utilities in New York focus on achieving expected net benefits for an approved energy efficiency plan. An incentive mechanism where net benefits are shared between customers and shareholders will result in efforts that are focused on maximizing benefits for customers.

Given the importance of achieving the desired level of savings from energy efficiency program efforts, the utilities should be allowed to earn a return that is commensurate with the return that it can earn on other investments as a reward for achieving desired results. Achieving the important public policy objectives of energy efficiency should be among the most profitable activity in which a utility engages.

**3. Incentive targets would be established based upon the level of MWh or MW expected from the program and would be independent of program cost projections by utilities.**

The Company advocates for incentive targets based on net benefits that would take into account the value of achieved energy and demand savings compared to cost. Such an incentive-setting mechanism is superior to one that focuses on energy or demand savings only as it would encourage efficiency on the part of the utility in its program implementation efforts.

National Grid suggests that there should be a relationship between a utility's targeted savings, program costs and any reward/ penalty mechanisms.

4. **A breakeven point would be established at 75% to 90% of the utility's proposed target. The incentive for performance within this "neutral" range would be zero basis points.**

The percentage of target that must be achieved before a utility may earn an incentive should reflect the challenges involved in achieving desired results. If the target is set at a high level, then the threshold, or percentage of achievement at which the utility can earn an incentive might be lower than if the target is set at a lower level. If the threshold is set too high, this would discourage sustained program implementation efforts if it appears to the utility that actual performance will fall short of this threshold level. Significant potential benefits may be lost as a result.

The energy savings targets for New York State are overall quite aggressive. In recognition of the challenge involved, an appropriate "neutral" band might be 50% to 75% of the utility's target, rather than the 75 to 90% as is suggested by the Guidelines. A "neutral" band of 50% to 75% of target would still require significant effort and results before an incentive could be earned.

5. **Performance below 75% of the target would yield negative revenue adjustments with a linear relationship governing the negative revenue adjustment in the range between 60% and 75% and with the maximum negative adjustment occurring at 60% performance or lower.**

National Grid supports the inclusion of a negative revenue adjustment. However, setting the performance level that must be achieved too high given the ambitious targets in New York (e.g., 75% as is suggested by the Guidelines) would discourage utilities from pursuing new and innovative technologies and implementation strategies due to the risk associated with these efforts. The Company suggests that the negative revenue adjustment apply only when actual results fall short of goals by more than 50%.

6. **Performance above 90% of the target would yield positive revenue adjustments. The total amount of the maximum incentive would be spread over the 90% to 120% range with a linear relationship governing the range between 90% and 100% of the target and a second more gradual linear relationship between 100% and 120% of the target. The maximum positive revenue adjustment would occur if 120% of the target is achieved.**

Again, the percentage of target that must be achieved before a utility may earn an incentive should reflect the challenges involved in achieving desired results, as noted in point 4 above. National Grid agrees that a linear relationship between threshold performance levels is appropriate for determining the amount of incentives or percentage share of net savings to be retained by the utility. The Company recommends that a target incentive rate be defined and applicable to results greater than 75% up to 100% of target with a higher incentive rate for results above 100% and up to 125%. If the target is exceeded, the higher incentive rate would apply to aggregate portfolio performance.

#### **D.1 The strengths and weaknesses of the Trial Staff Incentive Proposal.**

The Trial Staff Incentive Proposal has seven major elements set forth as follows to which National Grid is providing comments. The Company's comments follow the brief description of these elements.

1. **Utilities would have the opportunity to earn rewards once they have secured at least 90% of the annual energy savings goal with more generous incentives for performance that exceeds the goal.**

National Grid believes that the key performance measure for the shareholder incentive mechanism is net benefits achieved compared to the expected net benefits goal. Utilizing net benefits as the basis to earn rewards appropriately places the focus on achieving savings efficiently rather than simply achieving savings. The percentage of target that must be achieved before a utility may earn an incentive should reflect the challenges involved in achieving desired results. Setting the threshold appropriately

requires recognizing the significant level of effort that will be required. If the threshold is set too high (e.g., 90% as suggested by the Trial Staff Incentive Proposal), this would discourage sustained program implementation efforts if it appears to the utility that actual performance will fall short of this threshold level. Significant potential benefits may be lost as a result.

**2. A negative revenue adjustment should apply in cases of substandard performance.**

National Grid agrees with including penalties for substandard performance. The Company advocates a penalty be applied when less than 50% of the goal is achieved.

**3. The incentive would be capped at 12% of the program budget. Savings from funds in excess of approved budgets would not be counted when determining the earned incentive.**

National Grid recommends the adoption of an incentive mechanism where the shareholders and customers share in the net benefits created as a result of program efforts rather than an incentive mechanism based solely on the energy savings goal, or on the program budget. There will be a greater incentive to improve the efficiency of implementation efforts where there is a meaningful financial incentive to the utility for achieving those efficiencies. A net benefits-focused incentive mechanism encourages the maximization of benefits for customers.

**4. Trial Staff has proposed a tiered incentive payment structure. In Tier 1, up to 5% of the program budget would be available as a reward for achieving between 85% and 100% of the savings goal. In Tier 2, up to 9.5% of the program budget would be available for achieving between 101% and 111% of the savings goal. This higher incentive rate would apply to the incremental savings that create such results. In Tier 3, up to 12% of the program budget would be available for achieving between 112% and 122% of the savings goal. This amount would be available for the incremental savings above the Tier 2 level.**

National Grid reiterates its support for a shared savings incentive mechanism structure where the Company's shareholders and customers would share in the net benefits achieved by program efforts. While Trial Staff's tiered incentive structure does provide some incremental motivation for improved performance, a shared savings approach where the Company's share of the net benefits achieved increases as goals are exceeded is more likely to foster innovation, efficiency and improved results as well as a super focus on maximizing benefits for both customers.

**5. Trial Staff suggests that no incentive apply for achieving less than 85% of the program goal and more than 60% of the program goal.**

The percentage of target that must be achieved before a utility may earn an incentive should reflect the challenges involved in achieving desired results. Setting the threshold appropriately requires recognizing the significant level of effort that will be required. If the threshold is set too high (e.g., 85% of the program goal as suggested by the Trial Staff Incentive Proposal), it would discourage sustained program implementation efforts if it appears to the utility that actual performance will fall short of the threshold level. Significant potential benefits may be lost as a result. Given the aggressive goals established in the EEPS proceeding, National Grid suggests a "deadband" apply to performance between 50% and 75% of the goal.

**6. Trial Staff recommends defining substandard performance as achieving less than 60% of the program goal. When this occurs, a utility would be subject to a negative revenue adjustment equal to 33% of the maximum incentive (i.e., 1/3 of 12% of the budget or 4%). The remaining 2/3 of the maximum incentive would be assessed as a revenue adjustment for each GWh not achieved between 1% and 59% of the goal.**

National Grid agrees in principle with the inclusion of a negative revenue adjustment for substandard performance. However, the Company suggests that

substandard performance be defined as achieving less than 50% of target net benefits. If the performance threshold relating to the penalty is set too high (e.g., less than 60% as suggested by the Trial Staff Incentive Proposal), the utility will be discouraged from research and development efforts and from exploring innovative program implementation approaches.

**7. Trial Staff states that it is willing to consider incentives for utilities working with NYSERDA to implement programs.**

While National Grid has not proposed incentives explicitly related to working with NYSERDA, the Company is open to considering incentives that reward cooperative efforts. Some form of performance metrics that are independent of savings may be appropriate in such an instance. For example, it may be appropriate to provide a utility with a reward for each energy efficiency application created on behalf of its customers for participation in a NYSERDA program.

**D.2 The strengths and weaknesses of the California PUC Model.**

The California PUC Model has six major elements set forth as follows to which National Grid is providing comments. The Company's comments follow the brief description of these elements.

- 1. The incentive is based on achieving net benefits compared to plan benefits. A utility can retain 9% of achieved net benefits if actual net benefits are between 85% and 100% of target net benefits. It can retain 12% of net benefits if actual net benefits are between 100% and 125% of target net benefits. There is a deadband between 65% and 85% of target net benefits where no incentive is earned and no penalty is assessed. The maximum penalty is equal to the maximum incentive amount. The utility must also achieve at least 80% for each individual savings metric (e.g., MW, MWh, MTherm).**

National Grid conceptually supports an incentive mechanism similar to the California PUC Model that is based on a sharing of net benefits between customers and shareholders. However, the Company does not support the inclusion of separate metrics uniquely focused on MW, MWh and MTherm savings targets. Such a focus unnecessarily complicates the incentive mechanism.

**2. All net benefits calculations are verified by independent EM&V contractors with two impact measurements at 18 months and 36 months.**

There is a benefit to being able to close out an incentive calculation within a reasonable amount of time following the end of a program year. National Grid suggests that year-end results for the incentive calculation be based on the same assumptions that were in place when the program goals were established. Evaluation study results would be used to plan future efforts. Moreover, the Company recommends that each entity implementing a program should be involved in that particular program's evaluation. National Grid proposes to hire independent consultants to conduct evaluations of its program efforts. These consultants would be selected through a competitive bidding process. The consultants' efforts would be managed by National Grid with input from Staff.

**3. If portfolio costs exceed verified savings, shareholders pay ratepayers back dollar-for-dollar for those negative benefits.**

This particular aspect of the California PUC Model discourages innovation and research and development efforts. For that reason, National Grid does not recommend adoption of this element of the California PUC Model.

**4. Rewards/penalties are distributed in annual progress payments with a final true-up of the total amount at the end of the program cycle. Half of the expected earnings are held back in each interim claim to mitigate the risk to the ratepayer of earnings overpayments.**

As noted above, there is a benefit to being able to close out an incentive calculation within a short time following the end of a program year. National Grid suggests that year-end results for the incentive calculation be based on the same assumptions that were in place when the program goals were established. No progress payments would be needed under such an approach which in turn would ease program administrative efforts.

**5. Rewards/penalties are calculated on a cumulative basis over the plan period (i.e., three years).**

National Grid suggests that goals be set annually for the incentive mechanism. This would provide each utility with the ability to update goals and budgets for the next year informed by funding adjustments for the current year resulting from either over- or under-spending compared to budget, evaluation findings, and other significant program changes, including but not limited to the introduction of new programs or the discontinuation of any existing programs. A cumulative calculation would therefore not be required.

**6. There are two penalty provisions: (1) per unit penalties for kWh, kW, and therm savings shortfalls compared to 65% of the savings goal; and (2) a cost-effectiveness guarantee that obligates shareholders to pay ratepayers back for negative net benefits; with the greater of these two applying. Penalties are borne entirely by shareholders.**

National Grid supports the inclusion of a penalty for poor performance. Such a penalty should focus on the degree to which the utility has fallen short on delivering net benefits compared to a defined percentage of the goal for net benefits rather than focusing on the components that lead to the creation of net benefits. Moreover, the Company recommends that poor performance be defined as achieving less than 50% of target net

benefits. The penalty would equal the target incentive rate multiplied by the difference between 50% of target net benefits and achieved net benefits.

**E. Setting an appropriate incentive range for the Guidelines.**

The California PUC Model was premised on creating a “win-win” regulatory framework for energy efficiency programs – one that would provide a meaningful level of shareholder earnings.<sup>9</sup> The California PUC Model recognized that ensuring sustained and successful commitment to energy efficiency is best accomplished by creating incentives of sufficient level to ensure that utility investors and managers alike view energy efficiency as a core part of the utility’s operations that can generate meaningful earnings for its shareholders.<sup>10</sup> National Grid shares this belief and urges the Commission to adopt an incentive mechanism that will unequivocally make energy efficiency a priority for the utilities in New York State.

National Grid’s Three-Year Energy Efficiency Plan Petition filed on April 30, 2008 (the “Plan”)<sup>11</sup> included a proposal for an incentive mechanism focused on a sharing of achieved net benefits. The Plan proposed a penalty provision for achieving less than 50% of targeted net benefits; a deadband over which no penalty would be imposed and no reward available for achieving between 50% and 75% of targeted net benefits; a meaningful reward for achieving greater than 75% and up to 100% of targeted net benefits (with shareholders retaining 10% of achieved net benefits); and an enhanced reward for achieving over 100% of targeted net benefits (with shareholders retaining 15%

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<sup>9</sup> See Decision 07-09-043, *Order Instituting Rulemaking to Examine the Commission’s post-2005 Energy Efficiency Policies, Programs, Evaluation, Measurement and Verification, and Related Issues*, Interim Opinion on Phase I Issues: Shareholder Risk/Reward Incentive Mechanism for Energy Efficiency Programs, September 20, 2007, at p. 2.

<sup>10</sup> *Id.* at p. 4.

<sup>11</sup> Case 08-M-0484, *Petition of Niagara Mohawk Power Corporation d/b/a National Grid for Expedited Approval of Three-Year Energy Efficiency Plan*, dated April 30, 2008 (the “Plan”).

of achieved net benefits). A stepped incentive structure like the one proposed in the Plan focuses on maximizing benefits for both customers and shareholders. It is a model that fully supports the objective of aligning customer and shareholder interests and allows customers to retain 85% to 90% of achieved net benefits if program efforts are successful. The Company believes such an incentive mechanism is more likely to motivate performance that is in line with the aggressive energy savings envisioned in the EEPS proceeding.

### **III. Conclusion**

National Grid stands ready to implement integrated energy efficiency programs to achieve the aggressive goal of reducing New York's electricity usage 15% from expected levels by 2015. The Company urges the Commission to give consideration to the valuable role that National Grid and other utilities can play in the near-term as well as in the longer term EEPS. A meaningful and well-designed incentive mechanism will be an important tool to ensure utility focus on implementation of energy efficiency programs that deliver benefits to customers. National Grid appreciates the opportunity to comment on the incentive mechanism options under consideration in this proceeding and looks forward to working with the Commission in advancing the delivery of energy efficiency benefits to its customers in New York.

Respectfully submitted,

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