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Patrick C. Lynch, Attorney General

VIA ELECTRONIC AND REGULAR MAIL

April 23, 2008

Luly E. Massaro
Clerk
Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: RI Energy Efficiency And Resource Management Council's Proposed Standards For Energy Efficiency And Conservation Procurement And System Reliability – PUC Docket No. 3931

Dear Ms. Massaro:

Enclosed please find for filing in the referenced docket the original and nine (9) copies of the Division of Public Utilities and Carriers' (the "Division") written comments on the Energy Efficiency And Resource Management Council's (the "EERMC") proposed standards for energy efficiency and conservation procurement and system reliability. These comments, prepared for the Division by Mr. Robert Fagan, Synapse Energy Economics, Inc., a consultant retained by the Division to advise it on demand side management and renewable energy issues, set out the Division's position on the EERMC's proposed standards.

Thank you for your assistance in this matter.

Sincerely,

RHODE ISLAND DIVISION OF PUBLIC UTILITIES AND CARRIERS

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By its Attorney
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Rhode Island Public Utilities Commission
Docket # 3931 S
Proposed Standards for Least Cost Procurement of Energy Efficiency and System Reliability Resources

April 23, 2008

Synapse Comments on Draft Proposed Standards developed for the Division of Public Utilities and Carriers

The Comprehensive Energy Conservation, Efficiency, and Affordability Act of 2006 includes a section that states that the Rhode Island Public Utility Commission (Commission) must establish "standards for system reliability and energy efficiency and conservation procurement" (39-1-27.7). The standards that must be established need to address two areas:

1 System reliability procurement, including non-traditional supply alternatives or equivalent options including
  - Combined heat and power (CHP);
  - Distributed generation (DG);
  - Demand response (DR);
  - Diverse resources including renewable energy (RE); and
  - Standards and/or rates associated with the provision of DG, DR, and RE.

2 Least cost procurement of
  - Energy Efficiency (EE), and conservation, where prudent and reliable and when they are lower cost than supply alternatives.

The law also lays out the powers and duties of the Energy Efficiency and Resource Management Council (Council). The Council appears to have broad authority over the procurement mechanisms to be used for both system reliability and energy efficiency.

The proposed standards generally appear to be well-reasoned and supportive of the goals of the law. In particular, they are specific and address the key requirements for actually planning a procurement program, including the production of an "opportunities" report, and timely filing of reports to the Commission. The standards include recommendation of the use of a specific cost-effectiveness test, and they address, at least minimally, the impact of considering potential future costs associated with existing or prospective greenhouse gas regulation.

The only area of substantive concern is the proposed standards' inclusion of specific decoupling language. As noted below, Synapse believes it is unnecessary to include the decoupling provisions in the standards. Rather, decoupling issues are best addressed in more traditional ratemaking venues. While the issues of decoupling and energy efficiency are clearly related, procurement plans for least-cost energy efficiency and system reliability resources do not necessarily need to address some of the broader policy and utility ratemaking structure nuances.

However, Synapse also recognizes that the decoupling issue cannot be fully severed from some aspects of the proposed procurement plans. Current energy efficiency delivery in Rhode Island by NGrid includes a performance incentive mechanism that generally has been supported by all stakeholders, at least those included in the DSM collaborative process, and supported by past Commission rulings. It has been considered separately from rate structure issues such as cost recovery adjustment mechanisms. It is reasonable to assess this incentive mechanism in the context of decoupling considerations; and thus to the extent that the proposed standards are intended to incorporate specific incentive mechanisms as part of the procurement process, overlap exists between what is in the standards and the broader decoupling issues.

The remainder of these comments addresses the major issues included in the proposed standards.

Chapter 1 - Energy Efficiency Procurement

1.1 Plan Filing Dates. The standards properly recognize the need for overall budgets and targets that extend for three years, in accordance with the law. Traditionally, energy efficiency program filings in the fall of each year have been for a single year's worth of efficiency procurement. This methodology should allow for improved planning.

1.2 EE Procurement Plan Components. The standards properly address the "prudent and reliable" standard present in the law when considering the purchase of all cost-effective energy efficiency resource. It reasonably recommends use of a total resource cost test to determine program measures that are cost-effective. It recognizes that a ramp-up of activity will be required, yet rightly notes that a sustainable ramp-up is important. It includes a funding plan. Of particular note is the intention to develop "new strategies to make available the capital needed to implement projects in addition to the incentives provided". This is a laudable goal that if successfully implemented can help to leverage the funds available through the traditional financing from SBC and distribution rates.

This section also includes an "Efficiency Performance Incentive Plan". The standards rightly note that the existing incentive structure should be reviewed. It is reasonable that the existing incentive plan be considered the benchmark against which any revised structures would be measured.

1.3 EE Program Plan Components. This section covers those issues the DSM Collaborative generally addresses when formulating a detailed approach to the "annual filings" that NGrid has traditionally made in the fall of each year. It includes a reasonable approach that addresses principles of program design, funding plans, program descriptions, monitoring and evaluation plans and reporting requirements. A few elements of this section are noteworthy:

- It recognizes that there may be cost-savings synergies associated with EE program integration with renewable and reliability procurement and between gas and electric programs.
- It addresses market transformation activity, though any "crediting" of savings realized by the utility from market transformation needs to be reviewed carefully.
- It rightly emphasizes the importance of comprehensiveness of measure installation.
- It includes a plan to conduct sensitivity analysis that appears to address "potential" CO2 mitigation costs that might arise over and above Regional Greenhouse Gas Initiative costs. This properly recognizes that national plans to address greenhouse gases could result in higher supply costs; and thus some energy efficiency resources that might not otherwise be cost-effective could show net benefits if "carbon costs" increase over time.

1.4 Role of the Council. This section indicates that the Council will report on program performance and cost effectiveness, and the effectiveness of the performance incentive. This includes collaboration with the utility on design and implementation of monitoring and evaluation efforts. This aspect should be welcomed in Rhode Island as it will help provide additional insight into evaluation efforts and their impact on program effectiveness.

Chapter 2 – System Reliability Procurement

This section of the proposed standards comprehensively addresses key issues in the enabling legislation on what are essentially non-traditional forms of "supply" resources or resource alternatives. All of the alternatives covered will allow for reduction of purchase of traditional energy supplies by either directly reducing load (through load response), or by reducing the net load seen by the system (as with behind-the-meter combined heat and power, distributed generation and some small renewables), or by the purchase of grid-connected combined heat and power, distributed generation or renewable supplies. It also addresses potential savings associated with what would likely be deferment or elimination of certain transmission or distribution investments with targeted distributed generation, energy efficiency programs, CHP, renewable supplies and/or demand response.

This section of the standards appears to adequately address the section of the law concerning system reliability procurement.

Chapter 3 - Aligning Utility Incentives and Reforming Rates

This section of the proposed standards addresses a provision in the law that recognizes the effect that energy efficiency success can have on overall utility sales – it lowers those sales. Thus, based on current rate structures (i.e., regulated revenue recovery amounts vary according to sales) energy efficiency policies can have an effect on the overall level of revenues that are used to pay for overhead and fixed costs.

However, the law appears to only indirectly link the actions of the Energy Efficiency and Resource Management Council with the responsibility of the Commission to assess whether (or not) a "mandatory rate adjustment clause" may be established to provide for full recovery of reasonable and prudent overhead and fixed costs. Thus, the extent to which the Council is responsible, or should be responsible, for addressing such "decoupling" issues is unclear.

However, Section 3.1 of this chapter of the proposed standards takes the position that the issue of "decoupling" or "Removing the Link between Sales Volume and Utility Profits" is an issue to be included in the standards. It suggests that the utility and the Council will consult on proposed solutions before filing proposed procurement plans with the PUC.

System reliability and EE procurement standards could be considered without directly addressing decoupling issues. The current DSM collaborative approach has generally resulted in utility "incentives" for high-performing programmatic efforts, but has not addressed the larger picture of general ratemaking principles and the mechanisms that can be used for recovery of fixed and overhead costs.

The law does clearly state both that i) the Commission may establish a mandatory rate adjustment clause, and ii) the Commission shall conduct a contested case proceeding to establish a performance-based incentive plan. It certainly makes sense to address both the decoupling issue and any proposed incentive plans in the context of the contested case proceeding noted in the law. Therefore, the issues presented in Section 3.1 of the proposed standards might be best addressed outside of the standards process.

A Brief Discussion on Decoupling Issues

"Decoupling" is the term used to describe electric or gas utility ratemaking mechanisms that seek to "decouple" or de-link the relationship between a utility's sales volume (in MWh or therms) and its profits. Traditionally, a utility's rates are set for a number of years based on forecast energy sales. If those sales are lower than expected, a company earns less profit. If those sales are higher than expected, a company earns more profit. This is often cited as a "disincentive" to energy efficiency success because utility management explicitly realizes it will earn more profit with higher sales.

A large majority of electric utility costs are fixed, to pay for capital-intensive equipment such as wires, poles, transformers and generators. Utilities recover most of these fixed costs through volumetric-based rates, which change every 3-5 years with each so-called major "rate case", the traditional and dominant form of utility ratemaking. But between rate cases, utilities have an implicit incentive to maximize their retail sales of electricity (relative to forecast levels, which set "base" rates); i.e., to maximize the "throughput" of electricity across their wires, in order to ensure recovery of fixed costs and maximize allowable earnings (recovery of variable costs is assured through regular – e.g., quarterly - adjustments such as for fuel, and thus doesn't impose analogous disincentives.)

With traditional ratemaking, there is no mechanism to prevent "over-recovery" of these fixed costs, which occurs if sales are higher than projected; and no way to prevent "under-recovery", which can happen if forecast sales are too optimistic (such as when weather or regional economic conditions deviate from forecast or "normal"). This dynamic is often said to create an automatic disincentive for utilities to promote energy efficiency or distributed generation, because those actions – even if clearly established and agreed-upon as less expensive means to meet customer needs - will reduce the amount of money the utility can recover towards payment for fixed costs.

If ratemaking accounted for this effect, for example by allowing more frequent true-ups to rates to reflect actual sales and actual fixed cost revenue requirements, or by scrutinizing load forecasts during rate cases to more carefully discern the effect of EE programs, then this disincentive would be removed, or minimized, and energy efficiency options would then be able to compete on a truly level playing field with alternative supply options. Separate, supplemental shareholder incentive mechanisms, such as performance-based ROE guarantees, could then operate more effectively in the absence of the disincentive that the standard ratemaking otherwise imposes on utility managers.

Thus, a coherent financial incentive structure for utilities helps align company profit aims with installation of cost-effective demand-side resources such as energy efficiency (EE) and distributed generation (DG). Traditional regulatory approaches link a utility's financial health to the volume of electricity or gas sold, via the ratemaking structure, thus providing a potential disincentive to investment in cost-effective demand-side resources that reduce sales. The effect of this linkage is exacerbated in the case of distribution-only utilities, since the profit impact of electricity sales reduction is disproportionately larger for utilities without generation resources. Aligning utility aims through "decoupling" profits from sales volumes, ensuring program cost recovery, and providing shareholder performance incentives, can "level the playing field" to allow for a fair, economically-based comparison between supply- and demand-side resource alternatives.

However, isolating energy efficiency effects on sales when considering ratemaking structures is sometimes considered as "single issue" ratemaking, and may be at odds to traditional state regulatory policy. While EE impacts on sales are important, there are other affects on sales (e.g., weather and economic activity) and there are utility cost trends that vary over the time frame between rate cases.

In some jurisdictions – e.g., Vermont – third party provision of EE removes the "need" to even consider "decoupling"; it does mean that utilities need to carefully account for EE effects in their load forecast.

Decoupling concepts must be addressed in ratemaking forums. They cannot be addressed solely within the context of EE programs and least cost procurement of EE and system reliability. While straightforward in concept, the details of how decoupling precepts are placed into practice are crucial.