**STATE OF RHODE ISLAND**

**DIVISION OF PUBLIC UTILITIES & CARRIERS**
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March 19, 2021

Luly Massaro,
Commission Clerk
State of Rhode Island
Public Utilities Commission
89 Jefferson Blvd.
Warwick, R.I. 02888

**In re: Docket 5076 --- National Grid's 2021 Energy Efficiency Program Plan**
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Dear Luly,

Please find attached the Rhode Island Division of Public Utilities and Carriers (Division) Comments with respect to the Commissions PIM proposal for filing with the Rhode Island Public Utilities Commission. Thank you for your attention in this matter.

Sincerely,

/s/ Jon G. Hagopian

Jon G. Hagopian
Deputy Chief Legal Counsel

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# Memo

**To:** **Luly Massaro, Commission Clerk**
**Rhode Island Public Utilities Commission**

**From:** **Linda George, Administrator**
**Joel Munoz, Rate Analyst**
**Tim Woolf, Synapse Energy Economics**

**Date:** **March 19, 2021**

**Re:** **Docket No.: 5076 – The Narragansett Electric Company d/b/a National Grid 2021-2023 Energy Efficiency Program Plan & 2021 Annual Energy Efficiency Program Plan**

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## Background

The Division of Public Utilities and Carriers ("Division") respectfully offers the following comments in response to the Public Utilities Commission's ("PUC") Solicitation of Comments on its Performance Incentive Mechanism proposal ("Commission PIM Proposal").

## Summary of the Key Elements of the Commission PIM Proposal

Table 1 summarizes and compares the Commission PIM Proposal with the settling parties' proposal ("Settlement Proposal"). One of the key differences is that the Commission PIM Proposal includes a much narrower definition of eligible benefits, where half of resource benefits and all of the non-resource and environmental benefits are excluded. This results in the eligible net benefits for the Residential and Income-Eligible sectors being negative. Negative eligible net benefits result in negative payout rates, which cannot be used to calculate payouts. Consequently, the Commission PIM Proposal includes three new elements that the Settlement Proposal does not:

1. The total portfolio design performance payout rate is allocated to the Commercial and Industrial ("C&I") sector.
2. The design payout rates for the Market Residential ("Res") and Income Eligible ("IES") sectors are set by the PUC at a positive amount.

3. The service quality adjustment is added to provide National Grid (the "Company") with incentive to reduce costs and increase benefits in the Res and IES sectors.

The Commission PIM Proposal also includes two additional elements that are not driven by the difference in eligible benefits:

1. The design payout rate adjustments, which is intended to address the sharp break in the incentive that results from the 65% threshold in the Settlement Proposal.
2. The boundary rules, which are intended to encourage more efficient use of funds when actual costs exceed design levels.

**Table 1. Commission PIM Proposal Compared with the Settlement Proposal**

| Element | Commission PIM Proposal | Settlement Proposal |
|---|---|---|
| Eligible Costs | Program costs and regulatory costs. | Program costs. |
| Eligible Benefits | Utility system benefits: 100%<br>Resource benefits: 50%<br>Non-resource benefits: 0%<br>Environmental benefits: 0%<br>Macroeconomic benefits: 0% | Utility system benefits: 100%<br>Resource benefits: 100%<br>Non-resource benefits: 100%<br>Environmental benefits: 100%<br>Macroeconomic benefits: 0% |
| Design Performance Achievement | Res: $2 million.<br>IES: $2 million.<br>C&I: eligible net benefits. | Res: eligible net benefits.<br>IES: eligible net benefits.<br>C&I: eligible net benefits. |
| Design Performance Payout (2021) | Res: $0.5 million.<br>IES: $0.5 million.<br>C&I: $5.5 million.<br>Total: $6.5 million.<br>Plus the Service Quality Adjustment. | Res: $1.9 million.<br>IES: $1.1 million.<br>C&I: $2.5 million.<br>Total: $5.5 million. |
| Payout Rates | Equals performance payout / performance achievement. | Equals performance payout / performance achievement. |
| Design Payout Rate Adjustments | Includes a payout threshold at 25% of design performance achievement. After that, the payout scales linearly and has step adjustments at 50% and 75% of performance. | Includes a payout threshold of 65% of design performance achievement. After that, the payout scales linearly up to the payout cap. |
| Payout Caps | Design performance payout * 1.25 | Design performance payout * 1.25 |
| Service Quality Adjustment (SQA) | To encourage performance in Res and IES, if design performance achievement is not reached. | Not needed because the eligible net benefits for Res and IES are positive. |
| Boundary Rules | To encourage more efficient use of funds when actual achievement and actual costs exceed design levels. | None. |

## Division Comments

Eligible Costs

The Division does not oppose the PUC's proposal to include regulatory costs in the eligible costs. The Company has no control over the regulatory costs, so there is no value to including them in the PIM mechanism. On the other hand, they are relatively small and are likely to have no bearing on the Company's earned PIM because the Company is very likely to spend exactly 100% of those costs.

Eligible Benefits

The Division's primary concern with the Commission PIM Proposal is the way that the eligible benefits are defined. By eliminating half the resource benefits and all the non-resource and environmental benefits, the Company will not be encouraged to implement some Res and IES programs as they are currently designed in the 2021 Annual Energy Efficiency Program Plan ("EE Plan"). This is especially true for the two Energy*Wise* Res programs and the two IES programs, because these programs offer numerous benefits that fall within the resource, non-resource, and environmental categories.

For example, the resource benefits for the Single-Family Energy*Wise* program represent roughly 80% of the total benefits (where the total benefits exclude macroeconomic benefits). These resource benefits are achieved almost entirely from reducing oil, gas, and propane for space and water heating. One of the easiest ways for the Company to maximize its earned incentive for this program under the Commission PIM Proposal is to downplay, or even eliminate, customer incentives to switch to more efficient water or space heating equipment. This would result in a much less effective Energy*Wise* program, as water and space heating savings are among the biggest efficiency savings available from that program. It would also undermine the fuel-neutral, one-stop-shopping delivery approach that has made these home energy retrofit programs so successful in Rhode Island and other leading states.

As another example, the resource benefits for two IES home energy retrofit programs represent roughly 23% of the total benefits and the non-resource benefits represent roughly 45% of the total benefits (where the total benefits exclude macroeconomic benefits). The non-resource benefits are made up partly of utility system benefits[1] and partly of low-income participant benefits.[2] There are two problems with excluding these non-resource benefits. First, the non-resource utility system benefits are actually power system benefits that flow to all electricity customers by lowering utility costs. Second, the Company is not being provided any incentive for achieving low-income participant benefits, even though protecting low-income customers is clearly an important policy goal of the PUC, the Division, and the state.

These incentives created by the Commission PIM Proposal are inconsistent with the fundamental purpose of PIMs, which is to encourage utilities to achieve regulatory goals as efficiently and effectively as possible.[3] In this case, the regulatory goals have been established in the 2021 EE Plan, but the Commission PIM Proposal will encourage the Company to deviate from that plan, perhaps in some significant, undesirable ways.

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[1] These include reduced arrearages; bad debt write-offs; terminations and reconnections; notices; and safety related emergency calls.

[2] These include thermal comfort; home durability; equipment maintenance; and health and safety. The societal low-income program benefits, such as reduced energy burden, poverty alleviation, and local economic benefits, are not currently captured in the Company's benefit-cost analysis, even though they are recognized as benefits in the Rhode Island Test.

[3] See, for example: Regulatory Assistance Project, *Next-Generation Performance-Based Regulation*, Volume 2, Primer—Essential Elements of Design and Implementation, September 2017, Section 3. Synapse Energy Economics, *Utility Performance Incentive Mechanisms: A Handbook for Regulators*, Prepared for the Western Interstate Energy Board, March 2015, Table 1 and Section 3.4.

The Energy*Wise* and IES home energy retrofit programs play a critical role in the EE Plan in that they promote customer equity by serving low-income residents, renters, and other hard-to-reach customers. The fuel-neutral approach offered by these programs is the most cost-effective way to achieve long-term energy savings, revitalize Rhode Island's housing stock, and meet the state's GHG goals. Approximately 30 percent of Rhode Island homes are heated with delivered fuels. All these homes receive electric service and pay into the EE programs. The Commission PIM Proposal may encourage the Company to downplay or eliminate incentives to replace inefficient water and space heating systems, creating lost opportunities and inefficient use of EE funds.

Further, providing the Company with an incentive to significantly modify these programs is inconsistent with policies that the PUC has had in place for many years. The PUC has approved the use of low-income non-resource benefits since the 2009-2011 EE Plan (Docket No. 3931); the use of resource benefits since the 2003 EE Plan (Docket No. 3463); and the use of environmental benefits since Docket 4600.[4]

The PUC's treatment of eligible benefits apparently stems from the PUC's preference for providing a utility incentives for only direct "cash" benefits to utility customers, as opposed to "non-cash" benefits.[5] In the Rhode Island Test, established in Docket 4600, these cash benefits are referred to as "power system" benefits, because they reduce the costs of running the power system.[6] The resource, non-resource, and environmental benefits can be described as non-cash benefits because they are not directly experienced by utility customers in terms of lower bills.

The Division appreciates the goal of prioritizing power system benefits and agrees with the PUC's goal of reducing customer utility bills. The Division is concerned, however, that this distinction being made in this instance will result in too much of a deviation between the regulatory goals included in the energy efficiency programs and the financial incentives created by the PIM.

PIMs allow utilities to earn shareholder incentives to achieve specific regulatory goals that they might not otherwise achieve under the financial incentives provide by the current ratemaking framework. In this light, there is nothing wrong with providing utilities with a financial incentive for non-cash benefits. PIMs are intended to provide utilities with financial incentives to achieve regulatory goals, including those that do not have a cash benefit. In fact, it might be more important to provide utilities with incentive to achieve some non-cash regulatory goals, because the utility might have less incentive to achieve those goals than they do for cash-based goals. One example of this is providing a financial incentive to support low-income energy efficiency programs. Achieving the non-cash, non-resource benefits of low-income programs is more expensive and more challenging than achieving the cash benefits associated with Res and C&I programs. But achieving these non-cash, non-resource low-income benefits, as well as promoting customer

[4] Regarding the environmental benefits, it is important to note that as Rhode Island's GHG goals become increasingly concrete and binding on the electricity and gas sectors, these indirect, external environmental benefits will become direct, internal benefits to customers. Not achieving these benefits now will result in higher costs to meet GHG goals in the future.

[5] PUC's Guidance on Principles for the Development and Review of Performance Incentive Mechanisms (Section IV, Principle #2) approved on May 8, 2020, in Docket No. 4943.

[6] The Rhode Island Public Utility Commission, *Notice to Accept Comments on Draft Guidance Document*, Re: Investigation into the Changing Electric Distribution System and the Modernization of Rates in Light of the Changing Distribution System, Docket No. 4600-A, Appendix A.

equity, is an important regulatory goal. Thus, it is completely appropriate to provide utilities with an incentive for achieving this non-cash regulatory goal.

The Division appreciates the PUC's concerns about spending too much of customer energy efficiency funds to achieve non-cash benefits and regulatory goals. The Division is always cognizant of the impacts of the EE programs on electric and gas customers and their bills. However, if the PUC believes that the Company should not be pursuing non-cash benefits through the EE Plan, then it should establish that regulatory principle *prior to the development of an EE Plan* so that principle can be applied in the Plan. To have a PIM proposal that provides incentives that are inconsistent with regulatory goals already established in the EE Plan jeopardizes those goals, provides mixed signals to utilities and other stakeholders, and will likely lead to unintended, undesirable outcomes.

This is by far the main concern that the Division has with the Commission PIM Proposal. The EE PIM should provide the Company with incentives that are consistent with regulatory goals embedded in the EE Plan. However, the Commission PIM Proposal does not do this. The Division is concerned that this approach would not only lead to a bad outcome regarding the 2021 energy efficiency programs, but it will also set a bad precedent for other PIM mechanisms.

Further, the Commission PIM Proposal creates a critical question for future EE Plan development: should the development of future EE programs be driven by the Least Cost Procurement Standards and Docket 4600 guidance, or should they be driven by the Commission PIM Proposal?

Design Performance Achievement

The design performance achievement targets in the Commission PIM Proposal are apparently included to provide the Company with incentive to achieve positive net benefits, even in those sectors where the net benefits as defined in the EE Plan are negative. This new feature is an artifact of the way that the Commission PIM Proposal defines eligible net benefits.

The Division is concerned that the Res and IES design performance achievement targets are so high that the Company is unlikely to reach these targets. If they do reach these targets, it will only be by significantly deviating from the approved energy efficiency programs, which as described above is not necessarily a desirable outcome.

The Division is also concerned that the value assigned to these targets has not been explained or justified by the PUC. For example, it is not clear why both the Res and IES sectors have the same design performance achievement target even though they offer very different benefits and net benefits. This provision seems to provide very different incentives for achieving performance across these two important sectors.

Design Performance Payout

The design performance payout in the Commission PIM Proposal assigns the full amount of portfolio incentives to the C&I sector, apparently in order to account for the fact that the Res and IES sectors have negative net benefits as defined by the Commission PIM Proposal. This new feature is an artifact of the way that the Commission PIM Proposal defines eligible net benefits.

The Division is concerned that allocating the proposed $5.5 million to the C&I sector will have unintended consequences. Attachment 1 provides an example to illustrate this point. This is particularly troubling in light of the problems that the Division has identified with the Service Quality Adjustment mechanism proposed by the PUC, as discussed further below.

<u>Payout Rates</u>

The Division supports the formula proposed by the PUC to calculate payout rates. It is the same formula that is used in the Settlement Proposal.

<u>Design Payout Rate Adjustments</u>

The Division does not oppose these adjustments but offers instead that it would be much simpler to just lower the 65% threshold to 25%.

Also, the Service Quality Adjustment is designed so that the Company earns no incentive for performance under 65% in the Res and IES sectors. This creates a different incentive for Res and IES programs relative to C&I programs in this region of performance.

<u>Payout Caps</u>

The Division supports these. They are the same as the ones in the Settlement Proposal. However, the Division notes that if the Company performs very well in all three sectors, then the total portfolio payout cap under the Commission PIM Proposal ($8.125 mil) is significantly higher than the total payout cap under the Settlement Proposal ($6.875 mil).

<u>Service Quality Adjustments for Residential and Income-Eligible Sectors</u>

The Service Quality Adjustments ("SQA") in the Commission PIM Proposal are applied to incentivize the Company to reduce costs and increase benefits in the Res and IES sectors, given that the net benefits in those sectors (as defined in the 2021 EE Plan) are negative and that the total portfolio design performance payout is allocated entirely to the C&I sector. This new feature is an artifact of the way that the Commission PIM Proposal defines eligible net benefits.

The Division has three primary concerns with the SQA proposal. First, the SQA includes two very different ways for the Company to be incentivized. One is through a positive incentive for exceeding the design performance achievement; the other is through the downward adjustment when performance variance is negative. This creates inconsistent incentives at different points in the performance space and creates a gap in the performance space where the Company does not experience any incentive. When the performance variance is greater than zero and the net benefits are less than design performance achievement ($2 million in net benefits), the Company has no incentive to reduce costs or increase benefits.

Second, the SQA creates an incentive structure for the Res and IES sectors that is inconsistent with the incentive structure for the C&I sector. These differences could easily lead to unintended, undesirable consequences. The key differences include the following:

- The performance variance approach used for the SQA provides different incentives than the net benefits approach that is applied to the C&I sector.

- The threshold at which the Company begins earning an incentive is 65% for the C&I sector, but 25% for the Res and IES sectors, as noted above.
- The incentives for the Res and IES sectors change at 65%, 95%, and 100% of net benefits, whereas the incentive for the C&I sectors change at 25%, 50%, 75%, and 100% of net benefits.
- The payout cap for the Commission PIM Proposal is significantly higher than that of the Settlement Proposal, as described above.

Third, the SQA is complex and counter-intuitive. One of the key principles in designing PIMs is to keep them simple and transparent.[7] Increased complexity and lack of transparency increase the risks of unintended consequences and utility gaming. The SQA is neither simple nor transparent.

Fourth, and most important, the SQA is necessary only because of the limited way that the PUC has chosen to define eligible benefits. A broader definition of eligible benefits would eliminate the need for this complex, counter-intuitive, and potentially problematic addition to the EE PIM.

Boundary Rules

The Division does not oppose the use of these boundary rules. While they add to the complexity of the Commission PIM Proposal, they might provide better incentives around the margins and they are not likely to have any unintended or undesirable consequences.

**Division Recommendations**

Given that most of the Division's concerns stem from the Commission PIM Proposal definition of eligible benefits and the features that are caused by it, the Division recommends a broader definition of eligible benefits. We recognize the PUC's concerns about providing utility incentives for non-cash benefits and therefore do not recommend that eligible benefits be defined as they were in the Settlement PIM. Instead, the Division recommends that eligible benefits be designed to include all resource and all non-resource benefits but exclude the environmental and macroeconomic benefits.

This will provide the Company with incentive to maintain the very important fuel-neutral approach to the home energy retrofit programs by including all resource benefits. It will also provide incentive to adequately serve the IES population by including the low-income non-energy benefits that are within the non-resource benefits. This definition of eligible benefits will also result in net benefits that are positive for each sector, thereby avoiding the need for the SQA and other problematic features described above.

Table 2 presents a summary comparison of the Commission PIM Proposal and the Division's recommendations. Attachment 1 provides some examples for how the Division's

[7] See, for example: Regulatory Assistance Project, *Next-Generation Performance-Based Regulation*, Volume 2, Primer—Essential Elements of Design and Implementation, September 2017, Sections 3.3. and 3.8. Synapse Energy Economics, *Utility Performance Incentive Mechanisms: A Handbook for Regulators*, Prepared for the Western Interstate Energy Board, March 2015, pages 30-31.

recommendation would affect incentives under several different scenarios. It shows that this approach provides preferable incentives than the Commission PIM Proposal.

**Table 2. Commission PIM Proposal Compared with the Division's Recommendations**

| Element | Commission PIM Proposal | Division Recommendations |
|---|---|---|
| Eligible Costs | Program costs and regulatory costs. | Program costs and regulatory costs.<br>*(Same as PUC.)* |
| Eligible Benefits | Utility system benefits: 100%<br>Resource benefits: 50%<br>Non-resource benefits: 0%<br>Environmental benefits: 0%<br>Macroeconomic benefits: 0% | Utility system benefits: 100%<br>Resource benefits: 100%<br>Non-resource benefits: 100%<br>Environmental benefits: 0%<br>Macroeconomic benefits: 0% |
| Design Performance Achievement | Res: $2 million.<br>IES: $2 million.<br>C&I: eligible net benefits. | Res: eligible net benefits.<br>IES: eligible net benefits.<br>C&I: eligible net benefits.<br>*(Same as Settlement)* |
| Design Performance Payout (2021) | Res: $0.5 million.<br>IES: $0.5 million.<br>C&I: $5.5 million.<br>Total: $6.5 million.<br>Plus the Service Quality Adjustment. | Res: $1.9 million.<br>IES: $1.1 million.<br>C&I: $2.5 million.<br>Total: $5.5 million.<br>*(Same as Settlement)* |
| Payout Rates | Equals performance payout / performance achievement. | Equals performance payout / performance achievement.<br>*(Same formula as PUC and Settlement)* |
| Design Payout Rate Adjustments | Includes a payout threshold at 25% of design performance achievement. After that, the payout scales linearly and has step adjustments at 50% and 75% of performance. | Includes a payout threshold of 65% of design performance achievement. After that, the payout scales linearly up to the payout cap.<br>*(Same as Settlement)* |
| Payout Caps | Design performance payout * 1.25 | Design performance payout * 1.25<br>*(Same as PUC and Settlement.)* |
| Service Quality Adjustment | To encourage performance in Res and IES, if design performance achievement is not reached. | Not needed.<br>*(Same as Settlement)* |
| Boundary Rules | To encourage more efficient use of funds when actual achievement and actual costs exceed design levels. | Included.<br>*(Same as PUC.)* |

## Responses to Questions Posed by the PUC

1. Anything that remains unclear about the PUC's PIM Proposal.

Regarding the Design Performance Achievement (column e in the PUC's table), why are the achievement levels set at $2 million for the Res and IES sectors? This seems to create a gap, between zero and $2 million in net benefits, where the Company is not eligible to earn increased incentive for increased performance. Further, given the fact the IES net benefits are lower than Res, why must it meet the same $2 million achievement level?

2. The allocation of regulatory costs.

   As noted above, the Division does not oppose the inclusion of regulatory costs in the PIM but believes that the decision will likely have no bearing on the EE program implementation, or the incentive earned by the Company.

3. Whether the graduations included in the Commission PIM Proposal adequately address the concerns about abrupt changes in the prior proposal.

   The Division believes that the Commission PIM Proposal adequately addresses concerns about abrupt changes in the Settlement Proposal at the 65% threshold. However, the Division believes that lowering the threshold would be much simpler and just as effective.

4. Whether certain gas resource benefits should be categorized as system benefits.

   The Division recommends that the PUC direct the Company to break out all of the benefits included in the gas EE programs. Once these are properly identified, it will be easier to determine which benefits qualify as eligible benefits.

5. Whether the PUC should adopt its PIM Proposal for one or three years. If adopted for three years, what, if any, parts of the Commission PIM Proposal would change each year, and what would the Company need to establish prior to the PUC adopting its PIM Proposal for three years.

   The Division prefers that the PIM mechanism adopted for 2021 be applied for only one year. After the first year, the PUC can revisit the question of whether to extend it into future years.

6. What, if any, impact would the Commission PIM Proposal have on the Company's ability to deliver programs to renters.

   The Division is concerned that the Commission PIM Proposal provides an incentive to deliver home energy retrofit programs that are significantly different from those proposed in the 2021 Energy Efficiency Plan, as described above. This incentive will hinder the Company's ability to deliver programs to renters, because renters rely heavily upon the home energy retrofit programs.

7. To what extent should the rules pertaining to the ability of the Company to transfer funds between programs be modified? Is the requirement that the PUC approve certain transfers necessary in light of its PIM Proposal?

   The Division recommends that the transfer rules included in the 2021 EE Plan remain in effect. Given the Division's concerns regarding the unintended consequences of the PUC's proposal on program implementation, it will be especially important to maintain transparency for funding transfers.

## Attachment 1: Illustrative Examples

### Comparison: General

Figure 1 and Figure 2 present the Division and the Commission PIM Proposals for a specific set of outcomes. These figures compare the earned PIM to the net benefits achieved by the Company. These figures are based on the assumptions that the percentage of costs achieved and the percentage of benefits achieved are equal. Under these conditions, the percentage of net benefits achieved is the same as the percentage of benefits achieved. Note that there are many alternative permutations that might occur with different achieved benefits, costs, and net benefits.[8] These figures are based on one set to simplify the comparison of these two proposals.

**Figure 1. Incentives Earned at Different Performance Levels: Division PIM Proposal**

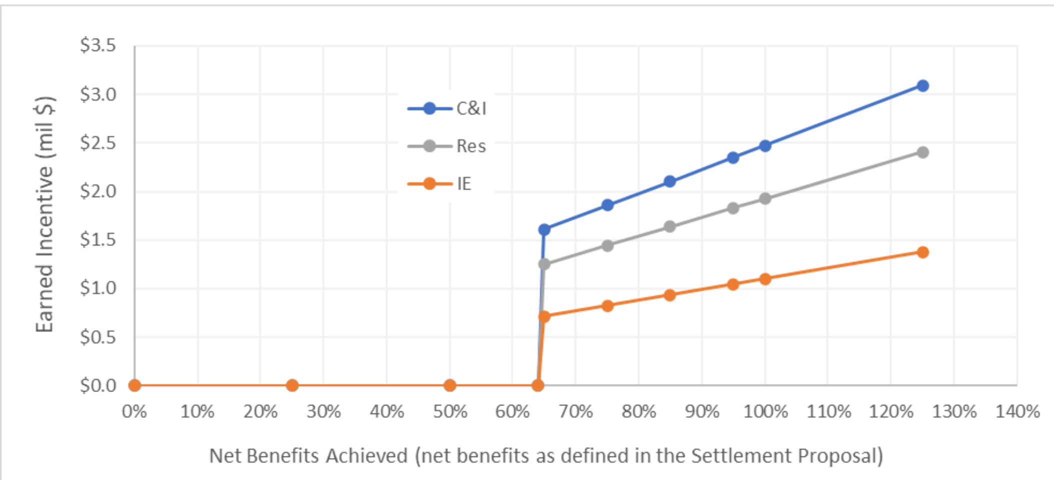
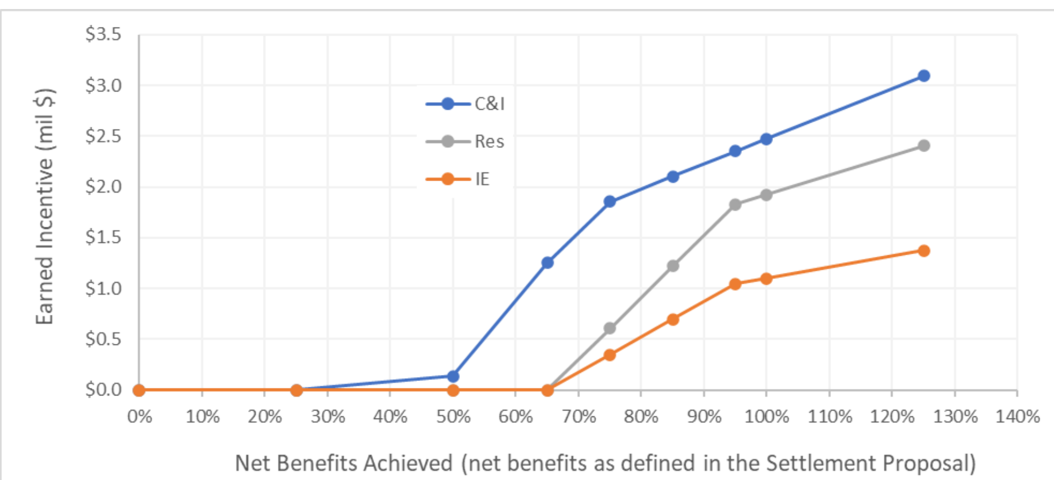



**Figure 2. Incentives Earned at Different Performance Levels: Commission PIM Proposal**




[8] For example, because of this presumption, none of these results show incentives that would result if the Res or IES sectors exceeds the $2 million design level of net benefits in the Commission PIM Proposal.

Two adjustments were made to the Commission PIM Proposal results in order to make Figures 1 and 2. First, the Res and IES sector earned incentives were backed out of the results. In other words, the positive incentives from these two sectors were calculated by starting from the full design level incentive for each sector as proposed in the 2021 EE Plan and subtracting out the downward adjustment in the relevant case. The C&I incentive was then adjusted to reflect the downward adjustment from the other two sectors. This adjustment is illustrated in Table 3 and Table 4 below. Second, if the Commission's PIM Proposal were applied literally as described in the Notice of Comments, the Company would experience negative incentives for the Res, IES, and C&I sectors when performance falls below 65% net benefits. The Division assumes that this is not the intent of the Commission, so those negative incentives were set to zero.

Figure 2 indicates how under the Commission PIM Proposal the Company is subject to a different incentive structure for the C&I sector relative to the other sector in the region when the net benefits are between 25% and 100% of design level.

A comparison of Figure 1 and Figure 2 indicates the extent to which the C&I, Res, and IES sectors are subject to different incentive structures across the two proposals, again in the region when the net benefits are between 25% and 100% of design level. Under the Commission PIM Proposal, the earned incentive begins at 0% of the design level incentive (at 65% of net benefits) and increases to 100% of the design level incentive, while under the Division Proposal, the earned incentive begins at 65% of the design level incentive (at 65% of net benefits) and increases to 100% of the design level incentive. This is an important difference because it gives the Company greater incentive to achieve net benefits in the C&I sector than in the Res and IES sectors. Further, this region of performance, between 65% and 100% of net benefits, is the most important region because this is where the Company's performance is most likely to end up.

**Comparison: Specific Examples**

In examples 1 and 2 below, two hypothetical performance outcomes compare differences between the Commission, the Division, and the Settlement PIM Proposals. Again, there are many permutations as to how the achieved costs, benefits, and net benefits might turn out. These are just two examples to illustrate some points. The same two adjustments to the Commission's PIM Proposal described above were made here in making these proposals.

<u>Example 1: Res and IES Sectors Underperform but the C&I Sector Meets Goals</u>

Table 3 and Figure 3 present a hypothetical performance outcome where the C&I sector meets both of its costs and benefits targets, but the Res and IES sectors spend only 90% of costs and achieve only 80% of benefits.

As indicated, under the Settlement and Division PIM Proposals, the Company would earn no incentive for the Res and IES sectors because the net benefits in those sectors fall below the 65% threshold. In contrast, under the Commission PIM Proposal the Company would earn positive incentives for the Res and IES sectors and a higher incentive for the C&I sector.

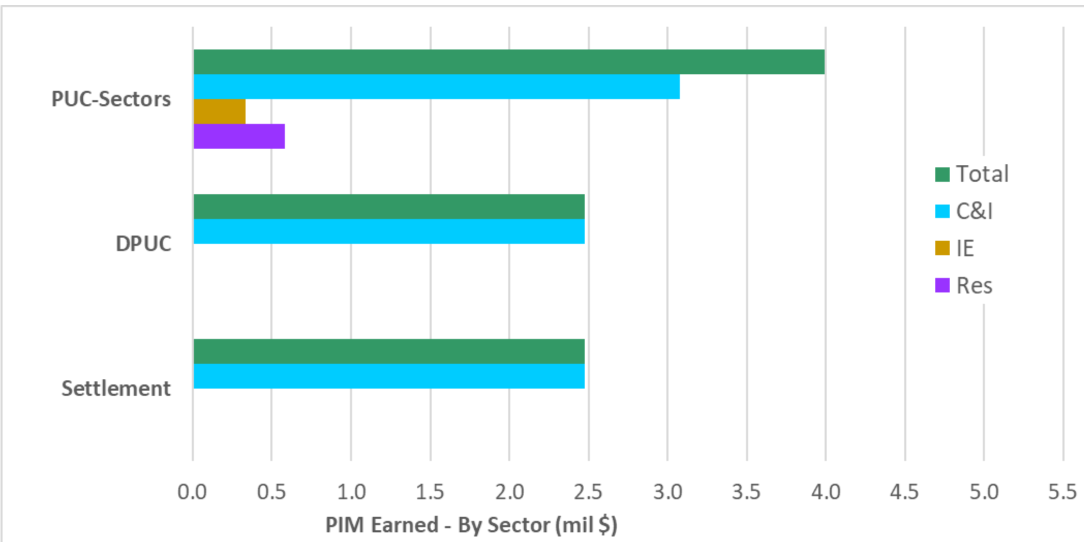
This example highlights the unintended consequences of allocating the proposed $5.5 million to the C&I sector and the application of the SQA to only Res and IES sectors. In this example, even though the Res and IES sectors underperform and have a higher spend to savings ratio, the Company is earning a larger PIM than under the Settlement and Division Proposals.

This difference between the proposals creates an incentive for the Company to focus its efforts on achieving the C&I goals at the expense of the Res and IES sectors since poor performance in those sectors has less of an impact on the PIM than achieving 100% in the C&I sector.

**Table 3. Res and IES Sectors Underperform**

| | Performance Costs | Performance Benefits | Performance Net Benefits | Performance Variance | PIM Earned ($) | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Settlement | Division | PUC-Sectors | PUC |
| Res | 90% | 80% | 60% | -10% | $0 | $0 | $580,708 | $-959,292 |
| IES | 90% | 80% | 63% | -10% | $0 | $0 | $331,833 | $-548,167 |
| C&I | 100% | 100% | 100% | 0% | $2,475,000 | $2,475,000 | $3,080,000 | $5,500,000 |
| Total | 95% | 95% | 94% | -1% | $2,475,000 | $2,475,000 | $3,992,542 | $3,992,542 |

**Figure 3. Res and IES Sectors Underperform**




Example 2: Res and IES Sectors Meet Design Goals but the C&I Sector Underperforms

Table 4 and Figure 4 present a hypothetical performance outcome where the Res and IES sectors meet both of their costs and benefits targets, but the C&I sector spends only 75% of costs and achieves only 70% of benefits.

As indicated, the Company would earn the same incentive for both the Res and IES sectors under all three proposals. This is because the incentives are identical for these sectors at the 100% performance level. Under the Commission PIM Proposal, however, the Company would earn significantly less than under the other two proposals for the C&I sector. This is because of the different performance thresholds applied in the Commission PIM Proposal.

This example illustrates that the Commission’s proposal provides the Company with more incentive to perform well in the C&I than under the other two proposals because underperformance in this sector would result in less earned incentive. While this might have a positive impact for the C&I sector, it creates the risk that the Company will emphasize the C&I sector at the expense of the Res and IES sectors. Note that this is the same risk that was identified in Example 1, except in that case the C&I sector performed well and the Res and IES sectors did not.

**Table 4. C&I Sector Underperforms**

| | Performance Costs | Performance Benefits | Performance Net Benefits | Performance Variance | PIM Earned ($) | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Settlement | Division | PUC-Sectors | PUC |
| Res | 100% | 100% | 100% | 0% | $1,925,000 | $1,925,000 | $1,925,000 | $0 |
| IES | 100% | 100% | 100% | 0% | $1,100,000 | $1,100,000 | $1,100,000 | $0 |
| C&I | 75% | 70% | 68% | -5% | $1,686,350 | $1,674,740 | $361,111 | $3,386,111 |
| Total | 87% | 77% | 73% | -9% | $4,711,350 | $4,699,740 | $3,386,111 | $3,386,111 |

**Figure 4. C&I Sector Underperforms**