STATE OF RHODE ISLAND
OFFICE OF ENERGY RESOURCES

March 19, 2021

Chairperson Ronald Gerwatowski
Commissioner Marion Gold
Commissioner Abigail Anthony
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, Rhode Island 02888

Re: Docket #5076 – Comments on the Commission's Proposed Performance Incentive Mechanism

Dear Commissioners:

The Rhode Island Office of Energy Resources (OER) submits these comments regarding the Commission's performance incentive mechanism proposal (Commission PIM Proposal) for National Grid's energy efficiency programs. OER first discusses a series of assumptions which may differ between parties and, therefore, lead to a discrepancy in how parties perceive the efficacy of the Commission PIM proposal. As requested in the public comment notice, responses to specific Commission questions are provided at the end of this letter.

Part I: Differing Assumptions

The concept of a PIM rests on a foundation of assumptions about company behavior and control of business decisions and outcomes – a company must be able to control the desired outcome that is being incentivized and the PIM payout must be of sufficient value (and sufficiently easy to understand) for the company to alter its behavior. Indeed, some of these underlying assumptions are implied in the Commission's PIM guidance document.[1] However, the Commission PIM Proposal seems to suggest a different perspective on certain underlying assumptions than is understood by settling parties and OER. These differing assumptions can drastically change the shape of a proposed PIM structure and its efficacy, but unfortunately may not be easily testable. In this section, we describe OER's perspective on seven key underlying assumptions, attempt to uncover where discrepancies may lie, and make recommendations for how those discrepancies may be resolved. We encourage the Commission to critically assess and question these assumptions when voting on an energy efficiency PIM structure.

Summary of differing assumptions discussed

1. Short-term versus long-term profit maximization
2. Degree of control over outcomes
3. PIM's role in driving program design
4. Motivating compliance versus innovation and optimization

[1] Public Utilities Commission's Guidance on Principles for the Development and Review of Performance Incentive Mechanisms adopted on May 8, 2020: http://www.ripuc.ri.gov/eventsactions/docket/4943-PIMs_Guidance_Document_Approved.pdf

5. Interpretation of historical precedents
6. Value of limited program overspend
7. PIM objectives and complexity

1. Short-term versus long-term profit maximization

First, OER believes that both settling parties and the Commission have made differing assumptions about National Grid's motivation to maximize profit. OER participated in PIM negotiations assuming that National Grid optimizes short-term profit from PIMs subject to maintaining/growing long-term earning potential and maintaining/improving public perception of the utility. For example, the provision of weatherization incentives for oil and propane heated homes suggests that National Grid uses a nuanced profit maximization scheme. Under current and previous energy efficiency PIMs, earnings for the utility were based solely on electric and natural gas savings – very little of which are achieved via oil or propane weatherization.

OER believes the utility is motivated to design programs that balance stakeholder priorities with short-term PIM earning maximization because, without stakeholder support, program administration responsibilities and earning opportunities could be assigned to another entity.

Expectations for utility behavior differ whether one assumes that the utility prioritizes short-term profit maximization or uses a more tempered optimization strategy. The following example highlights these differences and showcases how potentially perverse outcomes could occur under either assumption when using the Commission PIM Proposal.

Currently, National Grid's income eligible (IE) programs provide 100% cost-coverage for participants. Continuing this level of cost-coverage is a known priority for multiple stakeholders. Unfortunately, 100% cost coverage is unlikely to produce positive Commission-prioritized net benefits (i.e., net benefits calculated by excluding non-energy benefits and severely discounting delivered fuels benefits) even if substantial measure changes are made by the Company. Nevertheless, there is a large earning potential provided under the Commission PIM Proposal if National Grid can create IE programs that produce positive Commission-prioritized net benefits. Under a scenario where short-term profits are prioritized, National Grid may reduce cost-coverage for IE program measures and create IE programs with large, Commission-prioritized net benefits. OER does not support such an outcome as it could hinder IE consumer participation and realization of program benefits for those with significant energy burdens.

Under a scenario where desire to maximize short-term profit is tempered by risk of negative public reaction, National Grid is likely to maintain some form of 100% cost-coverage, which may keep the IE programs under the service quality rules in the Commission PIM Proposal. If IE programs are governed by the proposed service quality rules, the Company is strongly incentivized to lower IE benefit goals year over year – i.e., short-term profit maximization would be easiest when IE goals are less aggressive. OER recognizes that both the Settling Parties' PIM Proposal and the Commission's PIM Proposal suffer from incentivizing the Company to propose lower benefit goals and higher cost estimates in all sectors. However, the Commission PIM Proposal further exacerbates this problem by potentially stymieing IE program innovation. Rather than positioning the IE programs as a potential profit source, the Commission PIM Proposal – if played out under a limited profit maximization assumption where IE programs are unlikely to reach positive Commission-prioritized net benefits – frames the IE programs as only a risk to potential earnings. This suggests that making it easier to achieve service quality metrics will become the Company's primary IE goal. Over time, the Company may push for IE program simplification and will likely avoid testing new program delivery techniques. Such an outcome would harm Rhode Island's most vulnerable ratepayers.

Residential programs may also experience similar perverse outcomes as they may struggle to achieve positive Commission-prioritized net benefits. Therefore, to reframe the IE and residential programs as potential profit sources, OER recommends that some level of earnings be provided to the Company when these sectors, individually, perform better than planned.

2. ***Degree of control over outcomes***

The Commission's PIM Proposal seems to imply a high degree of control over program outcomes. In the workshops describing the theoretical basis for the Commission PIM Proposal, Commission staff used an example of the Company making a single business decision about what savings opportunity to pursue next.[2] While the example appropriately aided understanding of the savings space and PIM vector, OER views this degree of control over each decision as deviating from real-world frictions.

National Grid's energy efficiency programs have two notable features which lead to a lesser degree of control over program outcomes: number of agents and time to develop savings. First, National Grid employs a team of program strategists that oversee teams of program managers, who, in turn, oversee teams of program vendors and subcontractors. Each decision that results in energy savings and spending gets approved at a lower level rather than by one single agent. This is an appropriate way to manage a large business, as requiring all decisions to be approved by a single agent would be inefficient and costly, and would increase program costs and stymie program savings. Second, the majority of energy savings are the result of lengthy projects, which may take months (or more) to complete. Therefore, National Grid is not making a series of single decisions about which project to pursue next, but instead trying to steer a ship in the current of outcomes resulting from projects that have been in the works for months past. We point out this

[2] January 22, 2021 Public Utilities Commission Open Meeting, Slide #31, Presentation not yet posted under Docket #5076 but was received by OER via email on January 22, 2021

discrepancy to underscore the complexity of administering these programs and express our concern that the Commission PIM Proposal may not be as efficacious as intended.

3. PIM's role in driving program design

Throughout these preceding, there has been discussion that suggests the Commission expects National Grid and stakeholders to design programs according to the Docket 4600 framework. However, having a PIM that inconsistently values Docket 4600 categories will necessarily change how programs are designed. OER believes the Commission PIM Proposal's benefit categories (and weights) will start to be the dominant driver of program design over the equally-weighted categories in Docket 4600. This is concerning because it seems to dismiss years of stakeholder consensus and the value of non-Commission prioritized net benefits.

OER strongly recommends aligning PIM structures with stakeholder priorities. This alignment is critical for minimizing tension during program planning, encouraging collaborative and innovative thinking, and constraining unpredictable or unexpected program changes by National Grid or stakeholders. A PIM structure that deprioritizes some measures that are less than the cost of supply and screen under the Docket 4600 framework will harm the current, collaborative nature of Rhode Island's energy efficiency planning process. Such misalignment will either result in National Grid ignoring stakeholder priorities in pursuit of short-term profit maximization or it will incentivize National Grid to make achievement of stakeholder priorities as minimal and perfunctory as possible. Neither outcome is likely to support long-term collaborative stakeholder participation in energy efficiency planning. Therefore, any net benefits calculation used in an energy efficiency PIM should align with the Rhode Island Test used to determine energy efficiency cost-effectiveness.

4. Motivating compliance versus innovation and optimization

OER assumes that service quality metrics integrated into the Commission PIM Proposal primarily serve to motivate compliance rather than innovation or optimization. This is assumed because no upside is provided for marginal over-achievement in the residential and IE sectors. Instead, under the Commission PIM Proposal, National Grid would need to substantially redesign their IE and residential programs in order to experience increased earning potential related to these sectors. Because OER believes that these types of substantial program changes will be limited by potential negative stakeholder reactions, there is a high probability that existing residential and IE programs will stagnate. A stagnant program is undesirable because it will not keep up with changing energy efficiency technologies nor find new means of reaching ratepayers who have historically been underserved. To avoid this outcome, the Commission PIM proposal should be modified such that some limited earning potential is possible for surpassing planned benefits in the IE and residential programs.

5. ***Interpretation of historical precedents***

During energy efficiency PIM negotiations OER assumed that historically supported and still cost-effective program offerings, such as weatherization for oil and propane heated homes, should remain a program priority. This assumption was supported by the state's Heating Sector Transformation (HST) initiative,[3] which highlighted the need for on-going weatherization as a means of decarbonizing Rhode Island's thermal sector.

However, in the presence of potential earning reductions for under-delivering weatherization jobs and a lack of financial reward for marginal increases in weatherization delivery, National Grid will be incentivized to stagnate residential and IE oil/propane weatherization efforts, and erode delivered fuels weatherization goals year over year. This outcome is likely to be further exacerbated by the 50% discount applied to delivered fuel savings in the Commission PIM Proposal. Such a benefit discount suggests that the Commission is de-prioritizing delivered fuel energy efficiency savings.

OER does not support this outcome and recommends that any final energy efficiency PIM structure include financial earning potential for incremental (not just substantial) delivered fuel savings achievement. Without this type of change to the Commission PIM Proposal, National Grid's programs are likely to result in lower levels of greenhouse gas emission reductions than assumed in the HST report and shown to be cost-effectively available in the recent Potential Study.[4]

6. ***Value of limited program overspend***

OER assumes that limited program overspend, if used to achieve additional cost-effective energy efficiency that is less than the cost of supply, is beneficial for Rhode Island and consistent with Least-Cost Procurement law. OER does not suggest that program overspend should be unlimited. Rather, there should be a balance point between exposing ratepayers to some, limited budgetary uncertainty and delaying achievable, cost-effective energy efficiency procurement.

As is, the Commission PIM Proposal appears to prefer delaying energy efficiency procurement over most types of overspend – the exception being the procurement of energy efficiency that is more cost-effective than what was proposed in the approved energy efficiency Plan. This aspect of the Commission PIM Proposal contradicts Commission PIM Principle #5, which states that "(t)he utility should be offered the same incentive for the same benefit. Stated another way, no action should be rewarded more

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[3] Heating Sector Transformation Final Report: http://www.energy.ri.gov/documents/HST/RI%20HST%20Final%20Pathways%20Report%205-27-20.pdf
[4] Rhode Island Market Potential Study (2021-2026): https://rieermc.ri.gov/rhode-island-market-potential-study-2021-2026/
Heating Sector Transformation Final Report: http://www.energy.ri.gov/documents/HST/RI%20HST%20Final%20Pathways%20Report%205-27-20.pdf

than an alternative action that produces the same benefit."[5] In the case of the Commission PIM Proposal, a boiler upgrade conducted before the annual program budget level is reached is worth some $X/net benefit achieved for National Grid.[6] However, once the annual program budget is reached, that same boiler upgrade is worth $0/net benefit achieved. This could result in National Grid delaying the boiler upgrade or missing the opportunity to install a more energy efficient boiler in the case of an emergency replace-on-failure scenario. Although this same outcome could also occur under the 2020 energy efficiency PIM, its likelihood was relatively small since PIM earnings were permitted up to 125% of planned goals.

Of particular concern is the possibility that removing National Grid's incentive to install cost-effective energy efficiency near the end of an implementation year will result in temporary program pauses. Such variability in program availability should not be taken lightly as it may result in decreased participation and vendor misgivings, which, in turn, may limit energy savings in future years or lead to increasing program costs. Therefore, OER recommends that the earning potential for the utility continue up to some limited threshold above planned values both above and below the y=x line in quadrant I.

7. *PIM objectives and complexity*

During PIM negotiations with other settling parties, OER assumed that a PIM structure was a means of optimizing utility performance within a plane of potential program achievement. This plane of program achievement was defined by overarching rules such as budget management requirements and statutory standards including Least-Cost Procurement's mandate that procured energy efficiency be cost-effective and less than the cost of supply. In contrast, it appears that the Commission is seeking to combine all program requirements into one PIM structure. This approach is likely to result in a highly complex, multi-step PIM structure that is difficult to explain and impossible to optimize when working with imperfect information.

If a PIM is not easily understood or requires complex optimization, then it is likely to be less effective than intended.[7] It is also expected to create barriers to stakeholder participation in energy efficiency planning. Without a clear, concise means of describing what National Grid is incentivized to achieve, non-technical stakeholders will likely struggle to identify synergies between National Grid's goals and stakeholder priorities. For this reason, the Commission should use other tools (e.g., a bill impact standard to address energy efficiency cost concerns) rather than adding multiple if-then rules to a PIM structure.

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[5] Public Utilities Commission's Guidance on Principles for the Development and Review of Performance Incentive Mechanisms adopted on May 8, 2020: http://www.ripuc.ri.gov/eventsactions/docket/4943-PIMs_Guidance_Document_Approved.pdf

[6] i.e. X = $0.50

[7] For example, see also Parsimony Theory.

Overall, all eligible program offerings should be identifiable without knowledge of an established PIM. From that point, a PIM should incentivize a utility to deliver all eligible program offerings in a manner that is most beneficial to Rhode Island ratepayers. A PIM should not encourage a utility to ignore or dismiss any eligible program offerings

<u>Part II: Responses to Notice Questions</u>

1. Anything that remains unclear about the Commission PIM Proposal.

   OER has no remaining questions about the functional details of the Commission PIM Proposal, given corrections to typos identified in the workshop held on February 25, 2021.

2. The allocation of regulatory costs.

   Regulatory costs should not be included in the Commission-prioritized net benefits calculation. These costs are statutory in nature and the utility has no direct or indirect control over them. Moreover, in regards to finds directed to OER, the statutory guidance for how those funds can be utilized includes allowable uses well beyond energy efficiency-related activities.[8] The statute is clear. Therefore, it is quite possible that no cost-causation would exist upon which to base the inclusion of those costs in the calculation.

   If regulatory costs are included, OER recommends that regulatory costs be divided among the three sectors at the beginning of the implementation year such that they mirror the relative planned eligible benefits or planned program budgets for each sector. This would ensure better alignment with oversight time and resource commitments from the Energy Efficiency and Resource Management Council (EERMC).

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

   OER believes that the graduations related to IE and residential service metric achievement successfully address the concern about a lack of incentive for achieving IE and residential benefits above 65%. However, without earning potential for incremental IE and residential program improvements above planned benefits but below positive Commission-prioritized net benefits, innovation in these programs will stagnate and benefit goals will be eroded over time as National Grid seeks to maximize profits. OER

[8] RIGL §39-2-1.2(j) states, "Effective January 1, 2016, the commission shall annually allocate from the administrative funding amount allocated in subsection (i) from the demand-side management program as described in subsection (i) as follows: fifty percent (50%) for the purposes identified in subsection (i) and fifty percent (50%) annually to the office of energy resources for activities associated with planning, management, and evaluation of energy-efficiency programs, *renewable energy programs*, system reliability, least-cost procurement, *and with regulatory proceedings, contested cases, and other actions pertaining to the purposes, powers, and duties of the office of energy resources*." [emphasis added]

recommends that payout rates be created for the IE and residential programs such that profit opportunity is provided to National Grid when benefits achieved exceed benefits planned, or when total planned benefits are achieved and Commission-prioritized net benefits are less negative than planned.

In general, OER encourages the Commission to avoid positioning any sharp PIM boundary rules close to desired or expected program outcomes. Since planning is inevitably imperfect, uncertainty should be accounted for in the positioning of any boundary rules.

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

   As articulated earlier in this comment letter, all Docket 4600 cost and benefit categories should be included in an energy efficiency PIM without discount rates. The closer the alignment between the energy efficiency PIM and the Docket 4600 framework, the greater the alignment between National Grid's incentives and energy efficiency stakeholder priorities.

5. Whether the PUC should adopt the Commission 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 National Grid need to establish prior to the PUC adopting the Commission PIM Proposal for three years.

   The adoption of any new PIM structure that significantly deviates from the existing energy efficiency PIM should last for one year. A complex PIM structure may deliver unexpected or unintended outcomes which may necessitate PIM adjustments after a year of implementation. For this reason, adopting a new PIM for more than one year would be imprudent.

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

   OER is extremely concerned that the Commission PIM Proposal will provide a disincentive for National Grid to innovate and try new delivery approaches in the IE and residential sectors. This is especially concerning when we believe – based on a recent Massachusetts non-participant study[9] – that renters are being underserved by energy efficiency IE and residential programs.

   Rather than providing a financial incentive for all incremental IE and residential program enhancements – such as increased numbers of renters served– the Commission PIM Proposal creates a gap where National Grid experiences no incentive to innovate in these two sectors. This gap occurs when the IE or residential programs have achieved planned

[9] Massachusetts 2020 Residential Nonparticipant Market Characterization and Barriers Study: https://ma-eeac.org/wp-content/uploads/MA19R04-A-NP-Nonpart-MarketBarriersStudy_Final.pdf

benefits but continue to produce negative Commission-prioritized net benefits. Assuming that stakeholders will react negatively to drastic program redesigns which might achieve positive Commission-prioritized net benefits, OER expects National Grid's year-end performance to land in this gap. Under this scenario, National Grid will have no incentive to invest resources into further incremental program enhancements. In addition, National Grid will likely be incentivized to propose less aggressive IE and residential benefit goals in future years in order to make goal achievement easier.

During a time when more and more Rhode Islanders find themselves qualifying for IE services and program changes are desperately needed to better serve renters, removing or minimizing National Grid's incentive to develop cutting edge IE and residential programs is inappropriate and would be a disservice to our most vulnerable residents.

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 Commission approve certain transfers necessary in light of the Commission PIM Proposal?

   The Commission PIM Proposal does not remove the need for budget transfer rules. Oversight of fund transfers by DPUC, OER, and the EERMC should be approved by the Commission as proposed in the settlement. OER does not have any preference or recommendations for how the Commission might choose to modify its involvement in budget transfers.

Thank you for the opportunity to comment.

Sincerely,

Nicholas S. Ucci
Commissioner