

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

ENERGY MASTER PLAN

The Natural Resources Defense Council (NRDC) submits this proposal for consideration in the Energy Master Plan process.

Targets and EPS Structure

Governor Corzine's goal in the Energy Master Plan to reduce New Jersey's projected energy use by 20% by the year 2020 is an ambitious goal that we strongly support. This goal should apply to all load-serving entities (LSEs) in New Jersey, including regulated utilities, power authorities and municipal utilities, and as such, each entity should be required to achieve a 20% reduction in electricity consumption. The LSEs should be responsible for determining how the 20% will be achieved among the various energy efficiency service providers and programs in their respective service areas. It is thus critical that all efficiency programs use equivalent metrics and protocols for determining kWh or therm savings.

Interim targets must be set, as well, in order to ensure that effective energy efficiency measures are being implemented and that the State is progressing towards the 20% goal. To that end, the BPU should establish targets for the years 2010 and 2013. As with the 20% goal, the interim percentage reductions should be met through a variety of efforts that target all markets and sectors, including efficiency programs carried out by BPU's Office of Clean Energy and utilities, and codes and standards. Given the timeline usually required to put in place new codes and standards, however, significant energy savings from these measures may be challenging before 2020, but they are nevertheless important to pursue in tandem with other efficiency initiatives since they can provide very large savings over the longer term. Additional goals tied to other criteria should be set, as well. These goals can be used as countervailing influences, to avoid the LSEs simply focusing on savings at the potential detriment of critically important considerations such as equity and comprehensiveness. Examples could include: targets for low income participation; geographic or demographic equity goals; comprehensive treatment goals (e.g., at least X% savings among new construction participants), etc.

Utilities should have a lead role in the integrated delivery of efficiency programs since they enjoy certain inherent advantages with respect to their customer base. Office of Clean Energy's responsibility should be to develop a platform of core programs that can be delivered consistently throughout the State; to serve as a facilitator to ensure coordination among program administrators; and, to provide services that require a regional approach. BPU'S Office of Clean Energy should also focus on those efficiency initiatives that rely primarily on upstream, market transformation strategies and/or mass marketing.

We believe that a "20 by 20" target is appropriate for natural gas as well. Note that we support fuel switching conversions to gas that will reduce emissions of greenhouse gases. To the extent significant fuel switching to natural gas occurs, this will need to be taken into account when determining the actual efficiency gains off of a current reference-case forecast.

Utility Incentives

The award of incentives should be based largely on actual verified performance of achieving efficiency results and should be scaled, with higher incentives for higher achievement. The target award level should be based on aggressive but achievable goals, with the opportunity to earn greater incentives for exemplary performance beyond these base goals, which avoids the situation where utilities stop pursuing more cost-effective efficiency once they reach the base target.

The largest portion of incentives should be based on achieving actual benefits, ideally based on total resource net benefits, but could be based on therm, kWh and peak kW savings as well, or a combination of the three. For each company, the goals should be set so as to achieve the 20 by '20 target within their service territories. Ideally, the Energy Master Plan could establish interim targets for each company to achieve the 20 by '20 goal and a standardized utility incentive structure so as to avoid establishing goals and incentives on a case by case basis. As mentioned above, additional goals tied to other criteria should also be established, which can be used as countervailing influences, to avoid companies simply focusing on savings at the potential detriment of critically important considerations such as equity and comprehensiveness.

Incentives can be annual or multi-year. Multi-year goals have the advantage of allowing utilities more flexibility to modify designs over time to make more efficient and effective use of resources. It also allows for goals focused on things like market transformation that may take multiple years to show results. Finally, all incentive earnings should be subject to stringent independent verification of achievements (savings), and not pre-specified based on simply completing certain milestones. Ideally, this proceeding would also establish and standardize the methodologies for measurement and verification.

A good example of an appropriate performance incentive structure for Utilities was included in the State of California Public Utility Commission's August 9, 2007 Proposed Decision in Rulemaking 06-04-010.¹

Building on this model, we propose that a threshold be set at 85 percent of the base energy savings goal. At this threshold, a utility company would start earning an incentive of 9 percent of the net benefits. The incentive should be stepped up to 12 percent if the company's DSM performance level achieves 100 percent or more of the goals. This structure is important because if it is clear prior to the end of the period that a utility will not reach the target, it should still have an incentive for pursuing as much efficiency as possible.

Utilities should also be penalized for poor performance on their savings goals. Penalties should be assessed if the company's performance falls to or below 65 percent of the base goal, at which point penalties should be assessed per kWh or therm for each unit below the goal. Such a penalty would ensure that the company will have a consistent incentive to improve performance.

¹ State of California Public Utilities Commission, Rulemaking 06-04-010, Order Instituting Rulemaking to Examine the Commission's post-2005 Energy Efficiency Policies, Programs, Evaluation, Measurement and Verification, and Related Issues, Interim Order on Phase 1 Issues: Shareholder Risk/Reward Incentive Mechanism for Energy Efficiency Programs, Proposed Decision of Commissioner Grueneich and Administrative Law Judge Gottstein (August 9, 2007).

Decoupling Principles

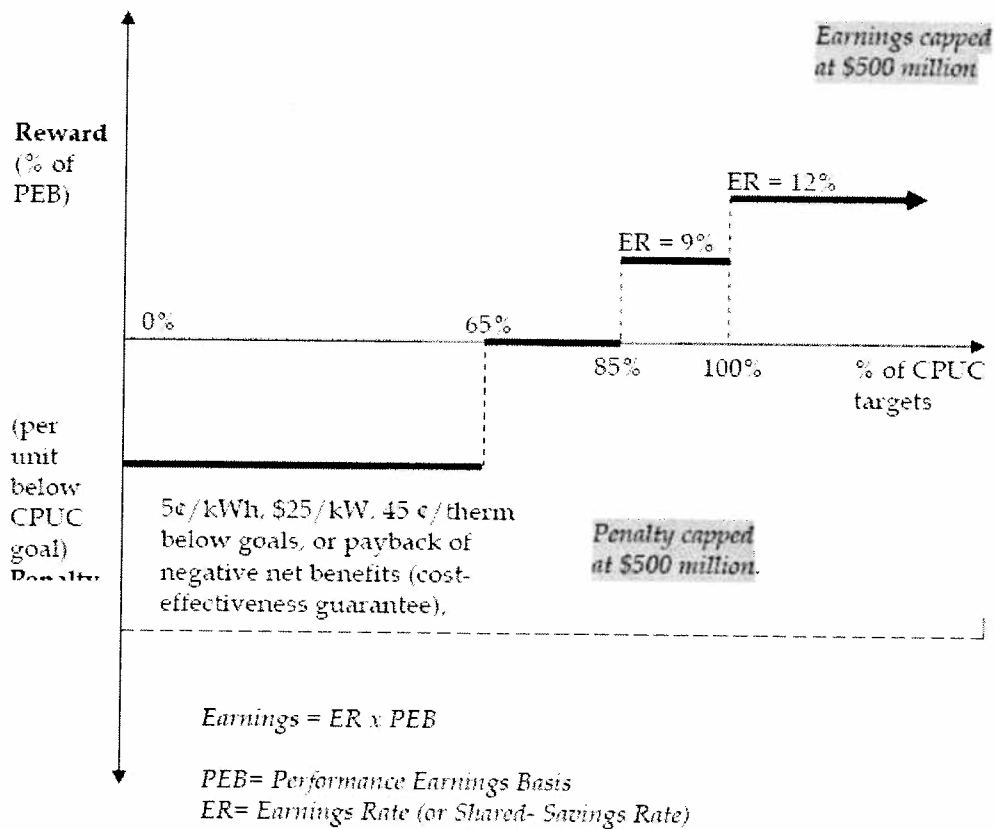
Under current regulation, in both the gas and electric sectors, utilities financial health is tied directly to retail sales, and therefore any reduction in consumption directly reduces the companies' profitability. This creates a direct financial disincentive for utilities to support energy efficiency and clean distributed generation such as solar photovoltaics, small wind turbines, fuel cells and combined heat and power (CHP). The purpose of a decoupling mechanism is to remove this disincentive, and thereby align shareholder interests with those of consumers in order to (i) promote investments that reduce energy costs as well as the environmental and public health impacts of energy use, and (ii) prevent either over- or under-recovery of approved fixed costs. Under decoupling, a simple system of periodic true-ups in base rates would either restore to the utility or give back to customers the dollars that were under- or over-recovered as a result of fluctuations in retail sales. This will correct for disparities between the utility's actual fixed cost recoveries and the revenue requirements approved by utility regulators. We have attached in bullet form principles of an effective decoupling mechanism.

- Decoupling must break the link between profits and sales.
 - Set allowed revenue and true-up actual revenues to allowed revenues.
 - Incentives for reliability (or anything else) and collection of deferred revenue should not be tied to sales.
- Allowed revenues should be adjusted for desirable or unexpected and unavoidable factors that increase or decrease costs.

- Growth in customers, jobs and businesses are all desirable factors that might drive up costs.
 - If these factors go down, costs should go down, as should allowed revenues.
- Extreme storms and terrorist attacks are factors that might unexpectedly and unavoidably drive up costs.
- Allowed revenues should be adjusted on a customer class basis if there are significant factors unique to each class.
- Adjustments to revenue, actual revenues, and true-ups should be calculated in a transparent way.
 - Any factors used to adjust allowed or actual revenue should be outside of the utilities' control.
 - Any adjustment formulas should be simple and readily replicable by any active party.
 - Adjustments based on number of customers and customer class should be carefully reviewed to avoid incentives for gaming.
 - Actual revenues can be weather normalized before being compared to allowed revenues as long as the weather normalization does not require overly complex calculations.
- Deferrals of rebates or surcharges should be avoided to the greatest extent possible.
 - Adjustments and true-ups should be done as often as practical without creating overly complex calculations.

- Limits on true-ups to avoid rate volatility or rate increases during economic down-turns may be appropriate, but the need for such limits should be determined with consideration of the deferral costs they impose.
- Frequent true-ups keep rates more in-line with average short-term costs.

Figure 1: Adopted Incentive Mechanism Earnings/Penalty Curve



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² Figure 1: Adopted Incentive Mechanism Earnings/Penalty Curve, Page 8, California's Public Utility Commission Rulemaking 06-04-010, Order Instituting Rulemaking to Examine the Commission's post-2005 Energy Efficiency Policies, Programs, Evaluation, Measurement and Verification, and Related Issues.

