Agenda Date: 12/14/11
Agenda Item: 2F

STATE OF NEW JERSEY
Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Post Office Box 350
Trenton, New Jersey 08625-0350
www.nj.gov/bpu/

DIVISION OF ENERGY

IN THE MATTER OF THE STANDARD OFFER 3 ENERGY SAVINGS AGREEMENT BETWEEN PUBLIC SERVICE ELECTRIC AND GAS COMPANY AND HONEYWELL INTERNATIONAL INC.

DECISION AND ORDER APPROVING BUYOUT SETTLEMENT AGREEMENT

BPU DOCKET NO. GO11110814

(NOTIFICATION LIST ATTACHED)

APPEARANCES:

Sheree L. Kelly, Esq. Assistant General Regulatory Counsel on behalf of Public Service Electric and Gas Company
David Holland, Account Executive on behalf of Honeywell Utility Solutions
Stefanie A. Brand, Director, New Jersey Division of Rate Counsel

BY THE BOARD:

By letter dated November 15, 2011, Public Service Electric and Gas Company ("PSE&G") requested that the New Jersey Board of Public Utilities ("Board") approve a settlement agreement between PSE&G and Honeywell International Inc., ("Honeywell") dated November 15, 2011 ("Settlement Agreement"). The Settlement Agreement sets forth a proposed buy-out of a certain Standard Offer No. 3 project. PSE&G's letter requested a Board Order in sufficient time to consummate the terms of the Settlement Agreement in December 2011.

Background

This matter stems from the Board's former Demand Side Management ("DSM") regulations, N.J.A.C. 14:12-1.1 *et seq.* and the Standard Offer program PSE&G implemented pursuant to the Board-approved DSM plans[1]. The former rules at N.J.A.C. 14:12-3.5 specifically allowed utilities to make available a" standard price offer" to customers and/or their energy service companies who met minimum threshold requirements for delivery of verifiable energy and capacity savings from DSM measures at a price based upon the formula outlined at N.J.A.C. 14:12-3.5 (2) i. and ii. Under these DSM Performance Based Programs, a measurement plan was to be filed. Pursuant to the DSM regulations in effect at that time, PSE&G filed and received Board approval for its 1995 DSM Resource Plan (including the PSE&G Standard Offer No 3). [2] PSE&G and Honeywell subsequently entered into a Standard Offer No. 3 Energy Savings Agreement dated October 19, 2000 ("ESA"), under which Honeywell is the sponsor of Project Number G3051, also referred to as the "Fort Dix Standard Offer Project" located in Burlington County, NJ. The project involved 81 buildings including, barracks, dining halls, administrative buildings, a conference center, warehouses, training facilities, a health clinic and other miscellaneous use buildings. The ESA between PSE&G and Honeywell was to continue through June 30, 2016.

According to PSE&G's letter, Honeywell installed certain energy savings measures to deliver a quantity of energy savings to PSE&G, and PSE&G in turn agreed to pay Honeywell for a certain level of verified energy savings delivered. Under the Fort Dix Standard Offer Project, according to Honeywell, a main steam boiler was disconnected and replaced with individual gas boilers in each building. According to the information provided, this upgrade installed more efficient boilers and reduced the line losses that had existed between the buildings from the main boiler. Both PSE&G and Honeywell expect that these energy savings would continue at least for the remaining five years of the existing ESA, and in fact argue that these savings will continue under the separate 15 year maintenance agreement that Honeywell has with Fort Dix through the year 2023.

According to the letter, PSE&G and Honeywell (collectively, "Parties") engaged in discussions and negotiations several months ago to reach a settlement under which PSE&G would buy-out the remaining approximately five years of the term of the ESA. These negotiations led to the execution of the Settlement Agreement. According to Honeywell, this is the last Honeywell project under Standard Offer No. 3. The other ESAs were also bought-out through various prior Board approvals. According to Honeywell, this buyout offer is an important part of Honeywell's Strategic Business plan for fiscal year 2011 which ends on December 31, 2011.

Terms of the Settlement Agreement

Under the proposed Settlement Agreement, PSE&G will buy-out the ESA via a lump sum payment equivalent to a net present value ("NPV") of $ 6,293,130 using calculations based on the December 2011 invoice period through the remainder of the term. The Parties derived this settlement figure as follows:

> Based on historical energy savings and reasonable calculations of future energy savings likely to be achieved from December 1, 2011 through the end of the ESA term on June 30, 2016, the ESA has a gross value of $8,566,993.
>
> The net present value (NPV) of the gross value is $8,068,115, using a discount rate of 2.5%
>
> The Parties also agreed to discount the figure of $ 8,068,155 by a further 22% to a net settlement amount of $ 6,293,130 as of December 2011. The Parties agreed that such a discount is appropriate in consideration for the settlement in this matter, to account for the possibility that the level of energy savings measures may decline over time, and to provide a net benefit to PSE&G's ratepayers.

[1] The Board's DSM rules expired on December 19, 2006 and were replaced by new rules in N.J.A.C. 14:8-1. See, 39 NJR 2652(a). N.J.A.C. 14:8-8.3 governs the continuation of Standard Offer agreements such as the ESA.

[2] I/M/O Consideration and Determination of Public Service Electric and Gas Company's Demand Side Management (DSM) Plan filed Pursuant to N.J.A.C. 14:12, Docket No. EE98060402, Dated October 1, 1999

Therefore, pursuant the updated Exhibit A attached to the Settlement Agreement, the remaining lump sum payment will be $ 6,293,130 if made in December 2011. Should the Board's issue of this order fall on a date that makes it impossible for PSE&G to make the lump sum payment on or about December 1, 2011, the Parties will adjust the amount of the lump sum payment pursuant to the terms of this Settlement Agreement and the projected value of the energy saving set forth in the spreadsheet attached hereto as Appendix A. For example, if the Board were to approve this Settlement Agreement on January 1, 2012, the "buy out" would be calculated for the periods of December 2011 through June 30, 2016 utilizing the savings data on Appendix A and applying an 2.5% NPV factor and a rate payer discount of 22%.

The Settlement Agreement also provides that the Parties will, upon receipt of a Board Order approving the settlement, execute mutual releases covering any and all claims under the ESA and the project, except as needed to enforce the terms of the Settlement Agreement. Additionally, the Settlement Agreement requests that the Board approve the settlement without modification and approve recovery of all payments made pursuant to the terms of the Settlement Agreement in PSE&G's rates, through the DSM component of the Societal Benefits Charge ("SBC"), or an appropriate successor rate mechanism.

On November 21, 2011, PSE&G and Honeywell presented the details of the Settlement Agreement to the Board's staff ("Staff"). Additionally, PSE&G and Honeywell provided written responses to Staff's discovery on November 22, 2011.

The Division of Rate Counsel ("Rate Counsel") has also reviewed the Settlement Agreement and by letter dated December 2, 2011, agrees that the buyout provisions appear reasonable and should provide a net benefit to ratepayers estimated at $1.77 million. Rate Counsel further states that the buyout calculation which uses a discount rate of 2.5% to determine the net present value of the projected stream of nominal payments to Honeywell for the energy savings and the ratepayer discount of 22 % appear reasonable

DISCUSSION AND FINDINGS

The Board has reviewed the terms of the agreement and believes that the proposed Settlement Agreement contains terms that will benefit both PSE&G and its customers.

Based on its review, and on the recommendation of Board Staff and Rate Counsel, the Board **HEREBY FINDS** that the proposed Settlement Agreement contains terms that should reduce PSE&G's and its customers' net cost under the project by a meaningful amount, since the remaining payments under the ESA were discounted by 2.5% through a NPV calculation and further discounted by 22%, while still providing the benefits of the Standard Offer energy savings to PSE&G customers. Thus the Board also **FINDS** that the proposed Settlement Agreement should result in savings to PSE&G's customers of costs that otherwise would be recoverable through the SBC over the remaining life of the ESA.

Accordingly, based on the foregoing, the Board **HEREBY CONCLUDES** that the Settlement Agreement is in the public interest. Therefore, the Board **HEREBY APPROVES** the Settlement Agreement. The Board also **AUTHORIZES** recovery of the buy-out payment calculated pursuant to the terms of the Settlement Agreement in PSE&G's rates, through the DSM component of the SBC or an appropriate successor rate mechanism.

If Honeywell accepts payment of $6,293,130 as full and final payment under the Settlement Agreement, PSE&G shall notify the Board within 10 days of the date of payment. In the event that any other payment amount is required, PSE&G shall provide a calculation of revised final lump sum payment amount to Honeywell, Board Staff and Rate Counsel at least 15 days prior to the actual payment. Unless an objection to the calculation is filed before the scheduled payment date by any of these entities, such payment may be made without further Order of this Board with notification to the Board within 10 days thereafter.

DATED: 12/15/11

BOARD OF PUBLIC UTILITIES
BY:

LEE A. SOLOMON
PRESIDENT

JEANNE M. FOX
COMMISSIONER

JOSEPH L. FIORDALISO
COMMISSIONER

NICHOLAS ASSELTA
COMMISSIONER

ATTEST:

KRISTI IZZO
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities

I/M/O the Standard Offer No. 3 Energy Savings Agreement Between
Public Service Electric and Gas Company and Honeywell International Inc.
BPU DOCKET NO. ER11110814
Notification List

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PSE&G & Honeywell

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CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

STEFANIE A. BRAND
Director

December 2, 2011

<u>Via UPS Overnight</u>
Hon. Kristi Izzo, Secretary
Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Trenton, New Jersey 08625

Re: In the Matter of the Standard Offer No. 3 Energy Savings Agreement Between Public Service Electric and Gas Company and Honeywell International Inc.
RC File No. 12-G-193
BPU Docket No. Pending

Dear Secretary Izzo:

Please accept for filing an original and ten copies of these comments filed on behalf of the Division of Rate Counsel ("Rate Counsel") regarding the above-referenced matter. Enclosed is one additional copy. Please date stamp the copy as "filed" and return it in the enclosed envelope. Thank you for your consideration and attention to this matter.

<u>Overview of the Honeywell / PSE&G –Standard Offer Buyout Proposal for Ft. Dix</u>

PSE&G and Honeywell entered into a 15-year, standard offer commercial contract for energy efficiency savings on October 19, 2000 for a series of heating and hot water system upgrades made at the US Army's Ft. Dix, New Jersey facilities. Essentially, central systems supplying heat and hot water were replaced with more efficient individual heating and hot water systems at each of about 81 buildings. The original contract was scheduled to continue through June 30, 2016.

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The PSE&G – Honeywell Ft. Dix Standard Offer Buyout Proposal ("Buyout ") will reduce the projected ratepayer costs of this project's natural gas energy efficiency savings by $1.77 million. In lieu of continuing the Standard Offer arrangement through June 2016 at an estimated total NPV amount of $8 million ($8.6 million nominal), the buyout will cost ratepayers $6.3 million, which will be recovered through PSE&G's annual Societal Benefits Charge ("SBC"). The basis for the $8.6 million nominal payments for energy efficiency is derived from the overall quantity of natural gas savings achieved with the project, and the valuation (dollars per therm) of those savings.

Rate Counsel Assessment of Buyout

The overall quantity of natural gas savings actually achieved through 2011 and projected to be achieved through June 2016 appears reasonable, based on the materials provided by Honeywell and PSE&G: (1) an estimate of what the natural gas consumption would have been absent the energy efficiency measures, and (2) what the consumption actually has been since the measures were installed. The "but for" estimate (i.e., the estimate of consumption absent the measures, if the old heating equipment was in place) was made using statistical regression analysis that accounted for actual consumption patterns in 1997, 1998 and 1999 (prior to measure installation) and weather (heating degree days). This estimate provides the baseline against which current (actual) consumption is measured, resulting in the "actual savings" estimate. The valuation of the natural gas savings uses projections of the commodity cost of gas (NYMEX futures) and the transmission and distribution rates applicable to gas use. These appear reasonable, based on futures prices as of October 14, 2011

The buyout calculation uses a discount rate of 2.5% to determine the net present value of the projected stream of nominal payments to Honeywell for the energy savings. Given the current low discount rates and PSE&G's use of low discount rates in its current tariff treatment of SBC funds over or under-collected, the 2.5% value used to account for the time value of money seems reasonable.

The buyout calculation uses a ratepayer discount of 22% to account for the possibility that savings may not persist over time through June 2016 (the end of the existing contract). Essentially, this provision provides a discount to ratepayers by Honeywell agreeing to receive 78% of what it would otherwise receive if the contract was not bought out. Previously BPU approved buyout provisions have used higher discounts – notably, 28% and 30% for two previous Honeywell-PSE&G buyouts – but those buyouts occurred in 2006, when the remaining term was 10 years[1]. This buyout has a remaining term of just five years. Therefore, the 22% value appears reasonable.

[1] See, *I/M/O Standard Offer No. 2 and Standard Offer No. 3 between PSE&G and Honeywell; BPU Docket Nos. GO06090656 and EO06090679, dated 12/28/06 and I/M/O Standard Offer Nos. 2 and 3 between PSE&G and Watt Busters, Inc., BPU Docket No. EO06090660, dated 12/28/06.*

Conclusion

Based on all the foregoing reasons, it is Rate Counsel's position that the buyout provisions appear reasonable and should provide a net benefit to ratepayers estimated at $1.77 million. Rate Counsel, however, reserves its right to review the final buyout calculations in PSE&G's next SBC proceeding.

Respectfully submitted,

STEFANIE A. BRAND
Director, Division of Rate Counsel

By: Felicia Thomas-Friel
Felicia Thomas-Friel
Deputy Rate Counsel

FTF/sm
cc: Service List (via electronic mail and regular mail)

In the Matter of the Standard Offer No. 3 Energy Savings Agreement Between Public Service Electric and Gas Company and Honeywell International Inc.
BPU Docket No. Pending

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