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February 6, 2020

By Hand Delivery and Electronic Mail
Honorable Aida Camacho-Welch, Secretary
NJ Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, NJ 08625-0350

Re: Clean Energy Act New Jersey Energy Efficiency Transition Stakeholder Process Energy Efficiency Stakeholder Meeting – Cost Recovery BPU Docket No.: Undocketed Matter

Dear Secretary Camacho-Welch:

Please accept for filing the enclosed original and ten (10) copies of comments being submitted on behalf of the New Jersey Division of Rate Counsel ("Rate Counsel") in response to the Cost Recovery Mechanism Draft, dated January 22, 2020, circulated by the Staff of the Board of Public Utilities and the Notice ("Notice") dated January 9, 2020. Rate Counsel reserves its right to supplement these comments as the technical process continues. In accordance with the Notice, an electronic copy will be emailed to EnergyEfficiency@bpu.nj.gov.

We are enclosing one additional copy of the comments. **Please stamp and date the extra copy as "filed" and return to our courier.**

Thank you for our consideration and attention to this matter.

Respectfully submitted,

STEFANIE A. BRAND
Director, Division of Rate Counsel

By: ______________________________
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Enclosure

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Clean Energy Act
New Jersey Energy Efficiency Transition
Stakeholder Process
Energy Efficiency Stakeholder Meeting – Cost Recovery

BPU Docket No.: Undocketed Matter

Comments of the Division of Rate Counsel

February 6, 2020

Introduction

As part of the process to implement the Clean Energy Act[1], the Staff ("Staff") of the Board of Public Utilities ("Board", "BPU") convened a Stakeholder Meeting on January 23, 2020 and invited stakeholders to comment on the cost recovery mechanism for energy efficiency ("EE") and Demand Response ("DR") programs in New Jersey.[2] The within comments are being submitted by the New Jersey Division of Rate Counsel ("Rate Counsel") pursuant to the Notice dated January 9, 2020 ("Notice") in this matter and Staff's "Cost Recovery Mechanism Draft," dated January 22, 2020 ("Draft").

Comments

A. Background

The CEA established aggressive energy reduction requirements over a five-year period, requiring that each electric public utility achieve energy use reductions of two percent or greater; and that each gas public utility achieve energy use reduction of three-quarters of a percent.[3] In

[1] P.L. 2018, c. 16 (C.48:3-87.3-87.7) ("Clean Energy Act" or "CEA").
[2] Technical working group meetings addressing cost recovery were also held on October 31, 2019 and December 13, 2019, for which Rate Counsel subsequently submitted comments on November 14, 2019 and January 3, 2020, respectively.
[3] N.J.S.A. 48:3-87.9(a).

addition, the CEA directs the Board to establish quantitative performance indicators ("QPIs") to evaluate each utility's achievement of the reduction targets and to apply performance incentives and penalties tied to the achievement of reduction targets.

To fulfill the CEA's requirements, the Board authorized its Office of Clean Energy ("OCE") to retain consultant Optimal Energy, Inc. ("Optimal') to complete a market potential study to help determine the energy savings potential in New Jersey and to develop recommendations consistent with the law. Optimal solicited data from the state's electric and gas public utilities and the State hosted four stakeholder meetings to develop a draft "Energy Efficiency Potential in New Jersey" study. The Optimal market potential study was issued in May 2019 and the Board accepted public comments for a two-week period.

After receiving extensive feedback to the Optimal market potential study, the Board preliminarily adopted the energy savings targets for electric and gas utilities as well as the QPIs identified in the study.[4] The Board also established an Energy Efficiency Advisory Group ("Advisory Group") and directed Staff to initiate a stakeholder proceeding to receive recommendations related to energy efficiency ("EE") and demand reduction programs (referred to as "EE transition programs") to meet the targets outlined in the CEA.[5] Members of the Advisory Group were appointed to provide guidance to Staff with an emphasis on hearing the concerns and recommendations of the utilities, the Division of Rate Counsel, environmental advocates and consumer organizations.

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[4] See I/M/O Implementation of P.L. 2018, c. 17 Regarding the Establishment of Energy Efficiency and Peak Demand Reduction Programs & Energy Usage Reduction Targets and Quantitative Performance Indicators, BPU Dkt. Nos. QO19010040 & QO19050536, Order (May 28, 2019).

[5] See I/M/O Implementation of P.L. 2018, c. 17 Regarding the Establishment of Energy Efficiency and Peak Demand Reduction Programs & I/M/O Clean Energy Act of 2018 - Energy and Peak Demand Reduction Programs and the Energy Efficiency Advisory Group, BPU Dkt. Nos. QO19010040 & QO19050547, Order (May 28, 2019).

The next phase of stakeholder engagement focused on the energy efficiency transition. Two technical meetings were held to discuss the subjects of cost recovery, lost revenues and performance incentives, and Staff invited the submittal of written comments by interested parties.[6] The Draft at issue is a product of Staff's stakeholder process.

Overall, Rate Counsel is pleased with the results of the stakeholder process and the Draft. Rate Counsel's comments on specific topics found in the Draft are detailed below and relate specifically to: Investment Treatment, Lost Revenue Treatment, and Performance Incentive and Penalty Treatment. Rate Counsel's general comments follow its specific comments.

B. Specific Comments

1. Investment Treatment

The Draft proposes to permit utilities to recover a return *of* and a return *on* their program investments. Specifically, the Draft proposes to permit utilities a return *of* their investments in the form of amortization for expenditures other than those incurred for operations and maintenance. The Draft proposes that these investments be amortized over a seven-year period. Further, the Draft states that this amortization over time is necessary to reduce the potential rate shock associated with EE transition programs by spreading program costs over a period of time which better matches program costs with program benefits.

The Draft also provides for a return *on* utility EE and DR investments.[7] Reflecting the lower risk attributable to near-contemporaneous recovery of its EE investments under the CEA, the carrying cost (return on) for these investments will be the utility's weighted average cost of capital ("WACC") established in its most recent base rate case, less 200 basis points. The

[6] Technical working group meetings addressing cost recovery were held on October 31, 2019 and December 13, 2019, for which Rate Counsel subsequently submitted comments on November 14, 2019 and January 3, 2020, respectively.
[7] Draft, p. 5.

WACC utilizes each utility's capital structure, incorporating weightings for both: (a) the cost of debt; and (b) the return on equity ("ROE"), Rate Counsel agrees that this 200-basis point reduction is necessary to reflect the reduction in risk provided for by the cost recovery mechanism. As the Draft correctly notes, there is an inherent reduction in risk associated with the contemporaneous cost recovery, where utilities are recovering a portion of costs as they are being incurred, as opposed to recovery in base rates where the utility may not recover costs for a period of time after they are incurred.[8] Moreover, Rate Counsel notes that unlike rates established in base rate cases where utilities face the risk of <u>not</u> recovering their revenue requirement, the Board's current rate recovery (surcharge) treatment of utility EE investments includes a true-up mechanism which virtually ensures that utilities will recover the full book value of their EE investments. For these reasons, Rate Counsel agrees that the reduction in risk merits a downward adjustment to the base rate case WACC for CEA EE investments. Although there is less risk involved with these EE programs than traditional base rate infrastructure project investment, EE investments would still be subject to a review of their "prudency and reasonableness," as well as a finding of "used and useful."

Ratepayers will be assuming the program risk through the proposed cost recovery mechanism and the resulting surcharge, and thus there should be a lower risk-adjusted return for the utilities on these program investments. An adjusted return on any EE investment is already an exceptionally generous allowance, given that most jurisdictions do not even allow for <u>any</u> return on EE and demand reduction investments.

The Draft notes that this proposal to allow a return on EE investments with a modified ROE is modeled on other states such as Maryland and Washington D.C. It is important to note

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[8] Id.

that there are just a handful of jurisdictions that even allow EE investments to be included in rate base: Washington DC, Illinois, Maryland, New Jersey, and Utah. In Maryland, the return on investment is based on the weighted average cost of capital ("WACC") and costs are amortized over a five-year period. While the rate of return calculation is not tied directly to an energy savings threshold, Maryland's utilities are statutorily obligated to meet energy savings performance requirements, and thus cost recovery is indirectly linked to energy savings performance.[9]

In Illinois, The Future Energy Jobs Bill in 2016 raised EE targets for the state's two investor-owned utilities.[10] In order to incentivize the utilities to meet their increased targets, the legislation included performance incentives for meeting or exceeding energy savings targets and penalties for not meeting the targets. The costs are amortized over the weighted average measure life of the portfolio of programs and the ROE is calculated as the average of the prior year's monthly average yields of 30-year U.S. Treasury bonds plus 580 basis points.[11,12]

The Draft also proposes to use an amortization period of seven years for EE investments.[13] Rate Counsel agrees that amortization of such investments will help to reduce

[9] American Council for an Energy Efficient Economy. 2018. Snapshot of Energy Efficient Performance Incentives for Electric Utilities; Available at: https://aceee.org/topic-brief/pims-121118; MD PSC (Maryland Public Service Commission), In the Matter of the Commission's Investigation of Advanced Metering Technical Standards, Demand Side Management Cost Effectiveness Tests, Demand Side Management Competitive Neutrality, and Recovery of Costs of Advanced Meters and Demand Side Management Programs. Order No. 81637, Case No. 9111, September 28 (Baltimore: MD PSC, 2007).

[10] See Illinois SB 2814, enacted into law on December 7, 2016 (Public Act 99-0906).

[11] American Council for an Energy Efficient Economy. 2018. Snapshot of Energy Efficient Performance Incentives for Electric Utilities; Available at: https://aceee.org/topic-brief/pims-121118.

[12] The 2019 average of the monthly yield on a 30-year U.S. Treasury bond was 2.58 percent. (https://www.federalreserve.gov/releases/H15/default.htm).

[13] Draft, p. 5.

rate shock and helps to reasonably match the rate recovery period of EE measures with the life of the measures.

The Draft notes that to encourage reaching the EE goals, there will not be a cap or constraint on the consumer distribution rate or customer bill.[14] The Draft further notes that rate impacts will be monitored and a cap on rates or customer bills may be put in place two years after approval of the EE transition programs.[15] While Rate Counsel recommends the establishment of a rate cap as a fallback "safety" mechanism, it does not object to the Draft's proposal for the possibility of a rate cap if rate and bill impacts are found to be unreasonable. Rate Counsel further recommends that any EE program will need to be evaluated with a cost-benefit analysis and any filing for Board approval will also need to include an analysis of rate and customer bill impacts.

The Draft also states that any over and under recoveries will have a carrying cost of the two-year Treasury bill rate plus 60 basis points.[16] This is similar to the Board's traditional treatment of such under/over-recoveries and Rate Counsel does not object to this provision.

2. Lost Revenue Treatment

The Draft explains that the proposal for treatment of lost revenue builds on the State's experience with the Conservation Incentive Plan ("CIP"), which the Draft describes as a limited decoupling mechanism currently in place for several New Jersey gas utilities.[17] Specifically, the Draft would permit utilities to recover lost revenues in the amount that they can demonstrate is attributable to their EE transition programs.[18] These lost revenues will be reviewed and

[14] Id.
[15] Id.
[16] Id.
[17] Id., p.6.
[18] Id.

recovered annually.[19] Only lost revenues associated with the utility's distribution base rates are recoverable and utilities will be required to file a base rate case within five years of the start of an EE transition program to ensure usage projections are updated and reset.[20]

The Draft also explains that its lost revenue treatment is intended to prevent EE transition programs from affecting the utility's ability to pay for its fixed costs.[21] The proposed mechanism will require an "earnings test" where the ROE of a utility will be determined by dividing the actual net income of the utility for the most recent 12-month period by the average of the beginning and ending common equity balances for the corresponding period.[22] If the specific program-calculated ROE exceeds the utility's allowed ROE by 50 basis points or more, recovery of lost revenues will not be allowed for the filing period.[23] Rate Counsel supports the use of an earnings test, although the earnings test methodology and process will need to be refined going forward.

Rate Counsel is generally supportive of the Draft's lost base revenue approach. However, some clarification is needed. First, Rate Counsel stresses that the CIP is not an actual revenue decoupling mechanism, contrary to the way the CIP is sometimes portrayed. While the CIP is a mechanism for addressing utility lost base revenues, it is not a pure form of revenue "decoupling" and has characteristics that are much more performance-based and symmetric than traditional revenue decoupling mechanisms. The Board adopted the CIP in 2006 for New Jersey Natural Gas ("NJNG") and South Jersey Gas Company ("SJG") as a way to address the

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[19] Id.
[20] Id.
[21] Id.
[22] Id.
[23] Id.

purported issues associated with the utilities' incentive to pursue energy efficiency programs.[24] The CIP allows the utilities to fund part of their respective energy efficiency programs with shareholder funds while allowing cost recoveries subject to conditions that assure ratepayers will benefit from efficiency gains.

The CIP is a performance-based mechanism that ties lost revenue recovery to a reduction in a utility's cost of acquiring interstate gas pipeline and storage capacity, thus assuring that all ratepayers receive efficiency benefits. This performance "tying" aspect of the CIP leads to an important difference from full revenue decoupling mechanisms. In contrast, full revenue decoupling mechanisms allow utilities to recover <u>all</u> revenue losses, regardless of the reason for those losses. These losses can include the recovery of revenue losses from commodity price changes, shifts in the regional economy, weather, and other factors that are unrelated to energy efficiency activities. The CIP, on the other hand, only allows for the recovery of revenue losses when a verifiable loss of capacity requirements has occurred, as reflected in the reduction of a utility's need for pipeline transportation and storage capacity.

Moreover, the Draft's lost base revenue approach is more consistent with the CEA than a full decoupling mechanism as it more appropriately bases lost revenues on utility actions and efforts that are directly attributable to their EE efforts. Although the CEA does not require recovery of such costs, the CEA requires an annual filing by utilities to recover the costs incurred as a result of its EE programs, "including but not limited to recovery of…the revenue impact of sales losses resulting from implementation of the energy efficiency and peak demand reduction

[24] <u>See</u> <u>I/M/O SJG and NJNG for the Implementation of a Conservation and Usage Adjustment</u>, BPU Dkt. Nos. GR05121019 and GR05121020, Decision and Order Approving Stipulation (December 12, 2006).

schedules, which shall be determined by the board pursuant to section 13 of P.L.2007, c.340 (C.48:3-98.1)."[25] The CEA clearly did not contemplate full decoupling.

Furthermore, like the current CIP, the lost revenue treatment proposed in the Draft mitigates potential utility performance risk. Rate Counsel believes that the Draft's lost revenue proposal balances the interests of both the utilities and ratepayers, whereas a full decoupling mechanism could allow for utilities to over-earn on their EE efforts.

Rate Counsel also agrees with the proposed 3-year review period as well as the proposed earnings test.

3. Performance Incentive and Penalty Treatment

The Draft also includes a proposal for performance incentives and penalties.[26] These will both take the form of a ROE adjustment applied to EE transition program investments. If a utility achieves between only 50 percent and 90 percent of its QPI achievement, there will be a performance penalty.[27] On the other hand, if a utility achieves between 110 percent and 150 percent of the QPI achievement there will be a performance incentive.[28] Achievement between 90 percent and 110 percent will be considered to be within a neutral or buffer area, and there will be no incentive or penalty assessed. The WACC used as a utility's carrying cost will be comprised of: (a) the cost of debt; and (b) the ROE less 200 basis points as identified in the Investment Treatment section of the Draft.

The performance penalty is set on a linear scale from the utility's cost of debt, if the utility reaches 50 percent or more of QPI achievement; to the utility's ROE less 200 basis points, starting at 90 percent and up to 110 percent of QPI achievement. The performance incentive is

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25 N.J.S.A. 48:3-87.9(e)(1).
26 Id., pp. 6-7.
27 Id., p. 7.
28 Id.

similarly set on a linear scale from the utility's ROE less 200 basis points (starting at 110 percent of QPI achievement) to the utility's full ROE (up to 150 percent of QPI achievement).[29] If a utility fails to reach 50 percent of the target, they will be deemed non-compliant and a penalty of 0.75 percent of base rate distribution revenue will be assessed.[30] Further, the Figures referenced in the Draft show that the ROE adjustments will be incorporated in a new adjusted WACC.[31] In addition, the performance incentive and the performance penalty structure will be reviewed three years after a utility's EE transition program is approved. The utility QPI's will also be reviewed and assessed at that time.

In concept, Rate Counsel agrees with the Draft's incentive proposal as it creates the appropriate incentive for utilities to reach their EE and demand reduction targets. Most importantly, it places a cap on the upper end of the performance incentive to a WACC based on the full ROE and not more. Rate Counsel believes that utilities should be encouraged to participate in EE and demand reduction programs, but not over compensated. Also, the performance penalty sends a fair and appropriate signal to utilities by encouraging participation without jeopardizing recovery of their EE investments.

C. <u>General Comments</u>

The CEA requires that each electric and gas utility file EE and DR plans with the Board no later than 30 days prior to the start of the energy year.[32] Furthermore, the CEA also requires annual filings by each utility.[33] The Draft's cost recovery proposal is complex and will require careful review. Annual computations of utility cost and lost revenues will also require careful

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[29] Draft, p. 7. Utility QPIs are also being addressed in a separate portion of the EE transition stakeholder process.
[30] Id.
[31] <u>See</u> Draft, pp. 8-9 (Figures 1 and 2).
[32] <u>N.J.S.A.</u> 48:3-87.9(d)(1),(3).
[33] <u>N.J.S.A.</u> 48:3-87.9(e)(1).

review by Staff and interested parties. The complexity and number of these filings are likely to overburden the resources of Staff and interested parties if they are filed simultaneously and subject to the RGGI Act's 180-day timeline.[34] For this reason, the Board should require staggered filings so that all the utilities do not file at the same time. Furthermore, the Board should set comprehensive minimum filing requirements and standard formats to expedite review.

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[34] P.L. 2007, c. 340 (C.48:3-98.1) ("RGGI Act").