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November 14, 2019

VIA ELECTRONIC MAIL (EnergyEfficiency@bpu.nj.gov)
AND HAND-DELIVERY

Honorable Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Trenton, New Jersey 08625-0350

**Re: Clean Energy Act – Energy Efficiency Transition
BPU Docket No.: Undocketed Matter
Technical Meeting – Cost Recovery
Comments of the Division of Rate Counsel**

Dear Secretary Camacho-Welch:

Enclosed for filing please find an original and ten copies of the comments of the New Jersey Division of Rate Counsel (“Rate Counsel”) submitted pursuant to the Board of Public Utilities’ Notice dated October 15, 2019 (“Notice”). In accordance with the Notice, an electronic copy will be emailed to EnergyEfficiency@bpu.nj.gov.

We have also enclosed one additional copy of the materials transmitted. **Please stamp and date the copy as “filed” and return to our courier.**


The Honorable Aida Camacho-Welch, Secretary
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Thank you for your consideration and attention to this matter.

Respectfully submitted,

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**Clean Energy Act
New Jersey Energy Efficiency Transition
Stakeholder Process
Technical Meeting - Cost Recovery**

BPU Docket No.: Undocketed Matter

Comments of the Division of Rate Counsel

November 14, 2019

Introduction

As part of the process to implement the Clean Energy Act¹, the Staff (“Staff”) of the Board of Public Utilities (“Board”, “BPU”) convened a Technical Meeting on October 31, 2019 and invited stakeholders to comment on the cost recovery of energy efficiency (“EE”) and demand response (“DR”) programs implemented pursuant to the Clean Energy Act. The within comments are being submitted by the New Jersey Division of Rate Counsel (“Rate Counsel”) pursuant to the Notice dated October 21, 2019 (“Notice”) in this matter and the meeting agenda (“Agenda”), which set forth four questions for comments.

At the outset, Rate Counsel urges the Board to strike a fair balance between customers and utilities when establishing cost recovery and incentive mechanisms to implement the Clean Energy Act. In order for us to reach all of our clean energy goals, it is important to avoid overpaying for any single aspect of our ambitious agenda. While utilities deserve to be paid fairly for their EE programs, the success of these programs depends on ensuring that ratepayers reap real benefits when they reduce their energy use.

As it now stands, pursuant to N.J.S.A. 48:3-98.1, utilities in New Jersey earn a return on their investment in EE and DR measures. This means that they not only get the recovery of their

¹ P.L. 2018, c. 16 (C.48:3-87.3-87.7) (“Clean Energy Act” or “CEA”).

costs, they get a return on those investments for the life of the asset. Their return is based on the weighted average cost of capital approved in their last rate case, which in recent cases has allowed a 9.6% return on equity, combined with the long term debt rate at the time the program is approved. In all but a few other states, utilities only receive the return of their investments, not the return on them as we allow in New Jersey. Given that N.J.S.A. 48:3-98.1 also allows recovery through a surcharge without the need to wait until the utility's next rate case, the risk to the utility in these programs is very low. Thus, by allowing the utilities to place their EE and DR investments into rate base and paying them their full weighted average cost of capital, we are already providing very generous cost recovery for these programs.

The Clean Energy Act now also requires the Board to establish incentives for utilities who meet their energy savings goals (and penalties for those who do not). The CEA also permits the utilities to ask for recovery for lost revenues that result from their programs. Lost revenue recovery or "decoupling," which separates utility revenues from energy sales have long been sought by the utilities as a means to counter lower energy sales attributable to EE and DR measures and remove a "disincentive" to utilities to participate in EE programs. However, the Clean Energy Act requires electric and natural gas utilities to meet certain energy savings targets. Thus, the Legislature itself has removed any disincentive by requiring the utilities to meet the statutory EE energy savings goals. So, other than setting performance based incentives and penalties, the issue for the Board is not what we should pay the utilities to encourage certain behavior, but what we should pay them to fairly compensate them for their investments. If we were to pay them a generous and contemporaneous return at their full weighted average cost of capital on their EE or DR investment, plus compensation for "lost revenues," and an incentive

for doing what they are required to do under the CEA, we will be paying too much for these utility EE programs.

Moreover, since all of these generous incentives will be paid for by ratepayers, the increased recovery will reduce the amount of savings customers see from their energy efficiency investments. Rate Counsel therefore respectfully urges the Board to consider the cumulative effect of such costs imposed on ratepayers and, ultimately, the affordability of regulated electric and gas utility service. That said, Rate Counsel offers its responses below to the questions posed by Board Staff.

Question 1. - Should recovery mechanisms be the same or different for programs administered or implemented by utilities versus non-utility parties?

Recovery mechanisms for regulated utilities and non-utility parties should be similar or equivalent to the extent possible. However, it will be very difficult to have a level playing field since non-utility parties do not have the rate recovery mechanisms or monopoly status of regulated public utilities. Given that utilities do not and should not have an advantage on all energy efficiency programs, utilizing similar or equivalent mechanisms for recovery to the extent possible may help balance the interests of all parties and provide for useful, meaningful and consistent results. The rate recovery mechanism should be “trued-up” annually for actual costs and the development of an estimate of the revenue requirement for the upcoming recovery period, together with a review of costs and energy savings.

Question 2. - Topic 1: Recovery of Program Costs

- a. **Should costs associated with efficiency program investments be expensed or amortized? If amortized, what is the appropriate amortization period, and what should the rate for the carrying costs be?**

Costs associated with energy efficiency program investments should be amortized, as

these programs are expected to benefit more than one period. The amortization period should be long enough to allow the investor the opportunity to recover all prudently incurred costs, as well as to minimize any overlapping or pancaking of existing and previously approved energy efficiency programs currently in effect. Carrying costs should mirror the level of risk faced by the utility or investor. Given the favorable contemporaneous recovery allowed in N.J.S.A. 48:3-98.1, recovery at the utility's full weighted average cost of capital is too generous and consideration should be given to lowering those carrying costs, particularly if the Board decides to consider granting some form of lost revenue recovery.

- b. Should costs be allocated by sector (e.g., residential, commercial, industrial)? If yes, how would you recommend doing the allocation?**

The rate recovery mechanism should be examined in the context of the EE and DR programs to see that the costs are allocated equitably among rate classes. Care should be exercised in program design and rate design to ensure that the beneficiaries of EE and DR programs fairly contribute to program cost recovery consistent, to the extent possible, with the benefits they receive from CEA programs.

Question 3. - Topic 2: Potential for Recovery of Lost Revenues

- a. Should there be a mechanism to recover lost revenues?**

No, a mechanism to recover lost revenues should not be implemented for the following reasons:

1. New Jersey utilities already have an incentive in place to promote energy efficiency and the ability to earn a generous return on energy efficiency program investments and receive contemporaneous recovery of program costs;

2. The CEA already provides for incentives and penalties for utilities' energy efficiency activities and performance.
3. The CEA does not require that lost revenues will be recovered, only that a utility may request such recovery.

However, if the Board considers allowing recovery for lost revenues, under the CEA such recovery may only be for lost revenues that result directly from the utility's energy savings programs. In addition, if lost revenue recovery is permitted, the generous incentives currently allowed under N.J.S.A. 48:3-98.1 should be reduced or eliminated. Each of these issues is addressed in greater detail below.

1. **New Jersey utilities already have an incentive in place to promote energy efficiency in the ability to earn a return on energy efficiency program investments and receive contemporaneous recovery of program costs.**

New Jersey utilities are already awarded an additional incentive to promote energy efficiency programs that utilities in most other states are not afforded. New Jersey is one of only four states that allow utilities to earn a return on their EE investments.² Furthermore, a utility's ability to earn a return on its EE investments is currently not tied to performance on energy savings or any other targets.³ If the utilities are allowed to earn a return on EE investments through a surcharge as they do now, be awarded incentives under the Clean Energy Act, and also recover lost revenues through decoupling, ratepayers will carry all the risks and burdens, thereby potentially overpaying for EE programs and measures.

2. **The CEA already provides for incentives and penalties for utilities' energy efficiency activities and performance.**

² American Council for an Energy-Efficient Economy ("ACEEE"), Snapshot of Energy Efficiency Performance Incentives for Electric Utilities, December 2018, pp. 8-10.

³ American Council for an Energy-Efficient Economy ("ACEEE"), Snapshot of Energy Efficiency Performance Incentives for Electric Utilities, December 2018, p. 9.

The Clean Energy Act establishes and modifies New Jersey's clean energy and energy efficiency programs in addition to modifying the State's solar renewable energy portfolio standards.⁴ Further, the CEA requires electric utilities, within a five-year period, to reduce electricity usage by at least two percent per year. This two percent reduction is relative to the prior three-year average electricity levels. Similarly, the CEA requires natural gas utilities to achieve at least a 0.75 percent annual usage reduction, over a five-year period. Again, this reduction is relative to the prior three year average annual usage level.⁵ Thus, the CEA removes any disincentive a utility has to promote energy efficiency because it is statutorily obligated to do so and if the utility fails to meet these requirements, it will be penalized.

The CEA also mandates the establishment of both incentives and penalties for utilities' energy efficiency activities and performance. The CEA requires the Board to define a set of incentives for utilities to reward them for their successful energy efficiency activities. In addition, the CEA requires the Board to evaluate utility failures to meet targeted usage reductions and to implement penalties when needed.⁶ Thus, the CEA directly addresses utilities' incentives for energy efficiency, eliminating the need for any other type of revenue decoupling mechanism or lost revenue adjustment mechanism ("LRAM"). While the incentives and penalties have not yet been determined, these may include shareholder incentives such as a return on equity ("ROE") bonus or adder recovered from ratepayers through an additional surcharge mechanism. A decoupling mechanism or lost revenue adjustment mechanism would only further burden ratepayers when coupled with other incentives that may be established.

⁴ P.L. 2018, c. 17 (codified at N.J.S.A. 48:3-87.8 et al.), enacted May 23, 2018.

⁵ N.J.S.A. 48:3-87(d), (g) & (h); N.J.S.A. 48:3-87.9.

⁶ N.J.S.A. 48:3-87.9(e)(3).

3. The CEA does not establish that lost revenues will be recovered, only that a utility may request recovery.

The CEA states that each electric public utility and gas public utility shall file an annual petition with the Board to recover on a full and current basis through a surcharge all reasonable and prudent costs incurred as a result of energy efficiency and peak demand reduction programs required by the Clean Energy Act, pursuant to N.J.S.A. 48:3-98.1, including but not limited to (1) recovery of and on capital investment and (2) recovery of the revenue impact of sales losses resulting from implementation of these programs.⁷ While this language allows the utility to request recovery of lost revenues it does not guarantee recovery of lost revenues.

Moreover, the Clean Energy Act also limits the lost revenues that may be awarded. The CEA specifically provides that utilities can request recovery of costs including revenues associated with the “sales losses resulting from implementation of the energy efficiency and peak demand reductions” that are mandated under the legislation.⁸ The CEA’s ratemaking treatment of lost revenues, therefore, is much more specific than a general decoupling mechanism. A full decoupling mechanism allows recovery of all revenue losses associated with any change in sales, regardless of reason: weather; electric and natural gas commodity price changes; economic conditions; exogenous shocks; efficiency changes; technological change; to name a few. The CEA, however, is much more specific and calibrated, only allowing utilities to ask for lost base revenues that are shown to be resulting from their respective energy efficiency activities. This language limits the recovery of lost base revenues to those that are directly attributable to the utility’s EE and DR programs. Additionally, the CEA provides that such recovery would only occur if costs are found to be reasonable and prudent. Many decoupling mechanisms allow cost

⁷ N.J.S.A. 48:3-87.9(e)(1).

⁸ N.J.S.A. 48:3-87.9 (e)(1), emphasis added.

recovery regardless of cause or reason without a prudency review to evaluate whether lost revenues resulted from effective energy efficiency or demand reduction programs. This is not consistent with the CEA's mandate.

In contrast to the lost revenue concept set forth in the CEA, revenue decoupling is a relatively blunt instrument for addressing energy efficiency incentives. Crude revenue decoupling mechanisms are not performance based and allow utilities to recover all revenue losses, regardless of the reason for those losses. Thus, a revenue decoupling mechanism shifts a large part of the revenue losses from efficiency activities away from participants and onto non-participating customers with little benefit.

b. If the Board allows for recovery of lost revenues, what should the lost revenue recovery mechanism be?

The Board should not allow recovery for lost revenues for the reasons discussed above. The CEA does not require the Board allow recovery of lost revenues, the CEA only permits a utility to request recovery of lost revenues. As previously stated, if considered, the lost revenue recovery mechanism should not be a full decoupling mechanism that recovers all lost revenue regardless of reason or cause. The CEA is explicit that recovery of lost revenues be restricted to "sales losses resulting from implementation of the energy efficiency and peak demand reductions" that are mandated under the legislation.⁹ Therefore, any lost revenue mechanism allowed should be restricted to only recovering sales losses shown by the utility to result from the implementation of a utility's EE and peak demand reduction programs. Moreover, if the Board does allow some form of recovery for lost revenues, the Board should not allow the utilities to also place their EE investments into rate base and earn their full weighted average cost of capital. Recovery of both for the reasons discussed above is too rich.

⁹ N.J.S.A. 48:3-87.9 (e)(1), emphasis added.

- c. **If the Board allows for recovery of lost revenues:**
 - i. **What methods should the Board employ to calculate lost revenues associated with energy savings?**
 - ii. **Should other factors (e.g., weather, non-program-related reductions) be taken into account?**

As noted above, if the Board were to allow recovery of lost revenues, the mechanism used to calculate lost revenues must be tailored to allow recovery only for the lost revenues that result from the utility's programs. Utilities should not be permitted to benefit from favorable weather, economic downturns, or other factors that lower usage but have nothing to do with the efforts of utilities.

Furthermore, any such lost revenue mechanism should also ensure that reduced usage due to outages should not be recoverable for the utility. For example, this was an issue in Maryland where customers were initially charged under a lost revenue mechanism after they lost service for a period of time due to a storm. The Maryland Public Service Commission subsequently issued an order disallowing such recovery and similar prohibitions should be included here if the Board allows lost revenue recovery.¹⁰

- d. **If the Board allows for recovery of lost revenues, should authorized return on equity be subject to adjustment based on reduced risk?**

A utility and its shareholders typically bear the risk of revenue and sales differences from the test year in a base rate case for a number of different reasons. First, it is the utility's responsibility to propose a typical year for rate-making purposes. It would not be in a utility's nor its shareholders' best interests to propose a test year that was unsupportive of what management believed was required to recover costs and earn its allowed return. Second, a

¹⁰ See I/M/O the Investigation into the Just and Reasonableness of Rates as Calculated Under the Bill Stabilization Adjustment Rider of Potomac Electric Power Company et al., Public Service Commission of Maryland Order No. 84653, Case Nos.: 9257, 9258, 9259, and 9260. (January 25, 2012).

utility's allowed rate of return, like that of any other business, includes some premium for the business risk inherent in the industry in which it operates.

Under decoupling, any revenue decreases related to contractions in the economy will be recovered from ratepayers. For example, a utility with a revenue decoupling mechanism will be made whole for revenue losses anytime a recession or economic slow-down occurs resulting in lower energy sales. The problem with this outcome is that decreases in sales associated with economic downturns have nothing to do with utility-sponsored EE programs. In other words, revenue decoupling allows a utility to be made whole for a change in usage it did not help motivate. Instead, these changes in usage associated with a recession are likely the natural reaction of households trying to reduce their expenditures during difficult economic times or, alternatively, businesses and industries idling or shutting down their operations. Under revenue decoupling, ratepayers would be required to make a utility whole for revenue losses during these economic downturns; whereas, under traditional regulation, utilities bear the risks of these economic contractions, just like many other types of businesses and industries.

Since the risk to the utility is lower if the Board allows for lost revenues, then the return on equity should also be lower. It would be fundamentally unfair to shift the risk to ratepayers but then pay the utility as if it was assuming those risks.

Question 4 – Topic 3: Energy Efficiency Incentives and Penalties

- a. How should performance incentives be structured? How should performance penalties be structured?**

The Clean Energy Act states that a utility that achieves “the performance targets established in the quantitative performance indicators” shall receive an incentive for its energy

efficiency measures and peak demand reduction measures for the following year.¹¹ The incentive is to be determined by the Board. In addition, the CEA states that “the incentive shall scale in a linear fashion to a maximum established by the board that reflects the extra value of achieving greater savings.”¹²

Rate Counsel supports incentives based on performance in achieving energy savings goals, as required by the CEA. Rate Counsel’s detailed responses to the Board’s questions are provided below.

i. Should incentives and penalties be handled as a percentage adjustment to earnings or as specific dollar amounts? Why? How?

Rate Counsel recommends establishing incentives and penalties in the form of adjustments to a utility’s allowed ROE, as permitted by the CEA.¹³ As discussed above, because of the reduced risk, the baseline ROE applicable to EE and DR programs implemented pursuant to the CEA should be lower than the ROE approved in a base rate cases.

ii. Should incentives and penalties be scalable based on performance? If so, in what manner?

Rate Counsel notes that the CEA requires that “the incentive shall scale in a linear fashion to a maximum established by the Board that reflects the extra value of achieving greater savings.”¹⁴ Rate Counsel supports this linear approach. The incentives and penalties should vary linearly in line with achieving verified energy savings goals. In addition, the incentives and penalties should be symmetrical, with a dead band where neither incentives nor penalties are

¹¹ N.J.S.A. 48:3-87.9(e)(2).

¹² N.J.S.A. 14:3-87.9(e)(2).

¹³ N.J.S.A. 48:3-98.1(b).

¹⁴ N.J.S.A. 48:3-87.9(e)(2).

imposed. Over time, the dead band could be narrowed as experience with EE and DR programs and performance measures are refined.

iii. How should incentives and penalties be reconciled? Should incentives and penalties be “refunded” to ratepayers through rate reduction?

Rate Counsel proposes that performance incentives be collected or refunded to customers through individual utility energy efficiency program riders as part of the annual true up.

b. If the Board establishes performance incentives and penalties, what level of total incentives and penalties is reasonable?

Any incentives or penalties should be considered in the context of the overall awards afforded utilities, including any lost revenue recovery and any EE or DR measures included in a utility’s rate base. Ultimately, the award of incentives should be fair to both ratepayers and utilities. In short, utilities should not be permitted to gain a windfall of full rate base treatment of program investments at their weighted average cost of capital (“WACC”), plus lost revenue recovery, and incentives.