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April 15, 2020

VIA 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: Rate Counsel's Comments on the Board of Public Utilities' Straw Proposal for New Jersey's Energy Efficiency and Peak Demand Reduction Programs
BPU Docket No.: Undocketed Matter

Dear Secretary Camacho-Welch:

Please accept for filing the enclosed comments being submitted on behalf of the New Jersey Division of Rate Counsel ("Rate Counsel") in response to the Straw Proposal for New Jersey's Energy Efficiency and Peak Demand Reduction Programs ("the Straw Proposal"), circulated by the Staff of the Board of Public Utilities for comment on March 20, 2020 with a corresponding Public Notice which was updated on March 25, 2020 noticing stakeholders of a public webinar to address the Straw Proposal on April 1, 2020. Rate Counsel reserves its right to supplement these comments as the stakeholder process continues. In accordance with the Notice, an electronic copy will be emailed to EnergyEfficiency@bpu.nj.gov.

Please acknowledge receipt of these comments.

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Thank you for your consideration and attention to this matter.

Respectfully submitted,

STEFANIE A. BRAND
Director, Division of Rate Counsel

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Enclosure

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Clean Energy Act
New Jersey Energy Efficiency Transition
Stakeholder Process

BPU Docket No.: Undocketed Matter

Comments of the Division of Rate Counsel

April 15, 2020

Introduction

As part of the process to implement the Clean Energy Act[1], the Office of Clean Energy staff ("OCE", "Staff") of the Board of Public Utilities ("Board", "BPU") circulated a document for comment entitled, "Straw Proposal for New Jersey's Energy Efficiency and Peak Demand Reduction Programs" ("Straw Proposal"). Staff also held a webinar, originally scheduled for March 27 but rescheduled to April 1, 2020, at which stakeholders were invited to provide verbal comments and questions.

The New Jersey Division of Rate Counsel ("Rate Counsel") provides the following comments on the Straw Proposal.

I. Program Administration

Rate Counsel supports the efforts to enhance consistency and comparability to programs available to all ratepayers in New Jersey. This is particularly important if, as proposed, increasing responsibility for the administration of some programs is to be transferred to the utilities rather than the state. Rate Counsel further supports the flexibility for utilities to propose "adders" to core programs as a way to support innovation, and also to recognize opportunities for savings that may be more specific to certain service territories or customers.

[1] N.J.S.A. 48:3-87.3-87.7, the "Clean Energy Act" or "CEA."

One benefit of designing consistent programs to be delivered to key sectors should be a reduction of administrative burden on all parties, as core program designs can be proposed to the Board, allowing it to more efficiently review such programs. Similarly, the focus on using consistent formulas, metrics, and protocols for evaluating subprograms and projecting energy and peak usage reductions has the potential to simplify the review process and enhance public confidence in the utilities' analyses. As a result, and as will be discussed further below, there should be a tailored set of Minimum Filing Requirements ("MFR") for these core programs. The MFRs should encompass what is needed to support budget approval and cost recovery for core programs that are implemented statewide, including a standard benefit-cost analysis of proposed programs, rate impact analysis, quality assurance, and plans for ensuring equitable access to programs for all customers. However, additional information should be provided for any customized utility-specific or pilot programs. For all programs, in additional to financial and ratemaking data, the utilities should provide sufficient information to allow the Board and other parties to evaluate whether the utility's programs are designed to efficiently and effectively meet or exceed the savings and other targets established by the Board under the CEA. These and other aspects of reporting requirements are discussed further in the Filing and Reporting section below.

The implementation of a consistent, coordinated marketing strategy will also help to reduce customer confusion and to ensure that ratepayers throughout New Jersey have access to a full suite of cost-effective energy saving strategies. Rate Counsel supports this approach and looks forward to participating in the proposed Marketing and Communications Working Group.

Rate Counsel supports the stated focus of the Board on equity issues, and agrees that equitable access concerns must be integrated into all aspects of program administration and implementation.[2] Rate Counsel supports the creation of an Equity Working Group ("EWG") while being mindful of the risk of creating an unmanageable number of working groups for this process. It may make sense to fold the Comfort Partners Working Group into the EWG, making the Comfort Partners program a part of its portfolio.

However, despite the goal of giving primary consideration to equity issues, this area is not well defined in the Straw Proposal. Equitable access must include not only low-income but moderate-income customers as well, a group which is given very little mention in the Straw Proposal. It must include consideration of access for these customers to all residential programs, with special attention to affordability along with health and safety issues. Finally, no metrics of success for achieving equitable access have yet been proposed. In fact, the proposed QPIs for years one and two do not include any consideration of equity issues. Thus, it is all the more important that focused attention be given to these issues by stakeholders as the initial "core" utility programs are being designed and implemented. Rate Counsel looks forward to working with the Board and with other stakeholders to make New Jersey a national leader in promoting equitable access to energy efficiency programs for all customers.

II. Application of Utility Targets

Rate Counsel supports the separation of savings goals into utility and CEP components consistent with a clearly defined division of responsibility for various types of EE programs, and the evaluation of utilities' performance solely on the basis of utility-specific targets. Determining this quantitative allocation of savings responsibility will not be simple, as there are likely to be (as there currently are) utility and CEP programs that complement each other, along with programs that produce both gas and electric savings. While the Straw Proposal does not

[2] Straw Proposal, p. 29.

address these issues it does provide for separate filings on program performance from each utility and from the CEP. Clear and transparent guidelines must be established at the outset regarding allocation of savings between gas utilities, electric utilities, and CEP programs where these overlap, so that the Board is not in the position of adjudicating competing claims for the same savings in subsequent performance review filings.

As noted in Rate Counsel's February 11, 2020 comments, the Board has not yet proposed metrics for most of the identified components of the utility QPIs. It is impossible to evaluate the weightings proposed in the Straw Proposal without knowing what metric will be used to measure each QPI component. Careful design of metrics and weightings is very important to ensuring that distorted incentives do not arise which unintentionally de-emphasize important policy goals of the CEA.

The targets established in Appendix A of the Straw Proposal do not yet reflect the available savings potential in each utility service territory; nor is it clear how the division of the savings targets between the utilities and the CEP was established. However, Rate Counsel believes that these savings targets should be achievable for all utilities through cost-effective EE programs, and that they are reasonably designed to achieve the initial savings required under the CEA. Rate Counsel supports these initial savings targets for each utility, but believes that the targets for years 4 and 5 should be subject to review and revision as part of the first triennial review.

One particular concern is the proposed weighting of 35% for the Utility Cost Test ("UTC") for years 4 and 5, which is greater than the combined weighting of annual and lifetime energy savings for these years. No metric for the UTC has been specified, but if the scoring were to be linearly related to the UTC ratio, this would provide a strong perverse incentive for utilities to "cherry pick" the most cost-effective measures at the expense of pursuing comprehensive savings. This could be a potentially fatal blow to low-income programs, for example, which generally do not score as highly on benefit-cost tests. Subject to more detail regarding how this metric is to be scored, Rate Counsel cautions against any approach that could overwhelm other policy goals through an overreliance on high scores on one benefit cost test, or any over-emphasis on achieving extremely high benefit-to-cost ratios at the expense of providing a broad range of cost-effective programs, high levels of savings, and equitable access for all customers.

III. Cost Recovery and Performance Incentives and Penalties

A. Proposed Investment Treatment

1. Overview of Straw Proposal

The Straw Proposal allows utilities to earn a return of and a return on their energy efficiency investments. This is an important provision of the Straw Proposal because it eliminates utility disincentives for pursuing EE investments. For ratemaking purposes, the Straw Proposal proposes to amortize EE expenditures (other than those associated with operations and maintenance) over a seven-year period to allow utilities to recover their EE investment costs more quickly while reducing the program return component and overall revenue requirement from ratepayers.[3] This shorter amortization period will also reduce the potential rate shock associated with EE transition programs and spreads program costs over a period of time to better match program costs with program benefits.[4]

More importantly, the Straw Proposal allows utilities to earn a rate of return on EE investments based on each utility's capital structure as established in its most recent base rate

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[3] Straw Proposal, p. 39.
[4] Id.

case, incorporating both: (a) the cost of debt; and (b) the return on equity ("ROE") less 100 basis points (or "bps").[5] The 100 bps adjustment factor is designed to account for the differences in risk associated with the immediate cost recovery of EE investments that are allowed under the CEA.[6] In order to encourage EE investment and attainment of EE goals, the Straw Proposal does not include an initial investment constraint, rate cap, or any other financial constraint on EE investments that are tied to ratepayers' distribution rates, or their overall bills.[7] The Straw Proposal does note however, that rate impacts will be closely monitored and a cap on rates or customer bills may be put in place two years after the approval of EE programs.[8] Lastly, the Straw allows utilities to assess carrying charges on its over- and under-recovery balances at a rate that is measured as the two-year Treasury bill rate plus 60 basis points.[9]

2. The Straw Proposal will Facilitate and Incent Cost-Effective EE

In general, Rate Counsel supports the Straw Proposal, but as noted throughout our comments, Rate Counsel offers suggestions on how the Straw Proposal could be improved. Rate Counsel believes the Straw provides considerable incentives to meet New Jersey's EE goals. These incentives are multifold and include:

- Utilities will be allowed to receive contemporaneous ratemaking treatment for their EE investments. They will not be required to wait until their next base rate case to receive ratemaking treatment of these investments.
- Utilities will be allowed a return on and of their EE investments.
- Utilities will be allowed to earn higher returns, through the program incentives, if they achieve high degrees of EE savings.
- Program investments will be amortized over a modest period that helps to minimize rate impacts but does not result in unnecessary ratepayer costs.
- Utilities will receive carrying costs on any over- or under-recoveries, assuring they are made 100 percent whole for their EE investments.

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[5] Id.
[6] Id.
[7] Id., p. 40.
[8] Id.
[9] Id.

- Utilities will be allowed to recover lost base revenues directly associated with their EE efforts.

The Straw Proposal affords New Jersey's utilities a set of incentives and ratemaking provisions that collectively, will be some of the most progressive in the country since few utilities in the United States are allowed an opportunity to even earn <u>any</u> return on their EE investments. While many states offer financial incentives to utilities for meeting EE targets, most regulators require utilities to expense their EE investments on a direct, dollar-for-dollar pass-through basis with no earnings opportunities.[10]

In this sense, Rate Counsel believes the Straw Proposal strikes a reasonable balance in creating a progressive set of EE investment incentives, while at the same time, balancing those incentives against ratepayer costs. Those stakeholders participating in the recent April 1, 2020 Straw proposal webinar who suggested that the Straw Proposal is deficient and will somehow "under-incent" EE investment, or create an environment in which traditional utility investment in infrastructure is preferred to EE investment, are incorrect for a number of reasons.

First, the single most important factor incenting utilities to promote EE in New Jersey is the CEA itself which requires electric utilities to reduce electricity usage by at least two percent per year over a five-year period. 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.[11] The CEA effectively eliminates any utility disincentive to engage in EE activities since it mandates utilities to adopt EE programs and meet

[10] 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.

[11] <u>N.J.SA.</u> 48:3-87.9(a).

target usage reduction levels. Further, the CEA and the Straw Proposal establish both incentives and penalties for utilities' EE activities and performance that should, in conjunction with the strict mandate, provide additional strong incentives to promote EE in New Jersey.

Second, several parties at the April 1, 2020 Straw Proposal webinar suggested that the Straw's allowed return, set as a utility's ROE less 100 bps, will create a preference for "traditional" utility infrastructure investments over EE investments. While overcapitalization is always an issue in utility regulation, and Rate Counsel does have concerns about future utility capacity investments, the "substitutability" of "traditional" utility investment and EE investment offered by these parties is misplaced, particularly given the nature of New Jersey utility capital investments over the past decade.

Consider for instance, that most utility infrastructure investments over the past decade have been overwhelmingly directed towards safety, reliability, and resiliency. The PSE&G Energy Strong I ("ESI") proposal was comprised of $3.9 billion in resiliency and system hardening investments for its electric and gas system. The Company proposed $2.6 billion in electric system resiliency and reliability investments and $1.3 billion in gas system replacement, safety and resiliency investments. Ultimately, the Board only approved $1.2 billion for the ESI program. Four years later (June 2018), PSE&G came back to the Board for a second bite at the apple requesting approval for a $2.5 billion Energy Strong II ("ESII") proposal ($1.5 billion electric system, $1.0 billion natural gas system); again, entirely dedicated to reliability, safety and resiliency investments. Ultimately, PSE&G was only awarded $842 million of the ESII request.

Rate Counsel highlights these PSE&G infrastructure proposals for a few reasons. First, these proposed infrastructure investments offered by PSE&G and similar proposals by other electric and natural gas utilities, have been entirely based upon resiliency, safety, and reliability: these investment programs have little to nothing to do with growth nor are they substitutable with a comparable EE investment (since no such comparable EE investment exists). Second, the Board clearly recognized the over-reach associated with both PSE&G proposals as filed, and has done so for many other New Jersey utility proposals, only approving 40 percent of the originally requested capital investment in the case of PSE&G (average over both ESI and ESII). Thus, it is: (a) highly unlikely in practice that the Staff's proposed EE incentive structure will incent unnecessary capacity investments over EE investments; and (b) to date, the Board has viewed most utility infrastructure requests with a critical eye in order to assure that only those investments with the highest likelihood of providing ratepayer benefits are approved. In sum, while infrastructure and EE investments are inherently different in nature, there are institutional safeguards in place to prevent over-investment in EE.

Thus, any concerns that the Straw Proposal would create a preference or incent utility infrastructure investments over EE investments is misplaced and inconsistent with past Board decisions. The infrastructure investments that have been proffered by utilities over the past few years have been primarily reliability and resiliency-oriented and these investments simply cannot be thought of as a substitute to EE investments. Further, even if there were some degree of substitutability or linkage between these types of investments, the Board has wisely reviewed and governed recent utility infrastructure requests and there is no reason to believe that this will change in the future with approval of the Straw Proposal.

Lastly, Rate Counsel supports the amortization period proposed in the Straw Proposal that will limit EE cost and investment recovery to a seven-year period. While longer amortization periods can have the benefit of smoothing rate impacts, they can also unnecessarily increase the total earnings that are collected in retail rates (i.e., longer financing periods often entail greater levels of financial support). These increased earnings opportunities come at ratepayers' expense: the longer the amortization period, the greater the overall earnings associated with these investments despite a lower annual revenue requirement from such investments.

Ratepayers should not be required to "over-pay" or "over-incent" utilities for promoting EE savings that they are required to already achieve by law. The fact that utilities receive a fair rate of return on these investments, over a reasonable time period, should suffice. The Straw Proposal therefore, draws an appropriate balance between creating utility incentives (through higher earnings) and minimizing rate shock and ratepayer financial support for higher utility EE investments.

3. Staff's Proposal Gives Utilities a Unique Opportunity to Earn a Return on EE Investments

The Straw Proposal's proposed return on EE investments was one of the more, if not the most contentious issue that arose during the April 1, 2020 stakeholder meeting. The Straw Proposal establishes a return on EE investment of a utility's ROE less 100 bps. A number of stakeholders claimed this as being a disincentive to EE investments, with others suggested it would be punitive to utilities. Rate Counsel wishes to emphasize that allowing a rate of return on any EE investment is an exception to the rule, not something that is commonplace in utility regulation around the U.S. Currently, there are only four other states/jurisdictions that allow for any rate of return on EE investments (Washington DC, Illinois, Maryland, and Utah).[12] Most

[12] 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

regulatory commissions treat EE as an expense that is recovered on a dollar-for-dollar basis with no allowed return of any kind.

Rate Counsel agrees with the rationale proffered by the Straw in setting the allowed return proposal:

> there is an inherent reduction in risk associated with the contemporaneous recovery available through this mechanism, 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 be able to recover costs for years after they are incurred and that recovery is not guaranteed. The energy efficiency programs are also less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs are not subject to the same project execution risks; will not undergo several years of construction with the associated regulatory lag; and do not face the traditional risk that the Board may find the investment not reasonable and prudent, or not used and useful.[13]

Thus, the Straw Proposal justifies this adjustment based on the fact that: (a) utilities will be receiving a unique opportunity to not only get contemporaneous cost recovery, but a contemporaneous return on investment with this proposed program; and (b) there are inherent differences in risk in the development of EE investments and physical infrastructure. Rate Counsel agrees with the Straw Proposal's rationale.

There is nothing in the CEA that prohibits the proposed 100 bps adjustment, contrary to certain assertions made during the April 1 stakeholder meeting. While the CEA requires the Board to allow utilities a "return" on EE investments, it does not identify how that return should be calculated. The CEA does not explicitly tell the Board what return should be used; only that some return be applied to utility EE investments. The CEA also allows an incentive restructure to be tied in some fashion to a base allowed return, yet, here again, the CEA does not directly tell

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Investigation of Advanced Meeting Technical Standards, Demand Side Management Cost Effectiveness Tests and Demand Side Management Programs. Order No. 81637, Case No. 9111, September 28 (Baltimore: MD PSC, 2007).

[13] Straw Proposal, p. 39.

the Board what return should be set nor does it tell the Board how this return should be established.[14] Thus, there is no support for stakeholder claims that the Straw Proposal is somehow "too low" or "inconsistent" with the CEA. The plain intent of the CEA is to require a "return" and it leaves the determination of this return to the Board. Rate Counsel, therefore, supports the return being proposed in the Straw as being fair and reasonable, and consistent with the CEA. Without this reduction the utilities could earn an ROE that is greater than 11 percent which would be simply unreasonable, particularly in today's environment.

Furthermore, the use of an adjusted or alternative ROE for EE investment returns is not uncommon in utility regulation, particularly in the handful of states that allow returns on EE investments. Consider that in Illinois, the Future Energy Jobs Bill in 2016 (SB 2814) allows utilities to amortize their EE investments over the weighted average measure life of the portfolio of programs. The return allowed for these investments is calculated as the average of the prior year's monthly average yields of 30-year U.S. Treasury bonds plus 580 basis points.[15,16] This would equate to a ROE of 8.38 percent and this approach is not dissimilar to the one included in the Straw.

Lastly, the Straw Proposal also allows utilities to recover, or credit, carrying costs on any unrecovered (or over-recovery) of EE cost balances throughout the course of any given year. These carrying costs are set at the two-year Treasury bill rate plus 60 basis points.[17] This is an additional important provision in the Straw that reduces risks for utilities. Under the Straw,

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[14] N.J.S.A. 48:3-87.9(e).
[15] 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.
[16] 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).
[17] Straw Proposal, p. 40.

utilities get not only contemporaneous recoveries and contemporaneous rates of return, but they also get a funding mechanism that keeps them whole for outstanding cost recovery balances. This is an additional risk-reducing feature of the Straw Proposal that further justifies the 100 basis point risk adjustment.

4. Program Rate Cap

In order to encourage attainment of EE goals, the Straw Proposal does not include a program investment or rate cap.[18] According to the Straw Proposal, rate impacts will be closely monitored and a cap on rates or customer bills may be put in place two years after approval of the EE transition programs.[19] This is a generous provision that reduces risk and once again, underscores the need for the 100 bps adjustment recommended by the Straw Proposal.

B. Proposed Lost Revenue Treatment

1. Overview of Straw Proposal

The Straw Proposal includes a lost revenue adjustment mechanism ("LRAM") that only allows utilities to recover those revenues that were lost from activities that are directly attributable to utility EE efforts.[20] This differs from a full decoupling mechanism that allows utilities to recover any changes in revenue from a base level, regardless of the reason for those revenue changes. The Straw Proposal's proposed LRAM will allow utilities to recover lost revenues in the amount that they can demonstrate were directly attributable to their EE transition programs.[21] These lost revenues will be reviewed and recovered annually.[22] Only lost revenues

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[18] Id.
[19] Id.
[20] Id.
[21] Id., p. 41.
[22] Id.

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.[23]

The Straw Proposal notes that the LRAM proposal builds on the State's experience with the Conservation Incentive Plan ("CIP") currently in place for natural gas utilities.[24] 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 purported issues associated with the utilities' incentive for adopting energy efficiency programs.[25] The CIP rests upon two fundamental pillars. First, that utilities have some "skin in the game" by sharing in the costs of providing energy efficiency services to its customers; and second, that utilities will provide capacity-oriented savings in return for any lost revenue recovery. In other words, utilities must work to create total system savings, and must incur some costs of end-user efficiency development if they are to receive any efficiency-specific lost revenue recovery.

2. The Straw Proposal's Lost Revenue Approach is Appropriate and Consistent with the CEA

The Straw Proposal's proposed LRAM is appropriate since it is a performance-based mechanism that ties lost revenue recovery to a utility's energy efficiency activities. In principle, a LRAM is consistent with the performance-based nature of a CIP since the LRAM requires utilities to perform certain activities prior to receiving any lost base revenue recoveries. Rate Counsel supports the Straw proposal that ties lost base revenue recovery to utility performance.

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[23] Id.
[24] Id, p. 40.
[25] See I/M/O SJG and NJNG for the Implementation of a Conservation and Usage Adjustment, BPU Dkt. Nos. GR05121019 and GR05121020, Decision and Order Approving Stipulation (December 12, 2006).

This is also consistent with the specific language in the CEA and the establishment of performance targets and quantitative performance indicators. In doing so, the Straw puts the risk of revenue recovery on the party best positioned to assume that risk: the utility, not ratepayers.

3. Full Revenue Decoupling is Inappropriate

During the April 1, 2020 Straw Proposal webinar, many stakeholders argued that full revenue decoupling mechanisms would be more appropriate than the Straw's proposed LRAM. These parties argue that utilities will not be fully incented to purse EE without full revenue decoupling. Rate Counsel wholeheartedly disagrees. The CEA effectively eliminates this disincentive since it mandates utilities to adopt energy efficiency programs and meet target usage reduction levels. The Board need not adopt full revenue decoupling to require any utility to behave in a certain manner since the CEA does that already.

Consider that the CEA, and the Straw Proposal: (a) gives utilities full cost recovery of the EE investments; (b) provides for a rate of return on these EE investments; (c) allows utilities to assess carrying charges on any unrecovered balance during the period of contemporaneous investment recovery. In addition, the Straw Proposal gives utilities an opportunity for financial incentives when they meet their designated EE targets. These provisions, in total, and coupled with the mandatory nature of the CEA, should be incentive enough. To give utilities, on top of this collective "de-risking" of EE investments, an additional revenue insurance mechanism, that makes utilities whole for revenue losses that have nothing to do with their efficiency efforts, does nothing but over-incent utilities and gives them additional revenues to which they are not entitled.

Lastly, and most importantly, revenue decoupling mechanisms shift revenue recovery risk from utilities and their shareholders and onto ratepayers. The Straw Proposal recognizes the risk shifting nature of a full revenue decoupling mechanism. It is imperative to highlight that in today's economic and social climate, a full decoupling mechanism would only serve to harm ratepayers. After experiencing a warm winter and decreased natural gas consumption, New Jersey finds itself in the middle of a global pandemic with energy prices plummeting, businesses closing, record unemployment levels and people already struggling to pay their bills. A full decoupling mechanism would ensure that utility shareholders are made whole for any losses while transferring 100 percent of the risk and responsibility for making up those loses onto ratepayers.

4. The Principles Underlying the CIP Should be Maintained

Two of the overarching principles of the Board's CIP for gas utilities has been that all lost revenue recoveries are tied to: (a) utilities participating in the cost of their own EE programs; and (b) utilities having to show demand (capacity) savings. Rate Counsel supports these CIP principles since they tie lost revenue recovery to real measurable changes in utility actions, and not to theoretical relationships. A gas utility under a CIP that is not committed to genuine EE savings, through program development or efficient execution of its EE agenda, will not receive lost revenues. In other words, a utility's ability to collect lost revenues under a CIP is tied to that utility's actions. Likewise, a gas utility under a CIP is required to measure and document upstream demand (capacity) savings (usually in transport and storage) in order to receive lost revenue recovery. Again, a utility's ability to collect lost revenues is tied to its actions, not theory. Rate Counsel supports these principles and encourages Staff to further tie the LRAM, as well as other EE cost recovery and incentive mechanisms to these kinds of principles. Programs tied to such performance-based metrics and actions will be good for the environment and good for ratepayers.

5. The Straw Proposal is Currently Not Entirely Consistent with CIP Principles

While the Straw Proposal's LRAM proposal is conceptually consistent with the CIP in its performance-based nature, the LRAM is still not entirely consistent with the two overarching CIP themes discussed above. The Straw Proposal does not, for instance, tie cost recovery, or a utility's ability to earn a return on investment, to lost revenue recovery. Further, while the LRAM is tied to energy savings that are measured through a utility's efforts, they are not tied to demand-oriented savings in a way comparable to the current CIP.

For instance, the Straw Proposal will not hold utilities accountable for demand savings during the "initial years." This type of provision is not consistent with the CIP which ties lost revenue recovery to capacity need reductions (through decreased peak demand requirements). Rate Counsel strongly encourages Staff to reconsider this waiver since having a set of measurable demand reductions is critical to assure that: (a) utilities are not overcapitalizing; and (b) that if fixed costs (from capacity investments) are going unrecovered, they can be tied or documented to corresponding demand reductions.

For instance, the Straw Proposal appears to not require utilities to report, nor be accountable for any active peak demand savings; at least in the initial years of the program. [26] Further, the Straw Proposal seems to limit the proposed incentive/penalty mechanism to just annual energy savings and lifetime energy savings, excluding any peak demand related incentives. The exclusion of any active peak demand reductions, coupled with the exclusive of peak demand savings from the incentive/penalty structure, will make it difficult to establish a lost revenue recovery mechanisms that is entirely consistent with past New Jersey CIP practices which, for gas utilities, has tied lost revenue recovery to capacity need reductions (through

[26] Straw Proposal, p. 34.

decreased peak demand requirements in transportation and storage). Rate Counsel strongly encourages the Staff to reconsider its collective peak demand waivers since having a set of measurable demand reductions is critical to assure that: (a) utilities are not overcapitalizing; and (b) that if fixed costs (from capacity investments) are going unrecovered, they can be tied or documented to corresponding demand reductions.

6. Gas utilities should continue with their CIP programs

Rate Counsel supports the Straw Proposal's recommendation to maintain the existing CIP for the two natural gas utilities that currently have such programs and extend that program to the state's other natural gas utility (PSE&G). Staff has noted in its Straw Proposal that the CIP has resulted in positive behavioral changes and has resulted in ratepayer benefits. Such a program, therefore, needs to be continued, at minimum, for all of New Jersey's natural gas utilities. The CIP program can be extended to electric utilities, as noted above, if the mechanisms of the LRAM are modified such that EE program costs are shared between utilities and ratepayers and, more importantly, lost revenue recovery is tied to peak demand (capacity) savings. For instance, the Board could set lost revenue recovery on a sliding scale similar to the Straw's EE incentives. This sliding scale would be tied to peak demand savings.

C. Proposed Performance Incentive and Penalty Treatment

1. Overview of Staff Straw Proposal

The Straw Proposal includes a mechanism for a performance incentive and performance penalty.[27] 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

[27] Straw Proposal, p. 41.

achievement, there will be a performance penalty.[28] On the other hand, if a utility achieves between 110 percent and 150 percent of the QPI achievement there will be a performance incentive.[29] 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 100 basis points as identified in the Investment Treatment section of the Straw.

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 100 basis points, starting at 90 percent and up to 110 percent of QPI achievement. The performance incentive is similarly set on a linear scale from the utility's ROE less 100 basis points (starting at 110 percent of QPI achievement) to the utility's full ROE (up to 150 percent of QPI achievement). 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] 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.

2. The Proposed Incentives are Appropriate

The Straw Proposal's proposed incentive structure should incent successful EE development. The proposed structure is well-constructed and incudes symmetrical incentive ranges, penalty ranges and a fair and reasonable deadband (QPI achievement between 90 to 110 percent of target). The linear scale increases both rewards and penalties as a utility's EE performance either exceeds or falls short of the target levels. This approach is consistent with

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[28] Id.
[29] Id.
[30] Id.

the plain language and intent of the CEA. While the incentive structure provides substantial financial rewards for utilities that achieve exceptional EE performance, those financial rewards are tempered, or capped at a utility's overall allowed rate of return as established by the Board. This creates positive incentives and maintains a balance between utility and ratepayer interests.

3. The Incentive Proposals will not "Dis-incent" EE Investment

Several parties at the April 1 stakeholder meeting raised concerns about the Straw's proposed incentive structure. The primary disagreement these parties expressed was that the sliding incentive structure that is tied to Straw Proposal's proposed base rate of return on EE investment will simply be inadequate. Rate Counsel disagrees with this position for many of the same reasons expressed earlier in the discussion of the return on EE investment. The Straw Proposal's proposed incentive structure affords utilities a generous and reasonable rate of return given the limited risk of the EE investments in question and the contemporaneous recovery of cost offered by the Straw. More importantly, Rate Counsel believes that the Straw Proposal's proposed incentive structure is entirely consistent with the letter and spirit of the CEA which itself suggests a similar type of sliding incentive structure.

Nowhere does the CEA, explicitly or implicitly suggest that utilities should earn returns on their EE investments that are higher, or even comparable to the returns they get from their normal investments. In fact, as noted earlier, the CEA defers the establishment of a specific return on EE investment to the Board and only speaks of such a return in general terms. The only requirement associated with the return on EE investments that is included in the CEA is simply that the Board shall provide utilities with an opportunity for a return on these investments, not a specific level nor rate of return.

There is no justification in the CEA for any position that utilities should be allowed to earn enhanced rates of return on their EE investments: but this is the position that has been suggested by several EE advocates and the utilities themselves in the recent April 1, 2020 stakeholder meeting. Rate Counsel believes there is no statutory justification for such a position and Rate Counsel strongly disagrees with any proposition that would allow utilities such extraordinary returns.

The recommendation for enhanced allowed returns on EE investments fails to appreciate that these excessive returns must be financially supported through retail rates. Rate Counsel does not support allowing utilities to be allowed to impose unnecessary financial burdens on retail ratepayers for EE investments that these utilities are required by law to achieve. No additional incentives, be it revenue decoupling, or enhanced returns on EE investments, are needed outside of the ones defined by the CEA and proposed by Staff in the Straw Proposal.

4. The Incentive Proposals Appropriately Reflect Risk

The Straw Proposal's proposed incentive structure adequately and fairly addresses risk. As noted earlier, the "base" allowed return embedded in the Straw Proposal's incentive structure recognizes the decreased risk associated with utility EE investments in New Jersey (under the Straw Proposal). The lower risk arises from the fact that utilities will be given contemporaneous recovery of not only their EE investment costs, but the rate of return on those EE investments; which is an opportunity not afforded to traditional utility capacity-oriented investments. Further, the Straw Proposal affords utilities the opportunity to recover carrying costs on unrecovered EE cost balances. Collectively, these provisions make EE investments inherently less risky than other types of utility investments and this needs to be accounted for in the base rate of return, and the incentive structure that relies on this base return as its starting point.

The Straw Proposal's incentive structure also recognizes the increased risk that will be taken by utilities as they move from the "lower hanging fruit" EE programs to those that may be more expensive or complicated (i.e., "risker"). The more risk a utility assumes in promoting such programs, the higher their earnings under the Straw Proposal since higher risk EE programs tend to result in higher savings, which will push total utility savings into higher performance bands. Thus, the Straw Proposal adequately reflects risk in both the base allowed ROE, and the increasing financial incentives needed to encourage utilities to take on more risky EE investments. The approach is consistent with the CEA and will result in outcomes where ratepayers are not over-incenting required utility efficiency behavior.

5. Utility Posturing on Incentives, and ROE, will over Incent EE Investments at Ratepayers' Expense

Rate Counsel does not support the positions offered by other parties, including utilities, that would increase allowed returns for utility investments. Increasing allowed returns above the levels outlined in the Straw Proposal will simply inflate utility earnings opportunities that will have to be financially supported by retail ratepayers. Rate Counsel suggests that it is not fair to burden ratepayers during these uncertain and challenging times with additional costs that are unnecessary and inconsistent with the spirit of the CEA.

IV. Evaluation, Measurement, and Verification ("EM&V")

A. General

Rate Counsel strongly supports the Straw Proposal's recommendation of a standard, clearly-defined, transparent, and replicable approach to EM&V that is consistent for all utilities and for the State, overseen by a Statewide Evaluation Manager, who would ensure coordination and consistency on key inputs. Rate Counsel also supports a standard approach to budgeting for

EM&V, for which 3%-4% of program budget is a reasonable guideline, although appropriate budget amounts may vary based on the nature of specific subprograms and customer groups. As noted in the Straw Proposal, close coordination and well-defined EM&V approaches will be particularly important for programs that are co-managed, or for which there are overlaps between gas and electric utilities and the CEP.

It is also essential that all parties are in agreement on EM&V approaches that will form the basis of New Jersey's EE incentive structure and any lost revenue recovery mechanism. Rate Counsel looks forward to participation in the EM&V Working Group, and with the proposed Statewide Evaluation Manager, to establish these clean and uniform standards and to ensure that the New Jersey Technical Resource Manual ("TRM") is regularly reviewed and updated. The Statewide Evaluation Manager will need further direction on how key policy objectives beyond energy savings are to be evaluated – for example, how equity is to be tracked and measured, and how costs and savings are to be attributed to individual gas and electric utilities and the state for calculating costs and benefits.

The evaluation of both net and gross savings will be important to enable reporting on savings that are attributable to utility programs, as directed under N.J.S.A. 48:3-87.9(c). Staff should provide the basis for its interim Net-to-Gross ("NTG") assumption of 0.84 (page 53) and clarify its assumptions about both free riders (customers that would have implemented EE in the absence of an incentive, so the rebate has no impact on energy use) and spillover effects (customers who are influenced to implement efficiency by the programs but do not participate themselves.)

B. Benefit-Cost Analyses

The CEA states that "[t]he energy efficiency programs and peak demand reduction programs shall have a benefit-to-cost ratio greater than or equal to 1.0 at the portfolio level, considering both economic and environmental factors."[31] As noted above in the Program Administration section, the need to maintain cost-effectiveness with a ratio greater than or equal to 1.0 should not be taken to imply that New Jersey's policy is to reach the highest possible levels of BCA ratios. To the contrary, the goal of the CEA is to achieve the "full economic, cost-effective potential for electricity usage reduction and natural gas usage reduction" along with peak use reduction.[32]

To determine cost effectiveness, Rate Counsel believes that the standard set of tests from the California Standard Practice Manual ("CSPM") provide an important multi-perspective assessment of cost effectiveness, and all tests should be retained. However, the specific reference to "considering both economic and environmental factors" suggests that achieving a ratio of 1.0 or greater on the Societal Cost Test ("SCT") should be given particular weight as a screening test. However, the SCT is also the test most subject to widely varying approaches to implementation, as there has historically been little agreement on what constitutes "societal" costs and benefits and how these should be quantified. Stakeholders and the Board should also establish discount rates to be used for each benefit-cost test, and in particular for the SCT. It will be crucial for stakeholders to establish this and other specific implementation details to be used by all parties so that there can be a consistent basis for evaluation and comparison for all utilities and the CEP.

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[31] N.J.S.A. 48:3-87.9(d)(2).
[32] N.J.S.A. 48:3-87.9(b).

In its Straw Proposal, Staff recommends the development of a Resource Value Test ("RVT") following the guidelines of the National Standard Practice Manual ("NSPM"). Rate Counsel notes that the multi-factor design of New Jersey's QPIs and the weighted scoring approach proposed in the Straw Proposal is itself reflective of the policy-driven design principles espoused by the NSPM. It is not clear how designing a BCA test based on these same principles would add value to this construct. Rate Counsel supports retaining the standard benefit-cost tests, clearly and uniformly designed and implemented, to be applied in the context of the multi-factor QPIs. However, if such a "New Jersey Test" is to be defined, Staff should provide a clear description, including examples, to show how such hard-to-quantify values as ecosystem health, increased resiliency, job creation, and comfort would be quantified and placed on a comparable basis with energy savings and other standard metrics.

V. Filing and Reporting

Rate Counsel generally agrees with the "guiding principles for program filing requirements" set forth on page 56 of the Straw Proposal. A central goal of the CEA, and of the stakeholder workgroup processes established pursuant thereto, is to establish consistent, transparent program design practices among the gas and electric utilities and the CEP, and thus to reduce the administrative burden on all parties. Moreover, comprehensive filing requirements should facilitate the efficient review of utility filings by providing more complete information and eliminating the need for time consuming discovery processes. Further, once utilities adopt standard "core" program designs, BCA, and EM&V practices, many of the proposed MFRs could be further refined. Final development of the MFRs should take place after policies for rate recovery, program administration, and other substantive aspects of CEA implementation have been set.

The MFRs should encompass what is needed to support budget approval and cost recovery for standard or core programs that are implemented statewide, standard benefit-cost analysis of proposed programs, rate impact analysis, quality assurance, plans for ensuring equitable access to programs for all customers, and additional information for any customized or pilot programs. In addition to financial and ratemaking information, they should also provide sufficient information to allow the Board and interested parties to evaluate whether the utility's programs are designed to efficiently and effectively meet or exceed the savings and other targets established by the Board under the CEA. Again, final development of the MFRs should take place after policies for rate recovery, program administration, and other substantive aspects of CEA implementation have been set.

Finally, in the interest of efficiently deploying limited regulatory resources, initial utility filings should be staggered. The Board should adopt a filing schedule delineating the particular filing date for each utility.

VI. Programs for Low and Moderate Income Customers

Rate Counsel recommends that the Board monitor the ability of all customers, including low and moderate income customers, to participate and benefit from CEA EE programs. The CEA and the Straw Proposal both acknowledge that lower-income customers face certain barriers that can impair cost-effectiveness, and therefore place special emphasis on ensuring that these customers have equitable access to programs and energy cost savings. These barriers can include health and safety issues, split landlord/tenant incentives, age and condition of dwellings, and lack of up-front capital.

These barriers to participation can be better understood by partnering with community organizations in low and moderate-income communities and by obtaining structured data from contractors. Partnerships with community organizations build trust and they can provide enhanced education to communities about available assistance, any costs involved, and the estimated benefit of the proposed energy efficiency measures. Additionally, split incentives to landlords and tenants require targeted consumer education. Community organizations can assist in understanding the average contribution a low or moderate-income family can afford and therefore assist in developing more narrowly-tailored programs in the future. Collecting structured data from contractors can help utilities and community organizations identify the most frequently-encountered health and safety barriers. The extent of these problems and other common health and safety barriers to the implementation of EE should also be explored and addressed systematically as they arise so projects for low and moderate-income consumers proceed expeditiously. To better streamline these projects, the Board should coordinate with other agencies in state government to address the underlying health and safety concerns when they arise. The costs and challenges of addressing these customers' needs will need to be continuously addressed as the utilities and the CEP reach for more aggressive levels of savings. This goal must not be compromised by incentives for reaching high benefit-to-cost ratios, as discussed above.

Staff should also consider offering more low and moderate-income EE programs in addition to Comfort Partners. In the absence of additional programs tailored to low and moderate-income consumers, the Board should at a minimum require utilities to track low and moderate-income participation in all EE programs. This can either be accomplished by collecting information about a participant's income or extrapolating the information from census tract data. Since Staff outlined in the Straw that it intends to continue to gain stakeholder input on equity issues through the summer of 2020,[33] Rate Counsel looks forward to working with Staff and other parties on this issue.

Furthermore, in light of the recent health pandemic the Board should pay particular attention to the affordability of utility service going forward, given the anticipated cost burdens of CEA programs and general economic conditions. The Board should also consider the impact on low and moderate income households when setting program objectives, oversight, and program management responsibilities. Careful program design and collaboration with other relevant state agencies can help to ensure that low- and moderate-income customers have access to as broad an array of programs as possible, and that the benefits from the savings achieved outweigh any additional cost burden for these customers.

[33] Straw Proposal, p. 29.