To: Missouri PSC Staff
From: Rebecca Stanfield, Natural Resources Defense Council
Date: April 13, 2010
Re: Initial comments on rules to implement S.B. 376

NRDC appreciates the opportunity to comment on the first draft of rules to implement S.B. 376, and commends the Staff on their critical work to establish a starting point for this process. There is much to be commended in this draft. Our comments today represent an initial assessment of the draft and are not intended to be comprehensive.

In adopting S.B. 376, the Missouri General Assembly recognized that utilities can be powerful partners in achieving the important public policy objective of eliminating waste in the use of electricity. Moreover, the General Assembly clearly articulated a system of ***both incentives and accountability*** for utilities in implementation of energy efficiency programs. In many ways, these rules are an attempt to flesh out and strike a balance between the mechanisms by which stakeholders can hold utilities accountable to the public policy goals of the statute, and by which utilities can be confident in their ability to recover their costs and earn on their efficiency investments, as they would on another resource choice. Rather than commenting section-by-section, our comments are organized according to those two basic functions of providing incentives and accountability, the combination of which is necessary to the success of the programs.

A. Accountability:

1. **How much efficiency should the utility plans capture**? The statute answers this question by stating clearly that the goal is to capture all of the cost-effective potential, i.e., all of the potential for energy savings that is less expensive than satisfying customer demand with additional generation, transmission and distribution of kilowatt hours. The current draft rules fall far short of ensuring that the utility program plans will be evaluated and either approved or rejected by the commission in part on the basis of whether this goal is achieved. In fact, in two instances it seems as though there is some confusion between the "all-cost-effective" goal and the separate (but equally important) concept of ensuring that the portfolio of programs meets the cost-effectiveness test. Section 3(C) of the draft rules states that any program contained in a utility's preferred resource plan under Chapter 22 is deemed to be meeting the "all cost-effective goal." This might make some sense if the intent here is to deem Chapter 22 programs as meeting the ***cost-effectiveness test,*** but there is nothing in the Chapter 22 rules that would lead to the conclusion that the programs in the preferred plan are sufficient to achieve all cost-effective savings potential. Similarly, in section 8(E)(i)(b)(ii)(a), the evaluation goals suggest that one of the goals should be to achieve "all cost-effective savings potential," but then describes remedies for a program that does not meet the cost-effectiveness test.
    - The rules need to clearly differentiate between the goal of achieving all cost-effective savings potential, and the entirely separate requirement that the portfolio of programs meet the total resource cost test.
    - Moreover, the rules need to specify in section 4 that the Commission's review of a utility's plan will result in rejection of the plan if it fails to capture all of the cost-effective savings achievable in that utility's service territory.

- In addition, the rules need specify how the Commission will determine whether this requirement is met. One possibility is that a utility would need to base its savings targets on potential studies specific to its service territory.[1] Another possibility is that performance targets can be established in this rulemaking based on existing potential studies from within and outside of Missouri, which the utilities, Commission and stakeholders could use as an approximation for all cost-effective energy savings. Similar targets have been set by commissions and legislatures in several Midwestern states including Michigan, Indiana, Ohio, and Illinois.
- Finally, the goal of capturing all of the cost-effective potential for energy efficiency should be articulated in the purpose section of the rule.

2. **How will we ensure that the savings are cost effective?** The statute clearly establishes the total resource cost test (TRC) as the relevant test for determining cost-effectiveness. The draft rules faithfully reflect this choice. However –
    a. In standard practice across the country, the TRC generally omits the costs of incentives. According to the November 2008 paper of National Action Plan for Energy Efficiency entitled "Understanding Cost-Effectiveness of Energy Efficiency Programs," http://www.epa.gov/rdee/documents/cost-effectiveness.pdf, the TRC includes as the costs the program overhead and installation costs, and the incremental cost of the measure, whereas the incentive is a straight pass through from utilities to customers, and therefore would be on both the costs and the benefit side of the equation, canceling itself out (See, e.g. pp. 3-2 and -7).
    b. The current draft includes definitions for alternative cost-effectiveness tests, but no indication of how or when those tests should be implemented. A utility may reasonably want to include a program in its portfolio that does not meet the TRC (although clearly the portfolio collectively would need to meet the TRC). Other cost-effectiveness tests can provide evidence that a program provides worthwhile benefits and should be approved as part of a portfolio. The rules should specify the appropriate use of alternative tests for this purpose.[2]
    c. In some places the current draft rules suggest that programs that fail the TRC should be eliminated. Again, there are some programs that provide worthwhile benefits, such as market transformation programs, that should be eligible for inclusion in a portfolio even if it fails the TRC test. The rules should allow the flexibility for utilities to include some programs that do not meet the TRC if there are other justifications, so long as the portfolio does meet the TRC.

[1] NRDC would like to take additional time to review the draft rule language specifying definitions of technical, economic, and achievable potential. The absence of comments on these definitions in this memo should not be interpreted as agreement.

[2] NRDC would like to reserve its comments on the specific definitions of the alternative cost tests to more thoroughly review this language.

3. **<u>How will the results be verified so that the public is confident that energy efficiency funds are spent wisely and as approved by the commission?</u>** We agree with Staff on the wisdom of having an independent 3rd party perform verification and evaluation of program results and report to the Commission and the stakeholder advisory group. Independent evaluation is critical to establish credibility of the claimed benefits and public confidence in the value of energy efficiency. There is some lack of clarity in the draft rules regarding the interaction between the independent evaluators and any additional evaluation performed by the utilities. The annual reporting requirements, for example, include evaluation results, but it is unclear whether this means the results as determined by the evaluator retained by the Commission or by evaluators retained by the utilities or both. There is significant potential for redundant evaluation costs that can unnecessarily drive up program costs unless the rules clearly prevent redundancy.
   In addition, there is no provision for evaluation of the opt-out customers who meet eligibility through section (7)(3) of the statute which requires a demonstration of energy savings achieved by the customers' own efficiency programs.

B. **Ratemaking policy** – While S.B. 376 clearly sought to encourage utility investment in energy efficiency, the Demand Side Investment Mechanism leaves the utilities facing significant risk that energy efficiency investments will result in revenue erosion and diminishment of shareholder value, compared to other resource choices. Under the rules as drafted, Missouri will emerge as one of the least favorable states in terms of financial risk for utility investments in energy efficiency, largely due to the insistence that program expenses be carried in a regulatory asset account and recovered only after the program is implemented and evaluated.

1. **<u>Cost recovery</u>** - NRDC agrees with the Staff that customers should not pay expenses for programs that are not prudently implemented, and that independent evaluation to determine whether the programs were faithfully implemented and are providing cost-effective savings is essential to the success of the program. However, there is ample experience with mechanisms by which revenues and expenditures are reconciled annually so that over-recoveries and under-recoveries are properly accounted for, and for prudence reviews to allow for refunds to customers for any amount that was collected or spent in ways that do not faithfully implement the commission approved program plan. One need only look to Iowa, Illinois, Michigan, or Ohio to find examples.

   Among the acceptable mechanisms for assuring timely cost-recovery, the most typical and the one we recommend is expensing of costs approved by the commission as part of a plan filing, with a balancing account to allow flexibility for programs where participation rates are either higher or lower than expected. Periodic true-ups can be used to adjust rates up or down so that either positive or negative balances are eliminated on a regular basis. Annual reconciliation processes can serve for taking account of expenses and revenues, as well as for assessing the prudence of plan implementation, and refunding amounts that were not used according to plan. This mechanism adequately protects customers from imprudence or over-recovery, while reducing recovery risk and eliminating the potential for large regulatory assets accumulating and building carrying costs that ultimately increase the program costs for customers.

2. **Lost revenues** – We agree that part of aligning utility incentives with the public policy goal of capturing cost-effective energy efficiency potential is dealing with the throughput incentive which encourages utilities to increase sales between rate cases, and appreciate recognition of this in the language of the draft rule. We have three comments on the current draft.
   a. Lost-revenue recovery mechanisms, whereby evaluators try to assess the impact of efficiency programs on recovery of fixed costs, do not address this throughput incentives. Even with a lost-revenue recovery mechanism, a utility will earn more than authorized if they raise sales between rate cases. Moreover, lost-revenue recovery mechanisms can result in expensive surcharges creating customer backlash, as we witnessed recently in the FirstEnergy territory in Ohio.
   b. The draft rule envisions a Commission determination regarding whether decoupling will be authorized as a mechanism for addressing the throughput incentive. However, it remains a mystery where and when that determination will take place. It was proposed in a recent rate case, and deferred until a rulemaking. This rulemaking could provide that forum, but the draft language appears to defer the subject once again. The continued failure to assess the merits of decoupling and provide clear guidance for utilities who may wish to propose decoupling undermines the stated goal of aligning utility incentives with energy efficiency goals, and eliminating the throughput incentive. We strongly recommend that this rulemaking process be used as the forum for thoroughly assessing decoupling, making a determination about whether it is an accepted mechanism, and providing guidance to utilities on the appropriate way to propose decoupling.
   c. We strongly agree that a demand-side incentive mechanism should in no way diminish the customer incentive to conserve. The main way in which this problem arises is through shifting costs from variable to fixed charges on customer bills. This dramatically increases the payback period for a customer investment in energy saving measures, while also shifting costs from the highest volume users to the lowest volume users. This "straight-fixed variable" ratemaking is sometimes mistakenly described as decoupling, and should be recognized as distinctly different and counterproductive to the public policy purposes stated in S.B. 376.

3. **Performance Incentives**- We applaud the Staff's inclusion of a performance incentive that rewards utilities on the basis of the savings ultimately realized by the programs. We entirely agree that better performance should result in a higher incentive and would simply suggest that some additional detail as to the percentage of savings available for a given performance level should be provided in the final rule. One caveat is that typically the utility itself is not in the position of setting the performance goal against which its performance will be measured, and therefore reiterate our earlier comment that the Commission should promulgate performance goals as part of this rule.

Again, we appreciate the opportunity to comment and look forward to working with Staff and stakeholders to finalize a rule.