By electronic mail

February 6, 2020

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NJ Board of Public Utilities
44 South Clinton Avenue, 3rd Floor, Suite 314
Post Office Box 35
Trenton, New Jersey 08625- 0350
ATTN: Aida Camacho-Welch, BPU Secretary

Re: New Jersey Board of Public Utilities' Staff Cost Recovery Draft Proposal Related to the Implementation of the Clean Energy Act.

Dear Secretary Camacho-Welch,

AARP, on behalf of its 1. 3 million Garden State members, thank you for the opportunity to comment on the NJ BPU's Staff Cost Recovery Draft Proposal to the Implementation of the Clean Energy Act.

Through the Clean Energy Act, an Energy Efficiency Resource Standard ("EERS") has been established. The CEA requires that each electric public utility achieve annual energy use reductions of two percent (2%) or greater and that each gas public utility achieve annual energy use reductions of three-quarters of a percent (0.75%) or greater in the prior three (3) years within five (5) years of their respective program implementation in their service territories. The CEA requires that each electric and gas public utility establish energy efficiency and peak demand reduction programs in order to reduce energy use in its service territory. The CEA further directs the New Jersey Board of Public Utilities ("Board") to establish quantitative performance indicators ("QPIs") to evaluate each utility's achievement of the energy use reduction targets, as well as to apply performance incentives and penalties, which are tied to the achievement of each utility's specific targets.

AARP supports sustainable energy policies where cost effective. We also look closely at the rate impacts of proposals in order that rates be kept affordable. This is particularly important given New Jersey's high cost of living, our already high and rising utility rates, the regressive nature of these rate hikes and the burden placed on those least able to afford their bills – those living on low and fixed incomes. New Jersey residents have already seen their utility bills increased by hundreds of millions of dollars over just the last several years, with seemingly no end in sight. It is paramount

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that decision makers and regulators consider affordability in reviewing any cost recovery mechanism in this proceeding and in all rate matters before the Board.

By using energy more efficiently, consumers can lower their energy use. In turn, this should reduce their energy costs. Consumers should not pay more for using less energy. The Board should ensure that utility consumers will see lower bills if they consume less energy. AARP generally frowns on paying or rewarding utilities for something they must do under regulations or legislation, including allowing them to earn a return on energy efficiency spending. We also generally oppose decoupling, an automatic rate increase mechanism that the utility is not entitled to under the regulatory compact.

Policymakers should ensure that the cost recovery, utility incentives and any form of revenue decoupling associated with utility-implemented energy efficiency programs are fair, reasonable, and include consumer protections. In determining whether these principles are met, policymakers should ensure that:

- Decoupling and incentive mechanisms are conditioned upon the utility meeting performance standards for minimum energy efficiency;
- Decoupling mechanisms are symmetrical so that any over-recoveries are refunded to consumers;
- A cap exists on the amount that a customer's electric bill can increase in any year;
- Costs are not unfairly allocated to residential customers; and
- Ratemaking incorporates the benefit of the revenue stability provided to the utility be decoupling and similar mechanisms.

AARP has reviewed the staff's proposal in light of the above and offer the following comments.

- The lost revenue recovery mechanism is appropriately limited to reductions due to energy efficiency and peak demand programs. We support the narrow mechanism as contained in the staff proposal.
- As describe above, AARP supports a cap on rates in each year of the program and urges the program to be so modified. In the absence of an immediate cap, AARP urges the staff proposal be modified to require a review after two years of the program to better protect consumers against unreasonable rates.
- The Staff proposal recommends that only lost revenues associated with the utility's distribution base rates will be recoverable. Utilities will be required to file a base rate case no later than five (5) years after the commencement of an approved energy efficiency transition program, in order to ensure usage projections are updated and to reset lost revenues. AARP urges the Board to require the utilities be required to file a base rate case no later than three (3) years after the commencement of the program to better ensure consumers are protected against unreasonable rates.

Thank you very much for your consideration of AARP New Jersey's comments on this important policy.

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Sincerely,

Evelyn Liebman
AARP NJ Director of Advocacy

Cc: Stephanie Hunsinger, AARP NJ State Director
Kathleen Frangione, Chief Policy Advisor – Office of the Governor of New Jersey
Stefanie Brand, Director, NJ Division of Rate Counsel

AARP is a nonprofit, nonpartisan organization with a membership that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. AARP does not endorse candidates for public office or make contributions to either political campaigns or candidates. We produce AARP The Magazine, the definitive voice for 50+ Americans and the world's largest-circulation magazine with over 35.1 million readers; AARP Bulletin, the go-to news source for AARP's millions of members and Americans 50+; AARP VIVA, the only bilingual U.S. publication dedicated exclusively to the 50+ Hispanic community; and our website, AARP.org. AARP Foundation is an affiliated charity that provides security, protection, and empowerment to older persons in need with support from thousands of volunteers, donors, and sponsors. We have staffed offices in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Island

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RE: Energy Efficiency Transition - Cost Recovery Mechanism
Comments of Atlantic City Electric Company

Dear Secretary Camacho-Welch:

On behalf of Atlantic City Electric ("ACE" or the "Company"), please accept these comments in response to the Energy Efficiency ("EE") Transition Cost Recovery Mechanism Draft (the "Draft") issued by the New Jersey Board of Public Utilities (the "Board") and dated January 22, 2020.

Summary of ACE's Position

ACE agrees with the Board that a seven-year amortization period appropriately balances rate impacts and utility cash flow, and also agrees with the Draft's treatment of annual over- and under-collections. However, ACE disagrees with the Draft's proposed reduction in return on equity ("ROE"), and recommends that a utility's full weighted average cost of capital ("WACC"), as approved by the Board, be used as the appropriate rate of return on EE investments. ACE continues to believe that in order to neutralize the "Throughput Incentive" and stabilize revenue, the Board should implement full decoupling, which can also protect ratepayers from rate increases associated with electrification initiatives and increased economic activity/development in Southern New Jersey. Full decoupling will also avoid the complicated attribution process required by Staff's limited decoupling proposal.

Additionally, ACE continues to believe that any performance penalty should be implemented in later program years, in conjunction with the statutory goals stated in the Clean Energy Act ("the Act"). Further, the proposed symmetrical "dead band" related to penalties and incentives does not consider that budgetary restrictions will reduce the upside potential for utilities,

resulting in an asymmetrical treatment of penalties and incentives. Furthermore, ACE believes that incentives and penalties should be earned at a symmetrical rate, in contrast with the Draft's propoal that has penalties accruing at twice the rate as incentives. A solution to his problem would be shifting the dead band lower, so that a penalty would not be imposed unless performance was below 80% of the utility's goal, and to earn an incentive, a utility would need to exceed its goal (such that the dead band would comprise 80-100% of the utility's goal[1]). Finally, while ACE is interested in exploring bidding EE resources into PJM markets, the Company believes that this aspect of the Draft is presently too uncertain to factor into a cost recovery structure at this time.

Investment Treatment

The Draft recommends amortization of costs with a recovery period of seven years. As reflected in ACE's previous cost recovery comments filed on November 14, 2019 and January 3, 2020, ACE believes that amortization avoids intergenerational inequities and initial rate shock, putting EE on the same playing field as traditional "poles and wires" investments from an earnings and a capital funding perspective. Additionally, amortization better supports the "matching principle." Under this principle, the period of cost recovery for an investment should correspond with the period over which customers receive the benefits provided by the investment. ACE agrees with the Board that a seven-year or longer amortization period appropriately balances these considerations. The Company also suggests a one-year amortization period for any operation and maintenance costs for utility-managed programs.

With regard to carrying costs and return on program investments, the Draft recommends incorporating the cost of debt and affording utilities their approved ROE less 200 basis points. ACE disagrees that a reduction in ROE is appropriate at any level. The Company believes, as indicated in its previously filed comments, that the correct approach to establishing the appropriate ROE value for EE is to use a utility's full WACC as approved by the Board. Realizing less than full WACC is a departure from existing utility-managed EE programs, as the New Jersey utilities currently offering programs earn their full WACC on their programs today.

The Draft suggests that the reduction in ROE "reflects the risk reduction associated with the contemporaneous recovery provided for by the cost recovery mechanism."[2] While the surcharge allows for costs to be recovered on a monthly basis, the amortization treatment discussed above means that, over a seven-year recovery period, only one-seventh of the EE investment will be recovered in the year it is incurred, and further one-sevenths will be recovered during each year thereafter throughout the seven-year period. The Draft recognizes this, citing that "a portion of the costs" will be recovered as they are incurred, but it reaches the unsupported conclusion that this approach will correlate to a reduction in risk. In fact, a decrease in ROE adds risk to a utility. EE programs inherently reduce revenues, and not realizing a full return for program operations further

[1] In previous comments, ACE recommended a dead band of 85% to 115% of the goal. This proposal was based on a previous set of assumptions and prior to receiving the Draft. Given the parameters outlined in the Draft, ACE recommends a dead band of 80% to 100% of the goal.

[2] See Draft, at 5.

decreases utility revenues, putting the utility at a disadvantage when seeking to attract funding from investors.

Further, utilities finance their entire businesses – not parts of their businesses. The WACC considers the full range of risks faced by a utility, providing a comprehensive view of overall business risk. Use of the full WACC, including the authorized ROE, avoids singling out EE investments for lower returns, ensuring that EE investments are viewed on a level playing field with all other competing distribution investments, thereby directly addressing a potential financial bias against investment in EE programs, and providing better support for the EE goals of the Act. Reducing a utility's ROE by 200 basis points would result in a deficiency between actual financing costs incurred by the utility and those recovered from customers. The only way for a utility to cure this deficiency would be to seek an increase in distribution rates, as higher amounts of equity will be required to fund the distribution business in order to maintain the utility's capital structure.

Applying a utility's full authorized WACC to EE investments is consistent with established approaches to addressing public utility investments in EE programs. For example, the Act permits utility investments in EE programs and provides that such investments "may be eligible for rate treatment approved by the board, including a return on equity, or other incentives or rate mechanisms that decouple utility revenue from sales of electricity and gas."[3] The Board's well-established practice has been to permit recovery of prudently incurred costs associated with EE programs, including a return of and on the utility's capital investment at the utility's authorized return on equity.[4] Additionally, it is consistent with the model used in Maryland, which was inaccurately portrayed in the Draft as incorporating a lower ROE for EE investments. Contrary to that statement, cost recovery for demand-side management programs is treated in the same manner to those on the supply side in Maryland, including the parallel use of authorized ROE. Through this approach, Maryland has encouraged investment in demand-side resources by putting it on an equal footing with investment in supply-side resources.

The Draft also claims that EE investments are less risky than traditional capital investments, which may have long construction periods. However, EE investments require customer action and typically, customer investment. Unlike a distribution transformer, for example, which can be specified, ordered, and installed largely on demand, EE programs require educating customers, motivating them to take action, and connecting them with the resources they need to implement the

[3] See N.J.S.A. 48:3-98.1(a)(1); N.J.S.A. 48:3-98.1(b).

[4] The Board has repeatedly authorized utilities to earn their full authorized ROE on energy efficiency investments. See, e.g., I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in Its Electric Green Programs Recovery Charge and its Gas Green Programs Recovery Charge ("2014 PSE&G Green Programs Cost Recovery Filing"), Amended Order Approving Stipulation, BPU Docket Nos. ER14070651 and GR14070652 (dated May 19, 2015) (including numerous schedules reflecting inclusion of a return of and on investments); In re the Petition of South Jersey Gas Company for Approval of an Energy Efficiency Program with an Associated Energy Efficiency Tracker Pursuant to N.J.S.A. 48:3-98.1, BPU Docket No. GO12050363, Order (dated June 21, 2013); I/M/O the Petition of South Jersey Gas Company for Approval to Continue Its Energy Efficiency Programs and Energy Efficiency Tracker Pursuant to N.J.S.A. 48:3-98.1, BPU Docket No. GR15010090, Order (dated August 19, 2015) at Paragraph 22 of the approved Stipulation.

energy efficient choice. As such, the hurdles and risks associated with EE investments can be greater than traditional investments.

ACE believes that the proposed 200-basis point reduction to utilities' ROE is arbitrary and unsubstantiated. The Draft offers no empirical evidence or analysis supporting the proposed reduction, other than saying it was based on recovery methods used in Maryland and Washington D.C.As the Company publicly stated at the recent stakeholder meeting on this subject, Maryland and Washington D.C. do not apply a 200-basis point reduction to utilities' ROE for EE programs.

For the foregoing reasons, as well as those stated in the Company's previous comments, ACE continues to believe that application of the full WACC is appropriate in establishing the ROE value for EE investments.

Decoupling and Lost Revenue

The Draft acknowledges that a decoupling mechanism will allow utilities "to aggressively pursue and endorse energy efficiency." The Company agrees, but does not believe that limited decoupling will suffice to achieve the State's EE goals. As reflected in the Company's previously filed comments, ACE believes that in order to neutralize a utility's financial benefit from increasing sales, referred to as the "Throughput Incentive," and to stabilize revenue, the Board should implement full decoupling.[5] Relevant research indicates that "[s]ome of the limited or partial forms of decoupling might not truly break the link between sales and profits, potentially failing to create benefits for both customers and utilities,"[6] and that "[o]nly full decoupling (as opposed to limited or partial decoupling) has the ability to break the link between utility sales and profitability, removing from the utility a powerful barrier to energy efficiency."[7] The preference for full decoupling is echoed in the *2019 State Energy Efficiency Scorecard*, which provides: "States losing ground also typically have not fully implemented changes to the utility business model that encourage utilities to take full advantage of energy efficiency as a resource, including through decoupling, performance incentives, and energy savings targets."[8] Because no forecasting technique can ever be exact, full decoupling is the cleanest, most straightforward solution to the shortfalls of forecasting that addresses the Throughput Incentive.

Notably, other stakeholders who have taken part in recent EE proceedings convened by the Board are supportive of full decoupling. A study performed by the American Council for an

[5] See National Action Plan for Energy Efficiency, Aligning Utility Incentives with Investment in Energy Efficiency (2007), at ES-3 ("Decoupling not only addresses lost margin recovery, but also removes the throughput incentive—the incentive for utilities to promote sales growth, which is created when fixed costs are recovered through volumetric charges. The throughput incentive has been identified by many as the primary barrier to aggressive utility investment in energy efficiency.").

[6] *See* Christina Simeone, Rate Decoupling: Economic and Design Considerations, Kleinman Center for Energy Policy (April 2016), at 9, *available at* http://ipu.msu.edu/wp-content/uploads/2017/09/Rate-Decoupling-Simeone-2016.pdf.

[7] Id., at 17.

[8] Id., at 14.

Energy Efficient Economy ("ACEEE"), *Valuing Efficiency: A Review of Lost Revenues Adjustment Mechanisms*, evaluated lost revenue adjustment mechanisms ("LRAMs") in 15 states deploying EE programs, and found:

> Creating a regulatory environment that incentivizes utilities to invest in efficiency is critical for programs to be successful, impactful, and long lasting. Doing so requires a mix of policy tools. In addition to energy efficiency targets, utilities need a business model that aligns their financial interests with energy efficiency, including program cost recovery, performance incentives that encourage utilities to achieve high levels of savings, and some policy mechanism to neutralize the throughput incentive. It is our opinion that decoupling is the best third leg of this stool. [9]

Additionally, in its comments of January 3, 2020, the Energy Efficiency Alliance of New Jersey ("EEA-NJ") stated:

> The BPU should avoid mechanisms such as LRAM and Partial Decoupling, as they allow for utilities to have a windfall of profits and fail to align utility financial incentives with state energy efficiency policies. Both LRAMs and Partial Decoupling simply compensate utilities for perceived revenue losses without properly addressing the core issue - the throughput incentive. Additionally, both mechanisms allow the utilities to earn a guaranteed income while also profiting from electricity sales, putting the ratepayers at risk of overpaying the utilities. In addition to being a mere half-measure for cost recovery, LRAM's and partial decoupling are administratively burdensome and technically complex. Under full revenue decoupling, no matter what factors impact sales, the true-up mechanism will ensure that utilities only earn their revenue requirements, no more, no less.

The comments of ACEEE and EEA-NJ support ACE's position. ACEEE has decades of experience researching and quantifying market impacts and outcomes and has advised both States and utilities regarding best practices for implementing EE. Additionally, EEA-NJ is comprised of more than 60 businesses that provide EE products and services across the State and the country, and have experienced first-hand what works and what does not when it comes to successful EE programs.

Further, ACE's sister utilities, Pepco, Delmarva Power, and Baltimore Gas & Electric, have realized the effectiveness of full decoupling in helping to achieve EE goals. Decoupling was implemented in Maryland prior to the establishment of Maryland's "EmPOWER MD" EE program, which established State-mandated goals to reduce energy consumption 15 percent by 2015.

[9] Annie Gilleo, *et al.*, Valuing Efficiency: A Review of Lost Revenues Adjustment Mechanisms, June 2015, ACEEE ("Valuing Efficiency"), at vii, *available at* https://aceee.org/sites/default/files/publications/researchreports/u1503.pdf.

Decoupling, in particular, have elped the utilities develop robust EE program portfolios that met this goal, and have led to increasing EE goals in subsequent program cycles.

For electric utilities, variations in sales can result from several different causes, including but not limited to conservation, energy efficiency, weather, and the economic cycle, making attribution much more challenging. This will be especially true in New Jersey, given the expected presence of both State- and utility-run programs. A limited decoupling scheme invites confusion and complexity, as utilities and intervenors will need to present on what should and should not be recovered. Therefore, limited decoupling may result in an undue administrative burden on Staff, utilities, intervenors, and other stakeholders, with contentious hearings that will unnecessarily strain their time and resources. Full decoupling, on the other hand, would not impose these burdens. At a minimum, any decoupling or "Lost Revenue Adjustment" mechanism should be formulaic to avoid the costly and time-consuming process described above, none of which would benefit customers or utilities, nor would it help the State reach its EE policy objectives.

As the Company indicated in previously filed comments, decoupling would not result in increased costs to ratepayers.[10] In fact, full decoupling is more protective of ratepayers than limited decoupling because "[f]ull decoupling policies eliminate the potential for windfall revenues when sales exceed expectations."[11] Under full decoupling, the utility will recover its approved revenue requirement and no more. Ratepayers are further protected because decoupling runs both ways, with symmetrical adjustments allowing for surcharges when revenue is below allowed levels, and refunds when revenue is above allowed levels. Overall, full decoupling is fairest to ratepayers, as it prevents the utility from receiving excess profits.[12]

Consider the hypothetical Scenario A displayed in *Table 1* below, which provides a simplified view of a full and a limited decoupling framework. The Company recognizes that this is a simplified example and that each State may consider additional factors in their decoupling models. In Scenario A, the utility sees a reduction in sales from its own EE programs (Row "D"), as well as a smaller reduction in sales from State-run EE programs (Row "E"). At the same time, the utility also experiences increased sales due to electrification (Row "F"). However, the outcomes under full decoupling and limited decoupling are markedly different. The full decoupling model returns additional revenue of $2.50 realized from electrification to customers, and the utility earns only the approved revenue requirement. Under a limited decoupling model, the utility realizes the revenue it receives for customer sales and the price set in the rate case for the lost sales due to EE. In this example of limited decoupling, the utility would earn $2.50 for additional sales due to electrification and an additional $4.00 (Row "C" times Row "D") for compensation of the decreased

[10] See id., at7.

[11] See id., at 10.

[12] See Regulatory Assistance Project, Revenue Regulation and Decoupling: A Guide to Theory and Application, at CS57, *available at* http://www.raponline.org/wp-content/uploads/2016/11/rap-revenue-regulation-decoupling-guide-second-printing-2016-november.pdf ("The allocation of revenue regulation revenue surpluses or deficits should be symmetrical so that overpayments are credited to customers just as underpayments are paid by those same customers.").

electricity sales due to EE programs for a total of $106.50, which is $6.50 greater than the approved revenue requirement.

Table 1: Scenario A – Full decoupling provides superior ratepayer protection when load growth is substantial

		Full Decoupling		**Limited Decoupling**	
A	Approved revenue requirement ($)		100		100
B	Expected sales (kWh)		1,000		1,000
C	Price set in rate case ($/kWh)	(A/B)	0.10	(A/B)	0.10
D	Decreased sales from utility energy efficiency programs (kWh)		40		40
E	Decreased sales from State energy efficiency programs (kWh)		10		10
F	Increased sales from electrification (kWh)		75		75
G	Actual Sales (kWh)	(B-D-E+F)	1,025	(B-D-E+F)	1,025
H	Actual revenue ($)	(C*G)	102.50	(C*G)	102.50
I	Revenue adjustment ($)	(A-H)	**(2.50)**	(C*D)	**4.00**
J	Total utility revenue ($)	(H+I)	**100.00**	(H+I)	**106.50**

Before revenue adjustment, the customer is paying the same amount in both the full and limited decoupling models. The full decoupling model returns the additional revenue of $2.50 realized from electrification to customers. In the limited decoupling model, the utility retains the $2.50 and collects an additional $4.00 for the decreased sales due to EE programs.

To elaborate further, the potential load growth associated with electrification demonstrates how full decoupling results in greater ratepayer protection. As noted in the Draft, a growth in electric vehicles and building electrification are part of the rapid market changes underway. This growth will be further accelerated in New Jersey by the recent enactment of P.L.2019, c.362, which establishes aggressive goals and incentives for the increased use of plug-in electric vehicles and related infrastructure. In Scenario A, the increase in sales from electrification exceeds the reduction in sales from all EE programs (*i.e.*, D + E < F), and the utility would therefore recover revenue in excess of its authorized revenue requirement. Under full decoupling, the utility would then refund customers associated with the additional revenue. By contrast, under limited decoupling, customers would be charged for the reduction in revenue caused by the EE programs, even though that outcome is not in the best interest of ratepayers.

In hypothetical Scenario B in *Table 2* below, the increased sales from electrification is equal to decreased sales from energy efficiency (*i.e.*, D + E = F). The limited decoupling model results in a surcharge of $4.00 to customers (C x D = $4.00), while full decoupling results in no revenue adjustment to the utility, nor any refund to the customer. This is due to the decrease in sales from EE is offset by additional energy sales due to any number of causes (*e.g.*, electrification, economic factors, weather, etc.). Accordingly, even in a lower load growth environment, full decoupling is

a better outcome for ratepayers as they will not be charged for decreased sales due to EE programs. In the limited decoupling model, customers will release a $4.00 revenue adjustment.

Table 2: Scenario B – Full decoupling provides superior ratepayer protection when load growth is equal to energy efficiency savings

		Full Decoupling		**Limited Decoupling**	
A	Approved revenue requirement ($)		100		100
B	Expected sales (kWh)		1,000		1,000
C	Price set in rate case ($/kWh)	(A/B)	0.10	(A/B)	0.10
D	Decreased sales from utility energy efficiency programs (kWh)		40		40
E	Decreased sales from State energy efficiency programs (kWh)		10		10
F	Increased sales from electrification (kWh)		50		50
G	Actual Sales (kWh)	(B-D-E+F)	1,000	(B-D-E+F)	1,000
H	Actual revenue ($)	(C*G)	100.00	(C*G)	100.00
I	Revenue adjustment ($)	(A-H)	**0.00**	(C*D)	**4.00**
J	Total utility revenue ($)	(H+I)	**100.00**	(H+I)	**104.00**

Additionally, the differing treatment of decreased sales from State-run EE programs illustrates an inherent unfairness to utilities using limited decoupling. In the hypothetical Scenario C shown in *Table 3* below, increased sales from electrification (Row "E") are zeroed out to make the explanation clearer. Under full decoupling, the utility would recoup its fixed costs attributed to lost sales from all EE programs – $4.00 from utility programs (C x D) and $1.00 from the State-administered programs (C x E). Full decoupling allows the utility to realize its total approved revenue requirement by adjusting lower than expected revenues (Row "H") by a total of $5.00 (Row "I") as adjusted from decreased sales due to EE programs. Under limited decoupling, however, the utility would not realize its approved revenue requirements as, in the Draft, utilities are not allowed to recover lost revenues associated with State-administered program. The utility would not recoup the $1.00 of fixed costs attributed to lost sales from the State programs. The revenue adjustment of $4.00 (Row "I") plus the actual revenue (Row "H") is less than the approved revenue requirement (Row "A"). This provides a disincentive for utilities to promote State-administered programs.

Table 3: Scenario C – Limited decoupling fails to provide full recovery to the utility

		Full Decoupling		Limited Decoupling	
A	Approved revenue requirement ($)		100		100
B	Expected sales (kWh)		1,000		1,000
C	Price set in rate case ($/kWh)	(A/B)	0.10	(A/B)	0.10
D	Decreased sales from utility energy efficiency programs (kWh)		40		40
E	Decreased sales from State energy efficiency programs (kWh)		10		10
F	Increased sales from electrification (kWh)		0		0
G	Actual Sales (kWh)	(B-D-E+F)	950	(B-D-E+F)	950
H	Actual revenue ($)	(C*G)	95.00	(C*G)	95.00
I	Revenue adjustment ($)	(A-H)	**5.00**	(C*D)	**4.00**
J	Total utility revenue ($)	(H+I)	**100.00**	(H+I)	**99.00**

Under Scenario C, ratepayers would be slightly better off under limited decoupling, because there would be no revenue adjustment for utilities for the State-administered programs. However, that is only because the utility bears the cost of the difference; the perception of ratepayer protection masks utility under-recovery. Theoretically, that shortfall could be made up in a future rate case, but it would still represent a near-term earnings challenge for the utility, which in turn could impact ratepayers through higher costs of capital.

The decoupling mechanism used to support New Jersey's EE goals should be formulaic and have a regular and scheduled filing and review procedure. A filing and procedural schedule with timely approval will ensure consistency that the utility's recovery period coincides with rate cases and other business operations, which will reduce uncertainity and regulatory lag.

Performance Incentive and Penalty Treatment

The Draft recommends a performance penalty if a utility achieves between 50% and 90% of goals pursuant to quantitative performance indicators ("QPIs"), relying on the provision of the Act that states"[i]f an electric public utility or gas public utility fails to achieve the reductions in its performance target established in the quantitative performance indicators, the public utility shall be assessed a penalty as determined by the board."[13] The Company cautions that inappropriately strident targets or earnings eligibility thresholds can have the effect of sending counterproductive signals to the utility regarding performance. ACE therefore recommends that the Board refrain from applying incentives and penalties in the "ramp up" years of EE programs, and instead begin assessing penalties and awarding incentives in program year five. This approach will provide opportunities for the utilities to apply lessons learned during the ramp up years, and would also

[13] Draft, at 2; N.J.S.A. 48:3-87.9(e)(3).

allow the utilities to responsibly experiment with their program designs in the ramp up years without fear of penalties.

Additionally, the Company agrees that Draft's inclusion of a neutral area or "dead band" is a best practice often implemented in the industry. ACE, however, believes that the Draft's dead band is too narrow, and would not allow utilities to innovate and bring forth new technologies, which could be slow to ramp up but provide valuable insights for years to come.

In designing the dead band, the Board should consider expanding its range, to reduce both the upside and downside potential to the utilities. Expanding the dead band is warranted because of the relative infancy of the EE programs currently under consideration. A wider dead band will ensure fairness during program initiation/ transition.[14] As the Brattle Group has observed, "[a]n overly restrictive (*i.e.*, tight) dead band can mean that a utility may be penalized (or rewarded) for slight variations in factors that are beyond its control or capability to foresee."[15] Additionally, the Company believes that any dead band utilized should be symmetrical, with identical incentive-side and penalty-side buffers, because this structure would be easier to understand and fairer to the parties involved. Further, this approach would align with generally accepted guidelines for performance incentive design, which "typically stress the importance of designing incentives such that financially favorable outcomes are as likely to be realized as unfavorable outcomes."[16]

The middle point of any dead band should coincide with the utility's authorized ROE. Under such a structure, a utility that meets program goals exactly would receive its authorized ROE, thereby putting successful program implementation on an equal footing with other utility investments. Centering the dead band around a utility's ROE is especially important given the nature of program funding. Utility budgets for EE programs are likely to be largely static during program cycles, and therefore the prospect of significantly ratcheting up program investment in order to reach unadjusted ROE is unlikely. Given limited budget flexibility, utilities should be given a reasonable chance to earn their authorized ROE on EE program investments. Accordingly, ACE recommends a dead band of 80%-100% of its energy savings goal is appropriate as budget constraints create a *de facto* cap on upside potential.

Finally, ACE notes that the Draft envisions that the maximum upside potential for an incentive is a 200-basis point increase over a utility's ROE, while the downside would be a 400-basis point reduction in a utility's ROE. ACE strongly recommends that the upside and downside adjustments should be the same.

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[14] *See* Ann Peterson, California Energy Commission and Charles Eley, Eley Associates, New Building Performance Contracting: Lessons Learned and New Ideas, at 5.202, *available at* https://aceee.org/files/proceedings/1996/data/papers/SS96_Panel5_Paper24.pdf.

[15] See Performance Based Regulation Plans: Goals, Incentives and Alignment (December 6, 2017), at xxv, *available at* https://www.michigan.gov/documents/mpsc/Brattle_Report_to_DTE_on_Performance_Based_Regulation_120617_613150_7.pdf.

[16] Id., at xxvii.

Energy Efficiency as a Resource

ACE is interested in exploring how the Company might bid EE resources into PJM markets. However, there is too much uncertainty surrounding PJM and FERC rules to make a firm commitment of this sort at this time.[17] Additionally, the Company believes that any revenue from bidding into PJM should not be viewed as part of the core cost recovery for these energy efficiency programs. Overall, given these layers of complexity and uncertainty, ACE believes that this aspect of the Draft is too indeterminate to factor into a cost recovery structure.

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ACE appreciates the opportunity to comment on the Board's Draft Proposal pertaining to the cost recovery mechanism for EE programs. The Company looks forward to providing further input on this important topic.

Respectfully submitted,

Andrew J. McNally

[17] Declaratory Order, 161 FERC ¶ 61,245 at 57, 59.

February 6, 2020

Aida Camacho-Welch
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Post Office Box 350
Trenton, NJ 08625-0350

Submitted via email: EnergyEfficiency@bpu.nj.gov

Re: New Jersey Energy Efficiency Transition Stakeholder Group, Cost Recovery Mechanism Draft Proposal, January 22, 2020.

Introduction

The Energy Efficiency Alliance of New Jersey ("EEA-NJ") is a trade association dedicated to expanding the market for energy efficiency in the Garden State. Together with its sister organization, the Keystone Energy Efficiency Alliance ("KEEA"), EEA-NJ has more than 65 business members who provide energy efficiency products and services and support an industry that accounts for more than 30,000 New Jersey jobs. Our membership is large and diverse, with experience designing and implementing a variety of demand side management solutions and energy efficiency programs across the globe. Simply stated, our members understand what works and what does not when it comes to successful demand side reduction programs.

EEA-NJ appreciates the opportunity to engage with the New Jersey Board of Public Utilities ("BPU" or "Board") on the the Cost Recovery Mechanism Draft Proposal ("Proposal") under the Clean Energy Act ("CEA"). With these comments, the joint comment submitted with partners across the state, and the individual comments of our member companies and partners, EEA-NJ hopes to provide the BPU with the information required to create a thriving market for energy efficiency in New Jersey. In addition to the comments provided, EEA-NJ would like to incorporate by reference previous comments submitted by the organization.

Cost Recovery Mechanism

EEA-NJ appreciates the time and effort put into the cost proposal. However, we believe that the proposed cost recovery mechanism fails to adhere to the intent of the Clean Energy Act and will hold back other energy policy goals of New Jersey. Therefore, our general recommendations are:

1. Investments should be amortized over the full-weighted average lifetime of the measures.
2. Full symmetrical decoupling should be used as the cost recovery mechanism instead of the proposed lost revenue adjustment mechanism.
3. The proposed Return on Equity penalty should be adjusted so that utilities have a real incentive to meet and exceed QPIs.

I. Investment Treatment

EEA-NJ recommends that utility investments should be amortized over the full-weighted average lifetime of the measures. Additionally, EEA-NJ recommends that the BPU allow for the Weighted Average Cost of Capital ("WACC") and Carrying Costs to be determined in a base rate case without any automatic adjustments up or down. Finally, EEA-NJ suggests that a cost cap, in the context of a rate on spending, should not be contemplated.

a. Investments Should Be Amortized Over the Full-Weighted Average Useful Life of The Measures.

The BPU has proposed that program investments be amortized over a 7-year period as this would "reduce potential rate shock…and spread the cost of measures ...to better match program costs with program benefits."[1] EEA-NJ agrees that costs should be spread over time to better match program costs with program benefits, but this goal would be better met by amortizing costs over the full-weighted lifetime of the measures rather than the seemingly arbitrary 7-year period. If the BPU was to accept such a policy, it should do so only after additional studies and considerations, which has been the practice in other states.[2]

Further, while we applaud the recommendation of an amortization period, it is best to allow for amortization to occur for the full weighted life of the measure as such a policy can encourage a mixed portfolio of projects and investments based on the needs of the state.[3] Additionally, utilities can customize programs to their territory needs, as amortization for the full weighted life allows for programs to be customized for a given service territory to incentivize both long- and short-term measures based on territory specific dynamics.

b. Return on Equity Should be Based on the Full Weighted Average Cost of Capital.

The BPU has proposed that "carrying costs for these investments will utilize the capital structure established in each utility's most recent base rate case…less 200 basis points."[4] Similar to the amortization rate of 7 years above this too appears to be an arbitrary adjustment that is not consistent with BPU's and the Clean Energy Act's stated principles and goals.

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[1] New Jersey Board of Public Utilities, Energy Efficiency Transition Cost Recovery Mechanism Draft, January 22, 2020 at pg 5. [hereinafter Cost Recovery Proposal].

[2] ACEEE, Topic Brief: Snapshot of Energy Efficiency Performance Incentives for Electric Utilities, December 2018, page 8, available at https://aceee.org/topic-brief/pims-121118. (Maryland has a five-year amortization period established "based on a recommendation from a demand-side management collaborative report filed with the Maryland Public Service Commission.").

[3] ACEEE, Topic Brief: Snapshot of Energy Efficiency Performance Incentives for Electric Utilities, December 2018, available at https://aceee.org/topic-brief/pims-121118. ("The opportunity for competitive returns on investments in energy efficiency can also drive a utility culture shift that makes energy efficiency a core part of the business.").

[4] Cost Recovery Proposal at 5.

Utilities should be incentivized to invest in energy efficiency, yet the current Proposal would do the opposite by arbitrarily penalizing investments in energy efficiency relative to capital investments. Any reduction in WACC should be based upon evidence and not assumptions. Staff provides no evidence to justify a 200-basis point reduction in WACC for energy efficiency investments other than the assertion that investment in energy efficiency provides utilities less exposure to risk compared to capital investments. This assertion is false, and energy efficiency should not be penalized for simply playing on a more level field with capital investments. For New Jersey to make the drastic changes in energy consumption mandated by the Clean Energy Act, the State needs to enact policies that align utility financial goals with state policy goals. For utilities, the amortization of investment in infrastructure and delivery assets provides financial security and incentives. If investment in energy efficiency is not put on equal footing to investment in infrastructure and the grid, there will be no reason for shareholders to change the current business model.[5] Therefore, ROE should be based on the full determined in a rate case.[6]

c. EEA-NJ does not recommend any kind of cap or constraint on customer distribution rate of customer bills that could translate to a cap on energy efficiency spending.

Although it is not being implemented immediately, EEA-NJ strongly cautions against any kind of a rate cap, and questions whether such a mechanism would be legally permissible under the Clean Energy Act. A cost cap, such as the mechanism instituted in Pennsylvania, could artificially limit a utility's ability to spend on energy efficiency and prevent utilities from meeting statutorily mandated energy efficiency targets. The impact of the cap has been devastating in Pennsylvania, where an American Council for an Energy-Efficient Economy study found that removing the spending cap would have saved customers an additional $240 million dollars a year and create 30,000 jobs.[7] The state should take a broader view of impacts than simple rates, instead looking at overall energy costs and also value non-energy benefits. Applying a thorough, symmetrical cost test, as EEA-NJ has discussed at length in other comments, will ensure that energy customers are protected from excessive costs.

II. Lost Revenue Treatment

EEA-NJ recommends that the BPU use a full symmetrical decoupling cost recovery mechanism as it fits with the intent of the New Jersey legislature in enacting the Clean Energy Act, provides a more accountable and responsive ratemaking mechanism, provides for protections for ratepayers as New Jersey shifts its energy policies towards environment that an LRAM will not, and utility shareholders with state policy.

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[5] Dan York et al., Making the Business Case for Energy Efficiency: Case Studies of Supportive Utility Regulation, December 2013, American Council for an Energy-Efficient Economy, available at https://aceee.org/research-report/u133.

[6] ACEEE, Aligning Utility Business Models with Energy Efficiency, available at: https://aceee.org/sector/state-policy/toolkit/aligning-utility.

[7] Annie Gilleo and James Barrett, Lifting the Cap: Estimating the Economic Impacts of Energy Efficiency Investments in Pennsylvania, April 2019, ACEEE White Paper, Available at https://aceee.org/sites/default/files/pa-jobs-040419.pdf

a. Full Symmetrical Decoupling fits with the intent of the Clean Energy Act.

For Cost Recovery Treatment, 48:3-98.1 or "RGGI" law states that:

> An electric public utility or a gas public utility seeking cost recovery for any program pursuant to this section shall file a petition with the board to request cost recovery. … All electric public utility and gas public utility investment in energy efficiency and conservation programs or Class I renewable energy programs may be eligible for rate treatment approved by the board, **including a return on equity, or other incentives or rate mechanisms that decouple utility revenue from sales of electricity and gas.**[8]

The Clean Energy Act Mandates that utilities reduce consumption and that in reducing this consumption, the Board establish penalties and incentives and a cost recovery mechanism pursuant to 483-98:1 aka the RGGI law, which includes recovery investment in EE and DR and the revenue impact of sale losses resulting from their implementation. The Clean Energy Act does not add cost recovery that has not already been contemplated by 48:3-98:1. The Legislature recognized that the existing utility business model did not align with investment in energy efficiency and explicitly directed that mechanisms and incentives should be revised in order to spur investment in energy efficiency.

b. Full Symmetrical Decoupling Will Provide A More Responsive and Accountable Ratemaking Mechanism Than the Proposed LRAM.

The current ratemaking framework in New Jersey determines rates by dividing the utility's revenue requirement by predicted sales and holds those rates stagnant until the next rate case is called by the utility. If sales are greater than predicted, the utility will over-earn unless there is a rate case to readjust rates. LRAM does nothing to alleviate this problem, thus providing a solution that satisfies neither energy efficiency objectives nor ratepayer concerns.[9]

Full Symmetrical Decoupling, outlined below, avoids these pitfalls by setting a revenue requirement based on volumetric rates and establishing protections for ratepayers that ensures the utility earns only that revenue. The process is similar to a usual rate proceeding with the addition of a responsive mechanism:[10]

1. Initially, rates are set in a traditional rate proceeding with an adjustment mechanism; this mechanism may take into account any increase or decrease in sales volumes

[8] N.J.S.A. §48.3-98.1 (emphasis added).
[9] Annie Gilleo, et al., Valuing Efficiency: A Review of Lost Revenues Adjustment Mechanism, June 2015, American Council for an Energy-Efficient Economy, pg. 21, available at https://aceee.org/sites/default/files/publications/researchreports/u1503.pdf. ("LRAM as a permanent policy fixture is fraught with flaws. The regulatory burden is great, and the potential to shortchange customers and overcompensate utilities is ever present.").
[10] Regulatory Assistance Project, Revenue Regulation and Decoupling: A Guide to Theory and Application, November 2016, pg. 11, available at: https://www.raponline.org/knowledge-center/decoupling-design-customizing-revenue-regulation-state-priorities/ [Hereinafter RAP Decoupling].

compared with the level assumed in the rate proceeding; changes in customer size, [11] or other true-up mechanisms decided on in the base rate proceeding;

2. As the mechanism is implemented, rates are adjusted periodically (up and down) through this mechanism to produce the target revenue agreed to in the base rate proceeding.

3. Finally, states that utilize this mechanism often require periodic rate cases so to ensure that the agreed upon revenue requirement is still appropriate.[12] At a predetermined time or triggering point (usually in a range of 3 -5 years), the utility will come in for another rate case to check on the earnings level and adjustment mechanisms and instill any changes to the mechanism in the case of disproportionate earnings to the predetermined budget.

c. Full Symmetrical Decoupling Aligns Utility Shareholder Concerns with State Energy and Environmental Policy.

Beyond energy efficiency, the state is currently pursuing robust policies in support of building decarbonization and electrification, electric vehicle deployment, nation-leading procurement of offshore wind resources, and a complete overhaul of its solar incentive program. These changes, along with others outlined in the Energy Master Plan ("EMP") will have a profound effect on the utility business model. Mechanisms that shift the utility business model away from dependency on the volume of electricity sales to a business model dependent on program performance toward state policy goals will allow New Jersey to achieve these energy and climate goals in a least cost scenario.

Traditional rate making structures motivate utilities to (1) increase sales and (2) resist reducing sales through energy efficiency programs or other means. Because LRAM does nothing to shift the initial earning mechanism – increasing sales, the state will have to force utilities to comply with a law that goes against their financial interest. Full symmetrical decoupling guarantees utilities a fixed revenue agreed to in a base rate case, making them indifferent to energy usage, and focusing profitmaking activities on cost savings and meeting minimum performance standards, including for energy efficiency. Full revenue decoupling allows utilities to focus on program performance and supporting other state-led efficiency efforts rather than focus on increasing sales.[13] Across the country, the states with the most successful programs are those that have instituted full decoupling and an EERS as it creates a sea change in

[11] RAP Decoupling at 17.
[12] Southern Environmental Law Center, A Troubling Trend in Rate Design: Proposed Rate Design Alternatives to Harmful Fixed Charges, December 2015, page 10.
[13] Regulatory Assistance Project, Revenue Regulation and Decoupling: A Guide to Theory and Application, November 2016, pg. 11, available at: https://www.raponline.org/knowledge-center/decoupling-design-customizing-revenue-regulation-state-priorities/ (Decoupling "eliminates a strong disincentive to invest in energy efficiency"; "[a]ssuming that management has a limited ability to influence costs and behavior [full symmetrical decoupling] allows concentration of that effort on cost reductions, rather than sales enhancement."). [Hereinafter RAP Decoupling]

utility priorities, prioritizing energy efficiency and climate goals. [14] Utilizing a full symmetrical recovery mechanism can put New Jersey on the path to surpass the energy reduction goals in the Clean Energy Act,[15] while also keeping with the policies and initiatives in the Energy Master Plan and state solar and electric vehicles initiatives.[16]

III. Performance Incentive and Penalty Treatment

a. EEA-NJ Supports A Performance Incentive and Penalty Treatment Structure Tied To A Return On Equity.

EEA-NJ appreciates the BPU's intake of feedback and incorporation of an incentive and penalty mechanism that is similar to the structure in place in Illinois. EEA-NJ agrees with the adoption of this mechanism, the incorporation of a buffer zone between incentives and penalties, and the allowance to review the structure every three years to ensure the QPIs are properly incentivizing and rewarding the right energy efficiency investments. For additional comments on the proposed QPIs please see our upcoming Utility Target comments.

b. The Proposed Mechanism Provides No Incentive Because the Scale Maxes Out at the Return on Equity Approved in the Most Recent Base Case, Instead of Providing a Higher Return on Equity.

As explained in the proposal:

> The performance incentive will scale linearly from the return on equity established in the utility's most recent base rate case less 200 basis points (starting at 110% of QPI achievement) to the return on equity approved in the most recent base rate case (up to 150% of QPI achievement). This lowered return on equity will be utilized as part of the carrying cost of energy efficiency transition program investment occurring in the following year. **The performance incentive will scale linearly from the return on equity established in the utility's most recent base rate case less 200 basis points (starting at 110% of QPI achievement) to the return on equity approved in the most recent base rate case (up to 150% of QPI achievement).**[17]

The Mechanism that the BPU has proposed provides no true incentive because if a utility reaches the maximum "incentive" level, 150% of their targets, they will receive a ROE equal to capital investments. Shareholders will want not invest in energy efficiency projects if the returns will be the same as other investment projects only if the programs the maximum level 150% of

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[14] RAP Decoupling at 12.

[15] Pacyniak, G., N. Kaufman, J. Bradbury, A. Veysey, H. Macbeth, M. Goetz, M. Kaplan, J. Herb, J. Senick, T. Abrahamian, and K. Zyla. 2017. An Examination of Policy Options for Achieving Greenhouse Gas Emissions Reductions in New Jersey. doi:10.7282/T30C4ZPZ, available at https://climatechange.rutgers.edu/docman-list/special-reports/589-njghg-final-9-21/file (Identifies decoupling as an avenue for New Jersey to incentivize efficiency and conservation measures by utilities.).

[16] Maggie Molina and Marty Kushler, Policies Matter: Creating a Foundation for an Energy Efficiency Utility of the Future, June 2015, pg.8, available at: https://aceee.org/sites/default/files/policies-matter.pdf.; Top 20 states within the ACEEE scorecard have a mix model of administration, but they do have decoupling and strong ERS.

[17] Cost Recovery Proposal at 7. (emphasis added)

the targets. The "incentives" in this case are high risk with no reward. While, the lower ROE is rationalized because it will be part of the carrying cost of energy efficiency investment in the first year, EEA-NJ has also stated earlier that the carrying cost should be determined at a base rate case. Additionally, ROE on carrying costs could incentivize spending on administration in the first year and such an incentive would disincentivize cost efficiency and effectiveness.

EEA-NJ believes that the proposed linear scale contravenes the intent of the Clean Energy Act. The Clean Energy Act mandates that if a utility achieves or does not achieve the performance targets, they shall receive a penalty or incentive, as determined by the Board.[18] An incentive is defined as something that "encourages a person to do something."[19] The proposed incentive ROE scale is not an inventive because allowing a utility to receive the full WACC from its most recent base case simply removes a disincentive.

Utilities do not invest in energy efficiency because (1) sales are tied to energy usage and (2) capital investments guarantee a higher return than energy efficiency investments. The proposed incentive scale does nothing to alleviate either one of these disincentives because for a utility to receive a return on equity equal to the guaranteed return in infrastructure and grid investments it must achieve 150% of its foals. This provides no incentives or security for utility shareholders. For this mechanism to be a true incentive – to encourage utility investment in energy efficiency – it must provide an avenue for shareholders to earn more than the WACC established in their base rate case.

BPU references Illinois as justification for their 200 bases point penalty and linear scale. However, Illinois does not place an automatic 200 bases point penalty on all utility ROEs. Rather, ROEs are determined utility by utility with a policy that the ROE can be adjusted by a **maximum or minimum ROE of 200 basis points.**[20]

The BPU can fix this lack of incentive by modifying the scale or removing the mandate that all energy efficiency programs start at less 200 basis points. As discussed above, EEA-NJ strongly disagrees with the establishment of WACC as 200 basis points below. This disincentivizes shareholder investment in energy efficiency and could work to deter utilities from investing in energy efficiency programs. Because the scale for penalties and incentives starts at 200 basis points below other investments, the scale for the penalties and incentives is disproportionately low in fact, utilities have to hit 150% of QPIs to hit the ROE approved for other infrastructure investments in the most recent base case. This works to remove the incentive, almost working against the clear legislative intent in the Clean Energy Act to provide an incentive based off performance.[21]

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[18] Clean Energy Act Section e(2). ((e)(2)If an electric public utility or gas public utility achieves the performance targets established in the quantitative performance indicators, **the public utility shall receive an incentive as determined by the board through an accounting mechanism established pursuant to section 13 of *P.L.2007, c.340* (*C.48:3-98.1*) f**or its energy efficiency measures and peak demand reduction measures for the following year. The incentive shall scale in a linear fashion to a maximum established by the board that reflects the extra value of achieving greater savings) (emphasis added).

[19] Cambridge Dictionary, https://dictionary.cambridge.org/us/dictionary/english/incentive.

[20] ACEEE, Topic Brief: Snapshot of Energy Efficiency Performance Incentives for Electric Utilities, December 2018, page 10, available at https://aceee.org/topic-brief/pims-121118.

[21] The Clean Energy Act, N.J.S.A. §48:3-87.9.

c. The Proposed Mechanism Creates Double Penalties.

In addition to the Return on Equity penalties, that a utility could incur, the Proposal includes a second penalty for utilities where if they fall 50% below the QPI target, where they will be "assessed a penalty of 0.75% of the base rate distribution revenue in the previous year."[22] While it is important to ensure that utilities are compliant with the law and mandates. A double penalty could deter utilities from taking any financial risks with their portfolio of programs. This sort of deterrence could lead to less innovative programs and less spending on energy efficiency.

IV. Energy Efficiency as a Resource

a. The state identifying bidding "Energy Efficiency as a Resource" as a policy for the cost recovery mechanism but then bidding into the PJM market as the sole mechanism under this policy.

EEA-NJ applauds the BPU for referencing the the policy concept of energy efficiency as a resource. Energy efficiency is the least-cost, most abundant, and cleanest energy resource available in New Jersey. However, the very specific policy mechanism of allowing utilities to capture all of the value from energy efficiency nominations to PJM is a misuse, or at the very least an extremely narrow use, of the phrase "energy efficiency as a resource." First, treating energy efficiency as a resource should have far more reaching impacts than bidding energy efficiency projects into PJM as a means of cost recovery. Second, while bidding energy efficiency into PJM can reduce overall rate prices the market is not stable enough to produce a predictable revenue stream and should not be seen as a method of cost recovery.

Energy Efficiency as a Resource should have more far-reaching impacts than bidding energy efficiency programs into PJM as a means of cost recovery. Treating energy efficiency as a resource, looks to treat energy efficiency's reduction in energy usages, similar to other utility fuels, as something that is "capable of yielding energy and demand savings that can displace electricity generation from coal, natural gas, nuclear power."[23] These programs see to place energy efficiency on the same playing field as current generation investment through incorporating policies such as a non-wire alternative programs, decoupling, and other measures.

Bidding energy efficiency into the PJM market should not be considered a cost recovery mechanism as it is hard to predict costs and the benefits are not so direct. While bidding energy efficiency into the PJM market can drive down the costs of energy, it does not guarantee a return in a way a cost recovery mechanisms can and should because of large price deviations and financial risk. The prices on these contracts fluctuate based on the current policy, cost to ensure adequate generating resources are available to meet electric demand, and the time in which these contracts are bid on. [24]Pricing in the capacity market, on the other hand, is driven by resources

[22] Cost Recovery Proposal at 7.
[23] Grace Reif and Brendon Baatz, Energy Efficiency in Capacity Auctions: A Historical Review of Value, December 2017, American Council for Energy Efficiency Economy.
[24] *Id*. at 3.

other than EE. Additionally, failure to fulfill contracts results in forfeited revenue and out-of-pocket deficiency penalties. An ACEEE study reviewing the effects of bidding energy efficiency into PJM concluded that bidding EE into the Market "does not compensate energy efficiency program providers and therefore does not send an appropriate market signal of demand-side resources' value."[25] Therefore, we feel that it is unfit to characterize the process of bidding EE into the PJM market as a cost recovery mechanism;

b. Utilities should not be required to bid into the PJM market when there are already successfully operating programs from third party implementers in the state.

EEA-NJ opposes requiring utilities to bid into the PJM market. Bidding energy efficiency into the PJM Market is complex, with risks and rewards that must be balanced. Further, New Jersey already has numerous qualified participants implementing PJM programs and to the extent that economic opportunities exist in this market, these parties have and will continue to identify these opportunities at a lower cost and risk to ratepayers.

Allowing current participating business to continue running PJM energy efficiency programs is the least cost and most effective manner to implement these programs as there is a high learning curve to enter the Market. Entering this market requires high upfront costs that these businesses have already absorbed and have preestablished relationships and insider knowledge of how the business works within complex state and federal regulations. Additionally, while there is substantial participation, there has been no evidence to suggest that the current programs are unsuccessful or inefficient. In fact, they have excelled in a regulatory challenging and unique market.

The current format of third-party implementers protects ratepayers and provides statewide benefits. The PJM market has experienced businesses who know how to create economic opportunity in a complex marketplace. These businesses accept all the risk and make firm commitments to pay the ratepayers who participate, which carries no risks for ratepayers. There is no reason to change a successful program.

These programs are complex to regulate and ramp up, the BPU should use the already successful existing market to save ratepayers funds and lessen administrative burdens for the State. Core elements of New Jersey's future energy efficiency programs are still being designed. Therefore, it would be best for the State to focus on making successful core energy efficiency programs before attempting to regulate and require bidding energy efficiency in the PJM market, which has the risk of achieving little or no net benefit to NJ ratepayers. Those resources would be better directed to implementing EE programs into market segments that are underserved.

[25] *Id*. at v.

V. EEA-NJ Believes the Cost Recovery Mechanisms Recommended in These Comments will put New Jersey on the Best Path Forward to Create A Thriving Market for Energy Efficiency and Achieve the State's Climate Goals.

As New Jersey advances state policies that aggressively deploy energy efficiency, combined with electrification and aggressive deployment of renewable energy, the state must be similarly ambitious its energy and utility regulatory mechanisms as well. The next few years will create dramatic changes in the energy landscape of New Jersey. The BPU Program Administration Straw Proposal acknowledged this changing the program administration model and the charge in the Clean Energy Act for Utilities to lead the state in energy conservation. The BPU cannot hold the programs back by keeping a cost recovery mechanism in place that continues to deter utility participation in energy efficiency.

Sincerely,

Erin Cosgrove

Erin Cosgrove, esq.
Policy Counsel
Energy Efficiency Alliance of New Jersey

February 6, 2020

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Re: New Jersey Energy Efficiency Transition Stakeholder Meeting – Cost Recovery, Response to Draft Cost Recovery Mechanism Proposal

The Energy Efficiency Alliance of New Jersey, Environmental Defense Fund, US Green Building Council-NJ, New Jersey Sustainable Business Council, and the Natural Resources Defense Council submit the following letter in response to the New Jersey Board of Public Utilities (BPU) Draft Cost Recovery Mechanism Proposal (Proposal). Specifically, we take this opportunity to respond to the BPU's proposal of a Lost Revenues Adjustment Mechanism (LRAM) as a cost recovery mechanism.

The Clean Energy Act (CEA) mandates that the BPU require each of New Jersey's electric and gas utilities to reduce electricity and gas usage in the State.[1] Specifically, the CEA assigns an energy efficiency resource standard (EERS) of 2% for electric utilities and .75% for gas to be achieved within 5 years of program implementation. To ensure the utilities meet these targets, the CEA directs the BPU to establish an investment and cost recovery mechanism pursuant to N.J. Stat. § 48:3-98:1[2]; as well as an incentive and penalty structure pursuant to the CEA.[3] The goal being to align utility financial interest with New Jersey energy and environmental policy through reconfiguring the utility cost recovery structure so that it does not disincentivize energy efficiency investment.

On the onset, we would like to note that these comments are specific to the cost recovery mechanism as it would pertain to electric utilities. New Jersey's natural gas utilities have long been subject to revenue decoupling by way of the Conservation Incentive Program (CIP). Given the uncertainty about the role of natural gas in New Jersey's clean energy system, it is essential that whatever decoupling mechanism is applicable to natural gas be properly calibrated to be consistent with New Jersey's emerging greenhouse gas emissions policy. However, as the threshold question of whether the proposed mechanism is expected to be applicable to the natural gas system has not been answered, the comments in the balance of this letter pertain to the cost recovery mechanism as it would apply to electric utilities and do not raise any natural gas-specific issues.

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[1] Clean Energy Act, N.J. Stat. 48:3-87.9.

[2] Electric, gas public utilities energy efficiency and conservation programs, investments, cost recovery, N.J. Stat. § 48:3-98:1.

[3] The Clean Energy Act directs that each utility file a petition with the BPU "for cost recovery of the programs, including any performance incentives or penalties, **pursuant to section 13 of P.L. 2007 c.340** (C. 483-98.1)." N.J.S.A. §48:3-87.9(e)(1). Section 13(b) reads "**All electric public utility and gas public utility investment in energy efficiency and conservation programs** or Class I renewable energy programs may be eligible for rate treatment approved by the board, **including a return on equity, or other incentives or rate mechanisms that decouple utility revenue from sales of electricity and gas**." N.J.S.A. §48.3-98.1(13)(b) (emphasis added).

Full Symmetrical Decoupling Aligns Utility Shareholder Concerns with State Energy and Environmental Policy

Beyond energy efficiency, the state is currently pursuing robust policies in support of building decarbonization and electrification, electric vehicle deployment, nation-leading procurement of offshore wind resources, and a complete overhaul of its solar incentive program. These changes, along with others outlined in the Energy Master Plan (EMP) will have a profound effect on the utility business model. Mechanisms that shift the utility business model away from one that is dependent on the volume of electricity sales to one that is dependent on program performance and state policy goals will allow New Jersey to achieve these energy and climate goals in a least cost scenario.

Traditional rate making structures motivate utilities to (1) increase sales and (2) resist reducing sales, through energy efficiency programs or other means. Because LRAM does nothing to shift a utility's essential earning mechanism – increasing sales – the State will have to force utilities to comply with a law that goes against their financial interest. Full symmetrical decoupling guarantees utilities revenue – but does not guarantee profit. Making utilities indifferent to energy usage and allowing them to focus on cost savings and meeting performance standards, including for energy efficiency.[4] Across the country, states with the most successful programs are those that have instituted full symmetrical decoupling and an EERS as it creates a sea change in utility priorities, prioritizing energy efficiency and climate goals.[5] Therefore, utilizing a full symmetrical recovery mechanism can put New Jersey on the path to surpass the energy reduction goals in the Clean Energy Act, while also keeping with the policies and initiatives in the Energy Master Plan and state solar and electric vehicles initiatives.[6]

Full Symmetrical Decoupling Will Provide A More Responsive and Accountable Ratemaking Mechanism Than the Proposed LRAM.

The current ratemaking framework in New Jersey determines rates by dividing the utility's revenue requirement by predicted sales and holding these rates stagnant until the next rate case. If sales are greater than predicted, the utility will over-earn unless there is a rate case to readjust rates. LRAM does nothing to alleviate this problem, thus providing a solution that satisfies neither energy efficiency objectives nor ratepayer concerns.[7]

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[4] Regulatory Assistance Project, Revenue Regulation and Decoupling: A Guide to Theory and Application, November 2016, pg. 11, available at: https://www.raponline.org/knowledge-center/decoupling-design-customizing-revenue-regulation-state-priorities/ (Decoupling "eliminates a strong disincentive to invest in energy efficiency"; "[a]ssuming that management has a limited ability to influence costs and behavior [full symmetrical decoupling] allows concentration of that effort on cost reductions, rather than sales enhancement."). [Hereinafter RAP Decoupling]

[5] *Id.* at 12.

[6] Maggie Molina and Marty Kushler, Policies Matter: Creating a Foundation for an Energy Efficiency Utility of the Future, June 2015, pg.8, available at: https://aceee.org/sites/default/files/policies-matter.pdf.; Top 20 states within the ACEEE score card have a mix model of administration, but they do have decoupling and strong ERS.

[7] Annie Gilleo, et al., Valuing Efficiency: A Review of Lost Revenues Adjustment Mechanism, June 2015, American Council for an Energy-Efficient Economy, pg. 21, available at https://aceee.org/sites/default/files/publications/researchreports/u1503.pdf. ("LRAM as a permanent policy fixture is

Full Symmetrical Decoupling, outlined below, avoids these pitfalls by setting a revenue requirement based on volumetric rates and establishing protections for ratepayers that ensures the utility earns only that revenue. The process is similar to a usual rate proceeding with the addition of a responsive mechanism, which controls the utility's revenue stream:[8]

1. Initially, rates are set in a traditional rate proceeding with an adjustment mechanism; this mechanism may take into account any increase or decrease in sales volumes compared with the level assumed in the rate proceeding; changes in customer size, [9] or other true-up mechanisms decided on in the base rate proceeding;

2. As the mechanism is implemented, rates are adjusted periodically (up and down) through this mechanism to only produce the target revenue agreed to in the base rate proceeding.

3. Finally, states that utilize this mechanism often require periodic rate cases so to ensure that the agreed upon revenue requirement is still appropriate.[10] At a predetermined time or triggering point (usually in a range of 3 -5 years), the utility will come in for another rate case to check on the earnings level and adjustment mechanisms and instill any changes to the mechanism in the case of disproportionate earnings to the predetermined budget.

Full Symmetrical Decoupling Will Protect Ratepayers as New Jersey Pursues Policies that Will Grow Electric Demand.

With the numerous state policies that are changing the energy regulatory landscape, continuing to tie utility profits to sales, and incentivizing them through financial rewards such as an LRAM could end up costing ratepayers. [11] The 2020 Energy Master Plan as well as recently passed legislation sets the State on a clear path to grow its electricity consumption through electrification of the transportation and building sectors. Ensuring that the additional load from transportation and building electrification is added to the grid strategically is essential to contain overall system costs. The traditional utility model, which is designed to generate utility shareholder investment in power plants, poles, and wires, will not produce a least-cost integration of the electrification of the transportation and building sectors.

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fraught with flaws. The regulatory burden is great, and the potential to shortchange customers and overcompensate utilities is ever present.").

[8] Regulatory Assistance Project, Revenue Regulation and Decoupling: A Guide to Theory and Application, November 2016, pg. 11, available at: https://www.raponline.org/knowledge-center/decoupling-design-customizing-revenue-regulation-state-priorities/.

[9] *Id.* at 17.

[10] Southern Environmental Law Center, A Troubling Trend in Rate Design: Proposed Rate Design Alternatives to Harmful Fixed Charges, December 2015, page 10.

[11] Annie Gilleo, et al., Valuing Efficiency: A Review of Lost Revenues Adjustment Mechanism, June 2015, American Council for an Energy-Efficient Economy, pg. 21, available at https://aceee.org/sites/default/files/publications/researchreports/u1503.pdf. ("LRAM as a permanent policy fixture is fraught with flaws. The regulatory burden is great, and the potential to shortchange customers and overcompensate utilities is ever present.").

While we applaud the BPU staff's efforts during the public input process for the Clean Energy Act, the proposed cost recovery mechanism, Lost Revenues Adjustment Mechanism (LRAM), does not result in utility indifference toward the volume of electricity sold because under LRAM, utilities continue to see the biggest reward through increasing the total volume of electricity sales, not through a best value approach. Thus, LRAM will not only fail to incentivize utility cooperation and participation but will ultimately fail to put the state on the path to achieve the mandates of the CEA and ambitions goals of the EMP.

Full Symmetrical Decoupling is the Best Path Forward for New Jersey

As New Jersey advances state policies that aggressively deploy energy efficiency, pursue electrification, and prioritize the deployment of renewable energy, the State must be similarly ambitious with its energy and utility regulatory mechanisms as well. The next few years will create drastic changes in the energy landscape of New Jersey, the BPU cannot hold the programs back by keeping a cost recovery mechanism in place that continues to deter utility participation in energy efficiency.

Thank you for your time and consideration,

Erin Cosgrove, esq.
Policy Counsel
Energy Efficiency Alliance of New Jersey

Mary Barber
Director, Regulatory & Legislative Affairs
Environmental Defense Fund

William Amann, P.E., DCEP, LEED FELLOW
President, M&E Engineers, Inc
Vice Chair, US Green Building Council-NJ
Climate Reality Leader

Richard Lawton
Executive Director
New Jersey Sustainable Business Council

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NJ Energy Policy Director
Climate and Clean Energy
Natural Resources Defense Counsel

February 6, 2020

Aida Camacho-Welch
Secretary of the Board
Board of Public Utilities
44 S Clinton Ave 9th Floor
Trenton, New Jersey 08625

Comments of Gabel Associates on the Energy Efficiency Transition Cost Recovery Mechanism Draft

Dear Secretary Camacho-Welch;

Gabel Associates, Inc. ("Gabel Associates" or "Gabel") appreciates the opportunity to provide additional comments regarding Cost Recovery for the Energy Efficiency ("EE") programs in the State. These comments are in response to the EE Stakeholder Meeting on Cost Recovery, which took place on January 23, 2020, as well as the Energy Efficiency Transition Cost Recovery Mechanism Draft released by the BPU Staff ("Staff Proposal").

Executive Summary

The Staff Proposal on energy efficiency cost recovery requires adjustment to align customer interests, utility interests, and New Jersey's mandated goal of achieving a national leadership position in energy efficiency.

Specific issues which should be addressed include:

- For New Jersey to achieve its maximum feasible level of energy efficiency, ratemaking must be structured so that utilities are financially positioned to support this effort. The Staff Proposal provides an unreasonable and counter-productive financial incentive to utilities that undercuts the ability and incentive of utilities to "go all-in" in helping the State achieve its energy efficiency goals.

- The following elements of the Staff Proposal should be adjusted because they are counterproductive to providing motivation to utilities to support New Jersey's energy efficiency goals: a) it punitively reduces the rate of return on EE investments; b) it artificially constrains the amortization period for energy efficiency investments to seven years; c) it restricts lost revenue recovery to only utility program impacts; and, d) it suggests an asymmetric penalty/incentive structure. Each of these elements must be substantially adjusted for New Jersey to meet its energy efficiency goals and realize the anticipated customer savings.

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- The Staff Proposal should be adjusted to fully advance ratepayer interests by making investments in energy efficiency the "preferred investment" of utilities so that customer savings are maximized. Other ratepayer protections should include full decoupling so that increases in sales create rate reductions; continuing earnings surveillance by BPU staff; and review of utility cost recovery for reasonableness.

- The Staff Proposal on lost revenue treatment should be adjusted. The mechanism contained in the Staff Proposal is less protective for customers than other lost revenue treatments, such as decoupling. Decoupling will fix utility revenue requirements and limit New Jersey's exposure to distribution costs. Decoupling is used in 32 states (including two utilities in New Jersey) as an effective approach that protects ratepayers and provides clarity in the financial incentive to utilities to fully support maximizing energy savings. Decoupling is a symmetrical and fair approach to lost revenue treatment and should be the recommended approach in the Staff Proposal.

- The Staff Proposal should be adjusted to recognize, and help realize, a fundamental goal that should drive the BPU's decision in this matter: nothing less than achieving a sea change in corporate culture where utilities unleash their creativity, resources, and customer relationships to make New Jersey a leader in energy efficiency. This can only occur by changing the financial motivation of utilities.

We elaborate on these issues below.

Background on Gabel Associates

Gabel Associates is an energy, environmental and public utility consulting firm with its principal office located in Highland Park, New Jersey. We have spent decades working in and studying energy markets in New Jersey, and also have extensive utility ratemaking, cost of service, and tariff design experience, including our two principals, who both served as senior managers at the New Jersey Board of Public Utilities ("BPU") and others who have offered expert testimony around the country on ratemaking issues .

Our work with all types of clients provides a perspective on the cost recovery issue that we hope will be informative to the BPU. For example, we provide extensive consulting services to utility customers including hundreds of school districts, counties, and businesses. We also assist electric and natural gas utility companies develop and design cost effective energy efficiency ("EE") programs. Specifically, we have worked or are currently working on EE related activities with Atlantic City Electric Company ("ACE"), Public Service Electric and Gas Company ("PSE&G"), Elizabethtown Gas Company ("Etown"), New Jersey Natural Gas Company ("NJNG"), and South Jersey Gas Company ("SJG"). Because of the breadth of sectors where we provide our services, we have a deep and balanced sensitivity to the needs of all types of energy market participants.

These comments focus on two components: (1) feedback and comments to specific elements of the Staff Proposal; and (2) questions to the BPU Staff to foster a needed fuller understanding of

specific elements of the Staff Proposal. For your convenience, we have included our previously filed comments as an attachment to this document.

1. Feedback on the BPU Cost Recovery Proposal

The current BPU proposal on energy efficiency cost recovery still falls short of aligning customer interests and state policy goals of advancing cost-effective energy savings opportunities to ratepayers in New Jersey. Further, the Proposal does not include many of the best practice utility business model elements suggested by the American Council for an Energy-Efficient Economy ("ACEEE"), including decoupling, as vital for states looking to maximize energy savings from energy efficiency.

The specific topics from the Staff Proposal that merit additional discussion and adjustment include:

- amortization period;
- carrying costs for EE investments;
- rate or bill caps;
- lost revenue treatment;
- performance incentives; and,
- energy efficiency as a resource.

a. Amortization Period

Staff Proposal: 7-year amortization period

Discussion: The BPU regularly evaluates depreciation periods through base rate case process. Determining an appropriate depreciation period is typically an engineering exercise which uses industry standard practices and procedures to calculate the useful life of a piece of equipment and match the return of this investment with its useful life. In this context, energy efficiency equipment is no different than traditional 'wires' or 'pipes' investments. The engineering and evaluation studies on energy efficiency measures should stand as the basis for determining the appropriate amortization period. An asset's useful life rather than an arbitrary amortization period of seven years should be used when the data is readily available to better estimate the time period.

Recommendation: Gabel Associates continues to recommend an amortization schedule for energy efficiency investments based on the weighted average lifetime of the portfolio. The amortization period for energy efficiency investments should be determined on a case-by-case basis according to the weighted-average useful life of all of the measures contained within an energy efficiency portfolio. This aligns costs with the timing of benefits, reduces rate impacts over time, and more closely matches ratemaking practices for other utility investments.

b. Carrying Costs for EE Investments

Staff Proposal: The utility capital structure approved in its last rate case with a 200-basis point reduction on return on equity

Discussion: By setting the return on equity for energy efficiency below that of traditional infrastructure investment, the Staff Proposal encourages less investment in energy efficiency than other potential investments. Utilities have limited capital to invest and will naturally make investments in opportunities that provide the most return. Therefore, utilities will likely seek investment opportunities in other areas and minimize the priority to invest in energy efficiency.

In addition, the Staff Proposal to reduce the return on equity rate by 200-basis points for energy efficiency investments is lacking evidentiary support. The Staff Proposal inaccurately suggests that it is based on models in Maryland and Delaware. The Staff Proposal asserts "energy efficiency programs are also less risky than traditional infrastructure investment" and that "there is an inherent reduction in risk associated with the contemporaneous recovery available in this mechanism." However, the Proposal provides no support or references for either of these claims, and we are not aware of any precedent in other states that supports a 200-basis point reduction. Risk still exists for utilities in New Jersey on recovery of energy efficiency costs. The current stakeholder processes are answering many of these questions, including lost revenue recovery, utility target setting, establishment of quantitative performance indicators, savings evaluation protocols, and other policies that significantly affect the ability of utilities to receive timely and ongoing cost recovery of these investments. Utility base rate cases are the appropriate place for the Board to evaluate utility risk on a comprehensive basis and use this evaluation to set a return on equity on a holistic basis.

Recommendation: Gabel Associates recommends utility investments in energy efficiency be made as attractive as other utility system investments. The return on equity rate should be the same as other utility system investments and be determined in each base rate case proceeding.

c. Future Implementation of a Rate or Bill Cap

BPU Proposal: Opens the door for the potential for a rate or bill cap to be implemented two years following the approval of energy efficiency transition programs.

Discussion: Based upon the Program Administration Straw proposal, utilities will be filing programs of at least three years in duration. Implementing a rate cap in the middle of an approved program would adversely affect the ability of that program to achieve savings. This would be further compounded by the severe penalty structure proposed by Staff.

As discussed in our previously filed comments, rate or bill caps are an inexact tool that can disrupt the ability to achieve energy savings targets and reduce program performance. Rate or bill caps also place utilities in the position of choosing to eliminate more expensive programs. Two examples of where a rate or bill cap can cause program elimination are: 1) the potential elimination of low-income programs which are typically more expensive but also meet important goals and provide access to energy efficiency program benefits; and 2) commercial and industrial programs that achieve significant savings but command larger incentive investments. Both program types are necessary to ensure equity for all ratepayers and to achieve harder-to-reach savings. Moreover, all programs and portfolios will be subject to detailed cost-benefit analysis to assure ratepayers are protected.

Recommendation: The BPU should not adopt rate caps. These caps limit cost effective energy efficiency. Furthermore, the BPU will have oversight of rate and bill impacts during the filing process.

d. Lost Revenue Treatment in place of Decoupling

BPU Proposal: Lost revenue adjustment mechanism would recover only the lost net revenues from utility-specific energy efficiency programs.

Discussion: The proposed lost revenue recovery approach is narrowly focused and will not discourage utilities from promoting electric and natural gas sales because utilities will still have a strong financial interest to promote higher sales volumes to drive revenue. Under a decoupling mechanism, this incentive is removed: decoupling would align the utility business model in New Jersey with the state policy objective of conservation and promoting energy efficiency programs.

Also, the Staff Proposal does not allow utilities to collect lost revenues from the Division of Clean Energy ("DCE") programs. This means that DCE program success will financially harm utilities and create an environment whereby utilities may not be willing partners in promoting DCE programs. To achieve the aggressive energy savings goals contained in the Clean Energy Act, it will be critical to ensure all parties are working together to promote all energy savings opportunities to customers.

The lost revenue treatment contained in the Staff Proposal allows for circumstances where a utility can both expand revenues by increasing sales *and* collect lost revenues through the proposed Lost Revenue Adjustment Mechanism ("LRAM"). This is a worst case 'heads I win, tails you lose' situation against customers because the LRAM is a unidirectional recovery mechanism. That means that if utility sales increase, rates will not decrease, and in the same year, rates could increase due to energy efficiency savings from utility managed programs.

Increased electricity consumption is being directly called for in the 2019 New Jersey Energy Master Plan ("EMP"), which provides specific strategies and goals for the State, and includes the follow explicit targets:

1.1.1 Support the deployment of 330,000 light-duty electric vehicles on the road by 2025, per the State Zero-Emission Vehicle Program Memorandum of Understanding
1.1.2 Deploy electric vehicle charging infrastructure throughout the state
1.1.3 Encourage electric vehicle adoption through the purchase of electric vehicles and incentives for charging station installation in certain locations
1.1.4 Increase consumer and fleet owner awareness and acceptance of electric vehicles
1.1.5 Roll over the state's light-duty fleet to electric vehicles
1.1.8 Partner with industry to develop incentives to electrify the medium- and heavy-duty vehicle fleet with battery or fuel cell technology, and to support R&D that will enable such electrification
1.3.1 Support electrification of diesel-powered transportation and equipment at the ports and airports
4.1.1 Electrify state facilities
4.2.1 Incentivize transition to electrified heat pumps, hot water heaters, and other appliances
4.2.2 Develop a transition plan to a fully electrified building sector

6.3.1 Prioritize replacement of fossil-fueled public transportation fleets with electric fleets, with a focus on environmental justice communities

6.3.2 Support electrification of diesel-powered transportation and equipment, prioritizing those at or near the ports and airports, and consider a diesel truck buy-out program

6.3.3 Build or incentivize electric vehicle charging infrastructure and incentivize the adoption of electric vehicles in low-income communities

6.3.4 Develop shared mobility programs, including bike sharing, electric taxis, electric ride-hailing and electric car sharing, neighborhood electric vehicles, and scooters and e-bikes

All of these strategies and goals can lead to substantially increased electric sales. If a utility is also saving energy from energy efficiency programs, they could both increase revenues from expanded sales, as well as collect lost revenues, a compounded negative for ratepayers. Alternatively, a decoupling mechanism as recommended by many stakeholders, including ACEEE, would balance both expanded utility sales and lost revenues, while offering a symmetric recovery mechanism that credits customers to prevent utilities from over-earning. A decoupling mechanism would also capture factors such as weather variability and load changes due to electric vehicles, which are explicitly referenced in the Clean Energy Act.

The protections contained in the Staff Proposal such as a rate case requirement and the earnings test are not distinct features of an LRAM. In fact, those features are often found paired with decoupling mechanisms as well, to provide the ultimate protection to customers while removing the throughput incentive from utilities. New Jersey already has experienced success with decoupling since SJG and NJNG have had such programs for a significant period. In fact, the Staff Proposal includes a very positive outlook regarding New Jersey's experience with the Conservation Incentive Program ("CIP"), a modified form of decoupling, that has been in place for more than 13 years for NJNG and SJG. It acknowledges stakeholder input regarding how "CIP has contributed to shifts in utility behavior and culture, allowing for efficiency and conservation to be supported at all level of utility management". This is exactly the type of fundamental change the state indicates it is hoping to achieve, yet the Staff Proposal then proposes a dramatically different mechanism that would not lead to a full commitment to maximize energy efficiency. This experience as well the experience in 31 other states demonstrates that these programs can be effective and can support the Board's mandate to protect ratepayers.

The earnings test contained in the Staff Proposal was unclear on how it would operate. For example, the Staff Proposal states that the ROE "shall be determined based on the actual net income of the utility" and that "for any energy efficiency transition program approved by the Board, if the calculated ROE exceeds the allowed ROE from the utility's last base rate case by 50 basis points or more, recovery shall not be allowed for the applicable filing period." It is unclear what is included in the calculation of the ROE, as the first term appears to imply base rates, but the second term clearly states it is based on "any energy efficiency transition program." Energy efficiency riders are adjusted annually based on projections so there is little risk of over-recovery as those costs are automatically credited back the following year. It is also unclear on whether any recovery not allowed for the applicable filing period can be carried into future years.

Recommendation: The BPU should implement full revenue decoupling with customer protections to assure that utilities are not financially harmed, and are best positioned to promote savings, while also maximizing protections to customers. All the protections contemplated in the Staff Proposal

could be applicable to a decoupling mechanism, including rate case requirements, earnings tests, cost-benefit analysis, and other protections.

e. Performance Incentive and Penalty Structure

BPU Proposal: Performance incentive and penalty structure based on adjustments to return on equity

Discussion: The first penalty levied on utilities is the 200-basis point reduction to return on equity. Aside from the direct impacts of this choice discussed above, this flows through to the penalty and incentive structure by starting the baseline for performance at a substandard level.

In addition, the BPU proposal contains a non-symmetric penalty and incentive structure. While incentives and penalties are awarded between 10% and 50% above and below the baseline, the value of those penalties are not balanced. The penalty can reduce the return on equity by up to 400 basis points, while the incentive can only increase the return on equity by 200 basis points. That means that on a relative basis, the penalty amount is twice that of the incentive amount. By way of example, every one percent increase in savings above the neutral dead-band zone will result in a 4-basis point increase in return on equity. However, every one percent decrease in savings below the neutral dead-band zone will result in an 8-basis point reduction in return on equity.

While the neutral dead-band zone provides some protection, the BPU should recognize that the current regulatory framework makes under-achieving more likely than over-achieving. This is because utility spending is determined prior to administering programs, and unexpected circumstances, such as if savings estimates are adjusted mid-stream, if deemed savings exceed evaluated savings, if vendors cost more than expected, if customer preferences change, if weather is abnormal, or if there are other unforeseen costs, a utility will likely underachieve the goals with no ability to compensate for these real-time changes. Conversely, and for many of the same reasons, over-achieving goals is very difficult.

It is also premature to determine the performance incentive and penalty structure. Performance incentives and penalties are inseparably linked to the goals and QPIs, which are being discussed in a parallel process. The incentive and penalty structure should be determined after goals and QPIs are set.

Recommendation: The BPU should not define the performance incentive or penalty structure in a vacuum, and should consider a comprehensive approach to goals, QPIs, and performance incentives and penalties. The penalty should also not be overly punitive, especially in comparison to the potential incentives offered for over-performance. If and when the BPU does take up this issue, it must recognize how each of the components within this Proposal and the goals and QPI process compound in order to develop a scheme which is fair and reasonable. In addition, the proposed neutral dead-band zone should be expanded, especially in the initial stages of implementation.

f. Energy Efficiency as a Resource

We agree that entities administering energy efficiency programs should look to maximize revenues associated with those programs in order to minimize costs to customers. This includes attempting to participate in all applicable PJM markets. However, the recent Federal Energy Regulatory Commission ("FERC") ruling regarding state sponsored resources will likely result in all energy efficiency resources being subject to a Minimum Offer Price Rule ("MOPR") which will diminish their ability to clear in the capacity market.

Conclusion

Gabel Associates appreciates the opportunity to furnish these comments and provide the Board with insight into issues related to EE cost recovery.

We are happy to provide any supplementary information or answer any questions you may have regarding our comments. We look forward to continuing the open stakeholder process.

Sincerely,

Isaac Gabel-Frank
Vice President
Gabel Associates

Appendix A

Comments of
Gabel Associates on the October 31, 2019
Energy Efficiency Cost Recovery Technical Meeting

November 14, 2019

Aida Camacho-Welch
Secretary of the Board
Board of Public Utilities
44 S Clinton Ave 9th Floor
Trenton, New Jersey 08625

Comments of Gabel Associates on the Energy Efficiency ("EE") Cost Recovery Technical Meeting

Dear Secretary Camacho-Welch;

Gabel Associates, Inc. ("Gabel Associates" or "Gabel") is pleased to provide comments regarding the EE Technical Meeting focused on Cost Recovery, which occurred on October 31, 2019.

Gabel Associates is an energy, environmental and public utility consulting firm with its principal office located in Highland Park, New Jersey. For over 25 years, Gabel Associates has provided quality energy consulting services and strategic insight to its clients. Classified as a small business, the firm provides its expertise to a wide variety of clients involved in virtually every sector of the energy industry, including public and federal agencies, individual commercial and industrial end users, aggregated groups of customers, public utility commissions, power plant owners and operators, wholesale suppliers, and utilities.

Our recent work in New Jersey has included assisting several of the State's electric and natural gas utility companies develop and design cost effective energy efficiency ("EE") programs. Specifically, we have worked or are currently working on EE related activities with Atlantic City Electric Company ("ACE"), Public Service Electric and Gas Company ("PSE&G"), Elizabethtown Gas Company ("Etown"), New Jersey Natural Gas Company ("NJNG"), and South Jersey Gas Company ("SJG").

Gabel Associates also provides extensive consulting services to customers in New Jersey including hundreds of school districts, counties, and business customers, as well as services to utility commissions and wholesale market participants. Because of the breadth of sectors where we provide our services, we have a deep and balanced sensitivity to the needs of all types of energy market participants. The principals of Gabel Associates include two individuals who served as senior managers at the BPU where they were both extensively involved in utility ratemaking, cost of service, and tariff design issues.

The Agenda for the Cost Recovery EE Technical Meeting presented thirteen (13) specific questions across three (3) general topics for discussion. Based upon the lively debate at the October 31, 2019 the Cost Recovery EE Technical Meeting, herein we address each of the Cost Recovery Stakeholder Questions.

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

The establishment of the same matching recovery mechanism for utilities and non-utilities is not necessary and in fact in many cases is not possible. More important than whether recovery mechanisms match is utilizing a recovery mechanism that minimizes rate impacts to customers and optimizes program administration. A Societal Benefits Clause ("SBC") style "expensed" mechanism is rigid and cannot react or be tailored to the immediate needs of customers. One problem with the SBC is that it lacks budget certainty as the funds can be reallocated by the Governor or state legislature for other purposes. Since 2010, over $1.6 billion has been reallocated from clean energy purposes to other state budget expenses, spanning the Corzine, Christie and Murphy Administrations. Funds collected from customers for EE programs should be protected from reallocation and used for their intended purpose to ensure continuity in program offerings. Stability is needed to provide customers with bill savings opportunities while driving economic growth in New Jersey and assuring that the State makes continuous, long-term progress in reducing carbon emissions.

Additionally, fulfillment of incentives through an expense mechanism at the Board of Public Utilities ("Board") Office of Clean Energy ("OCE") are subject to delay as funds must be collected, routed through the Treasury Department, and dispersed to non-utility agencies (such as the OCE) prior to being distributed to program participants.

Utility funding and recovery is much more stable than OCE based funding and recovery. Additionally, it can provide an ongoing long-term commitment to clean energy and more accurately align costs with benefits. For example, the amortization of program costs method allows utilities to draw on access capital markets to quickly fund programs, amortize them in line with measure life and flow of benefits, and only fund those programs and incentives that are submitted through a rigorous evidentiary filing process and approved by the Board.

Another key element on the different cost recovery methods is how ratepayers' interests are protected. In utility funded programs, program review is approved by an independent party (the Board) and subject to the full range of discovery, testimony, intervention, and review in a contested proceeding. In contrast OCE program review and cost recovery is not subject to this type of rigorous review, and is instead subject to a summary presentation of program plans, an expedited "legislative style" hearing, and approval by the Board, who's own staff prepare and submit the summary presentations for approval.

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?

For EE to become a central component of utility planning and infrastructure development, EE program costs should be amortized over the weighted-average measure life of all the measures at the portfolio level. Amortizing over measure life is important as it not only provides inter-

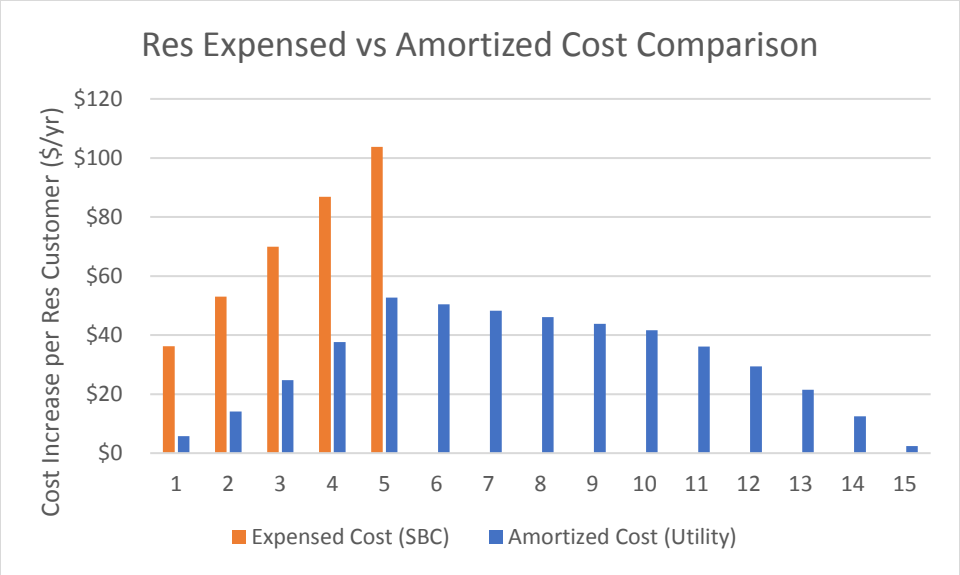
generational equity of costs and savings but aligns EE cost recovery with traditional utility ratemaking practices. If a utility were to invest in new lines or pipes, costs would be recovered over the useful life of those assets, often 20 to 60 years. EE investments should be treated similarly with a recognition of the length of time those EE assets will be in place. From a recovery perspective EE should be viewed by the Board as a central element of the state's investment in energy infrastructure. Recognizing that the Clean Energy Act[1] ("CEA") requires utilities to pursue EE savings targets, proper rate treatment can (along with an appropriate decoupling structure) make investment in EE as attractive to utilities as other utility infrastructure investments. With the State's ambitious clean energy goals, it is imperative to establish a structure like this to not only mandate, but actively encourage utilities to lead these transformational efforts by aligning ratemaking for EE programs with treatment similar to infrastructure investment programs.

Amortization will also reduce rate shocks and align cost recovery with program benefits and bill savings. The CEA calls for a 2.0% reduction in electric consumption and a 0.75% reduction in natural gas consumption. Regardless of the recovery mechanism, there will be rate impacts for customers to meet these objectives. Effectively managing the potentially significant spikes in electric and natural gas rates will make achieving EE policy goals more acceptable to policymakers and the public.

Amortization allows for costs to be spread over a longer period of time, therefore reducing the initial rate impacts associated with EE investments. The following graph provides a high-level example comparing the electric rate impacts of expensing costs in the year they are incurred against amortizing costs over a longer period.[2]

[1] https://www.njleg.state.nj.us/2018/Bills/PL18/17_.HTM

[2] This graphic contains numerous high-level assumptions, including 74,628,365 MWh of state electric load per the OCE Renewable Portfolio Standard ("RPS") Compliance Report, the savings targets set forth in Optimal Energy's Potential Study, a utility cost of capital rate of 7.0%, a cost of energy saved of $0.053/kWh sourced from the 90th percentile of utility administration costs contained in the ACEEE study *Does Efficiency Still Deliver the Biggest Bang for Our Buck? A Review of Cost of Saved Energy for US Electric Utilities*, a measure life of 11.1 years from the same ACEEE study, and residential consumption of 8,200 kWh per year. This was provided for theoretical illustration only and is not based upon actual real-life circumstances.

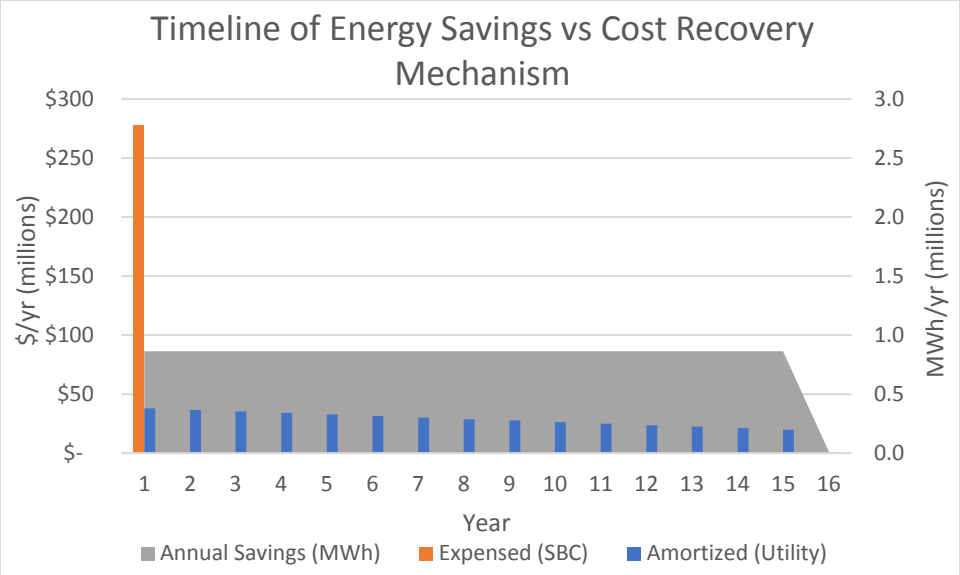


This graph illustrates what a potential five year build up to meet the goals set forth in the Optimal Energy EE Potential Study[3] (beginning at 0.75% in year one and ending at 2.15% in year five) could look like from a cost perspective. The program costs are based upon a review of program administrator costs contained in The American Council for an Energy Efficient Economy ("ACEEE") report titled: *Does Efficiency Still Deliver the Biggest Bang for Our Buck? A Review of Cost of Saved Energy for US Electric Utilities*.[4] The expensed scenario is illustrated in orange and shows that in year five costs could exceed an increase of $100 per year in electric rates for residential customers. The blue bars show the impact from amortized costs and illustrate that even in the peak year, the cost impact is roughly half that of the expensed scenario.

Please note that this is an illustrative example of residential electric costs only and is provided to offer a theoretical visual explanation of the difference in rate impacts between expensing and amortizing costs. Actual annual cost impacts are not yet known because the program portfolios needed to meet the CEA goals have yet to be developed. Commercial and industrial customers would also experience a similar relationship between expended and amortized mechanisms, with the costs per year being higher than that of residential customers.

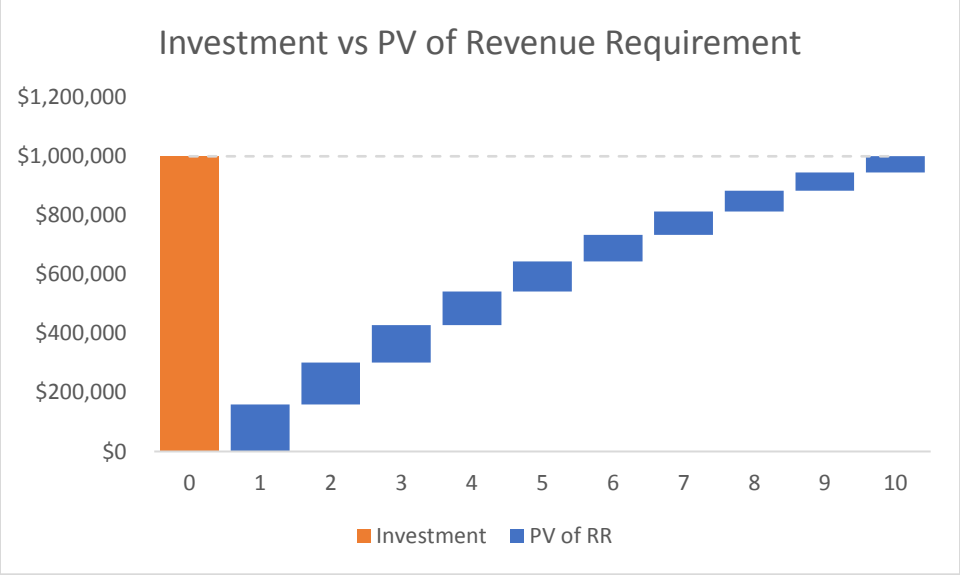
Amortization, if implemented over the weighted-average measure life of the EE portfolios, also matches program costs with program savings. The following graphic illustrates the OCE's FY20 budget as both an expensed and amortized cost and compares those against the OCE FY20 expected lifetime savings.

[3] https://s3.amazonaws.com/CandI/NJ+EE+Potential+Report+-+FINAL+with+App+A-H+-+5.24.19.pdf
[4] https://aceee.org/files/proceedings/2018/node_modules/pdfjs-dist-viewer-min/build/minified/web/viewer.html?file=../../../../../assets/attachments/0194_0286_000125.pdf



As seen in the graphic above, amortizing costs over time matches the costs to when the savings occur and assures that those customers receiving benefits are also paying a fair share of the costs.

EE costs should be amortized and accrue a return using a rate equal to the utility's weighted average cost of capital ("WACC") on the unamortized investment balances. The WACC is approved by the Board on a regular basis through the distribution ratemaking process and includes a comprehensive consideration of the various risks facing the utility. Further, using the WACC also means that on a present value basis, the total amortized costs equal the gross upfront investment cost if discounting at the same rate. This is illustrated in the following waterfall graphic, assuming a $1 million up-front investment compared against a high-level 10-year amortization example at a 7% return and 7% discount rate:



The orange bar represents all costs expensed in the first year. However, when amortizing over time, the payments are segmented and spread over a longer period. When accounting for the time-value of money (the Present Value, or "PV"), the return on investment costs are balanced out by the discount rate, resulting in a total payment stream that exactly equals the upfront investment amount in present value terms.[5]

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

Currently, EE costs are socialized across all customers. More information is required to gain a better understanding of the consequences of shifting from the current allocation method to sector specific distributions, such as an understanding of the portfolio of programs, how they are administered, and allotment of funds and achievement of savings between sectors. It should be recognized that many of the benefits of EE (such as advertising promoting EE, Demand Reduction Induced Price Effects, avoided Renewable Portfolio Standard purchases, and avoided Transmission & Distribution expenditures) are realized by all customers so it is not unfair for all customers to pay a share of costs even if such costs are for programs that are directed at other customer groups.

3. Topic 2: Potential for Recovery of Lost Revenues

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

Yes, there should be a mechanism to recover lost revenues. In fact, the CEA states that:

> *Each electric public utility and gas public utility **shall** file annually with the board a petition to recover on a full and current basis through a surcharge all reasonable and prudent costs incurred as a result of energy efficiency programs and peak demand reduction programs required pursuant to this section, including but not limited to recovery of and on capital investment, and **the revenue impact of sales losses resulting from implementation of the energy efficiency** and peak demand reduction schedules, which **shall** be determined by the board pursuant to section 13 of P.L.2007, c.340 (C.48:3-98.1)*
> -P.L. 2018 c.17 3.e.(1) (emphasis added)

This provides that utilities shall file annually to collect lost revenues, answering the question of whether a mechanism to collect lost revenues should exist. The CEA further cites that the Board shall determine these costs based upon the *Electric, gas public utilities energy efficiency and conservation programs, investments, cost recovery; terms defined* statute which specifically allows for "rate mechanisms that decouple utility revenue from sales of electricity and gas."[6]

[5] This graphic provided is an example and for illustration only. Actual revenue requirements calculations take into account additional factors such as taxes, Allowance for Funds Used During Construction ("AFUDC"), credits, and other factors. This was provided for theoretical illustration only and is not based upon actual data for any specific utility.

[6] https://www.njleg.state.nj.us/2006/Bills/PL07/340_.PDF

In addition to the statutory language cited above, there are very strong public policy reasons why the Board should establish ratemaking mechanisms that permit recovery of lost revenues. For the State of New Jersey to achieve or exceed its EE goals, it imperative that utilities "be on the same page" as New Jersey's policy goals. If utilities lose margin by developing EE, they may direct their capital to investments that allow them the ability to earn their authorized rate of return. Recovery of lost revenues is a critical element to eliciting the cultural shift needed to move utilities into fully helping New Jersey achieve its goals. In the context of addressing climate change – a key challenge facing the State (and the planet) – the need to get utilities rowing in the same direction as New Jersey in maximizing EE becomes even more profound.

As discussed in more detail below, while there are a range of lost revenue recovery mechanisms, a properly designed decoupling approach is the fairest way to address the lost revenue issue.

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

The preferred mechanism is full revenue decoupling that provides symmetrical recovery and return of under- and over-collection of distribution revenues by utilities. This already exists in New Jersey, as NJNG and SJG both have modified forms of revenue decoupling in place. In every base rate case, the Board authorizes a specific revenue requirement for each utility to cover its capital costs, expenses, and return. Decoupling assures that, regardless of sales volumes in a given year, utilities are able to recover those Board authorized revenues to pay for and maintain utility infrastructure, while limiting the ability of utilities to recover greater than the authorized revenue or return set by the Board.

Full revenue decoupling removes the link between volumetric sales and profits, eliminating any "throughput incentive". Without decoupling, utility profits are unquestionably linked to sales volumes. Therefore, a utility has a financial incentive to increase sales thereby increasing revenues. The incentive to increase sales exists regardless of any mandates to achieve CEA saving targets or other incentives or penalties that may be implemented. Decoupling severs the link between revenues and sales, removing the disincentive to decrease consumption.

Utility customers are also hedged against fluctuations in supply costs by the Basic Generation Service ("BGS") and Basic Gas Supply Service ("BGSS") mechanisms. A decoupling mechanism would provide a functional hedge for customers against fluctuations in distribution costs due to changes in sales by stabilizing total distribution collections to a fixed number.

Looking across the country there are numerous types of decoupling mechanisms; many, like the Conservation Incentive Program ("CIP") currently being implemented by NJNG and SJG, use margin per customer basis, but the mechanism can be tailored to the specific circumstances of the utility. Decoupling can and often does incorporate earnings and other types of tests to further protect ratepayers.

It is important to stress that decoupling is NOT against customer interests. A properly designed decoupling plan aligns a utility with New Jersey's goals to actively rollout EE that will reduce customer bills. Decoupling plans (including the Board approved modified version of decoupling for NJNG and SJG) also typically have specific provisions that allow the Board to periodically

review the impact and results of decoupling to prevent inordinate rate impacts or excessive earnings. It's no coincidence that nearly every state at the top of the ACEEE scorecard[7] has already implemented decoupling. Included on this list are states such as New York, Vermont, Massachusetts, California, and Rhode Island which are by no means viewed as "pro-utility commissions" by analysts.

Decoupling is a superior approach to a lost revenue adjustment mechanism ("LRAM"), which is the most likely alternative if decoupling isn't approved. LRAM is a common practice that allows a utility to calculate lost revenues driven solely by EE programs. This mechanism provides recovery of lost revenues, but unlike decoupling, is not linked to any Board authorized revenue level and only focuses on lost sales from specific EE programs. LRAM generally does not protect customers from utility over-recovery when sales increase and does not eliminate the utility incentive to promote higher consumption of electricity or natural gas, which is antithetical to the state policy goals in New Jersey provided for in the CEA.

Decoupling allows everyone to work together to maximize EE savings, which is the ultimate intent of the CEA.

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?

Decoupling naturally accounts for all increases or reductions in sales regardless of the reason, and therefore alleviates the need to calculate lost revenues each year. Because decoupling is indifferent to the source of increase or decline in sales, it transparently allows recovery of only the Board authorized revenues, and nothing more or nothing less. Moreover, if sales increase due to economic growth, electrification of transportation, or for other reasons, this growth is likewise fully captured by decoupling, to the benefit of ratepayers. Further, decoupling mechanisms are reset after every base rate case, enabling regulators to properly reset the authorized revenue components.

As an alternative, LRAM would require annual impact evaluations for every measure and program to accurately quantify the energy savings driving lost revenue requests. This process often becomes an administrative burden for regulators and utilities because every showing of lost revenue recovery can become a prolonged litigated process over the correct energy savings estimate. Full revenue decoupling avoids this issue entirely by simply ensuring utilities only recover Board authorized revenues, regardless of the measured energy savings from EE programs.

ii. Should other factors (e.g., weather, nonprogram-related reductions) be taken into account?

Under a decoupling policy, these factors are naturally captured and will not be relevant points of contention because the mechanism trues-up utility revenues based on Board authorized revenues. If the summer is unseasonably hot and electric sales are drastically increased, the revenue captured from the additional sales would be adjusted with the decoupling mechanism. Customer consumption reductions would also be captured through a decoupling mechanism, regardless of if

[7] https://aceee.org/state-policy/scorecard

the reductions were related to the utility or statewide EE programs or some other reason (federal appliance standards for example).

Under an LRAM policy, these factors are not naturally captured and would be subject to protracted litigation. The CEA allows utilities to count non-program reductions to meet goals; therefore, it is logical that utilities would be allowed to make a showing that non-program reductions are lost revenues and should be recovered. Without decoupling this can become a burdensome process because of the contested nature of measuring non-program related reductions.

It is worth noting that the Board has a long-standing precedent of supporting weather normalization of sales with all of the State's natural gas utilities having such recovery mechanisms in place for more than two decades. Weather normalization is an equitable practice that insulates both utilities and their customers from uncontrollable variations in weather and should remain intact or be incorporated into a decoupling mechanism.

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

Authorized return on equity for utilities' distribution investments is established during the base rate case process. A part of the return on equity evaluation is a review of peer utilities to determine risk and the appropriate levels of return, but also includes other key drivers such as market volatility and the proper level of return necessary to attract capital to finance investment. The impact of decoupling on utility risk and return on equity will be captured in this process. Since the establishment of authorized return on equity is based upon numerous factors, it is appropriate that it continue to be determined in the rate case process.

4. Topic 3: Performance Incentives and Penalties

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

The incentive and penalty structure should be simple and trued-up on an annual basis and should send a clear and measurable financial signal that encourages utilities to aggressively pursue EE results. However, without understanding the metrics against which incentives and penalties will be assessed, it's difficult to provide further specific detail on the magnitude of incentive and penalty amounts. In addition, the issue of whether the utilities or the OCE will administer programs has a significant bearing on the penalty/incentive discussion. Performance incentives and penalties should be provided in addition to, and not in lieu of, the other market design elements discussed above, including amortization of costs and decoupling.

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

It would be simplest and most effective to set incentives and penalties as a specific dollar amount. This could be based upon a percentage of program costs or a fixed $/unit value. Tying to a dollar

value provides transparency regarding the value of incentives and penalties and sends clear signals to utilities on what the exact reward or loss is for performance.

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

Yes; however, the Board should consider using a "dead band" or collar around specific performance milestones. Performance incentives are designed to reward utilities that exceed goals; likewise, the penalties are designed to provide a disincentive to ignoring the state mandates or running programs poorly. Small variations in performance around the goal, which can occur for reasons beyond a utility's control, should not be the difference between a penalty or incentive. A "dead band" or collar would alleviate this concern.

A scalable incentive will promote utilities to strive to maximize savings rather than to simply meet goals. Because the Board wants utilities to endeavor for the greatest possible savings, it should implement a scalable incentive. Penalties should be used to assure that all utilities are fully invested in meeting the goal and should be implemented to insure a minimum level of activity.

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

Incentives and penalties should be included as a line item in the revenue requirement calculation for each utility's EE surcharge. To the extent an incentive is awarded, it would increase the revenue requirement by the approved amount; to the extent a penalty is assessed, it would be a decrease to the revenue requirement by the assessed amount.

In that way, penalties are refunded to ratepayers. If a utility is awarded an incentive, it is indicative of the fact that the utility is exceeding its EE savings goals, meaning that its customers are achieving savings above those set by the Board.

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

The incentive or penalty should send a clear and measurable financial signal that encourages utilities to aggressively pursue EE results. The EE Potential Study conducted by Optimal Energy proposed an incentive between 5% and 7.5% of the planned and approved program budgets. On a preliminary basis, this range seems reasonable. Further evaluation and determination of the appropriate level on incentives and penalties should be set in each utility filing anticipated to be submitted in the summer of 2020.

Conclusion

Gabel Associates appreciates the opportunity to furnish these comments and provide the Board with insight into issues related to EE cost recovery.

As discussed above, it is imperative that the Board align all stakeholders to meet the strong goals set forth in the CEA, and this can only be done by amortizing program costs over the weighted-

average measure life of the EE portfolios, decoupling utility distribution revenues from sales volumes, and implementing incentive and penalty structures that are simple and provide clear signals to maximize energy savings.

We are happy to provide any supplementary information or answer any questions you may have regarding our comments. We look forward to continuing the open stakeholder process.

Sincerely,

Isaac Gabel-Frank
Vice President
Gabel Associates

Appendix B

Comments of
Gabel Associates on the December 3, 2019
Second Energy Efficiency Cost Recovery Technical Meeting

January 3, 2020

Aida Camacho-Welch
Secretary of the Board
Board of Public Utilities
44 S Clinton Ave 9th Floor
Trenton, New Jersey 08625

Comments of Gabel Associates on the Second Energy Efficiency ("EE") Cost Recovery Technical Meeting

Dear Secretary Camacho-Welch;

Gabel Associates, Inc. ("Gabel Associates" or "Gabel") is pleased to provide comments regarding the second EE Technical Meeting focused on Cost Recovery, which occurred on December 13, 2019. Our comments to the first EE Technical Meeting focus on Cost Recovery, which occurred on October 31, 2019, contained extensive discussion on each of the topics subsequently discussed in the second EE Technical Meeting focused on Cost Recovery. Our comments to the first EE Technical Meeting focused on Cost Recovery have been provided as an attachment to these comments for your convenience.

Following the second EE Technical Meeting focused on Cost Recovery on December 13, Board of Public Utilities ("BPU") Staff provided four (4) cost recovery scenarios for stakeholder comment. These comments focus primarily on the details of these four cost recovery scenarios, but also provide some general observations which were largely addressed in our reply comments to the first EE Technical Meeting focused on Cost Recovery.

Gabel Associates is an energy, environmental and public utility consulting firm with its principal office located in Highland Park, New Jersey. For over 25 years, Gabel Associates has provided quality energy consulting services and strategic insight to its clients. Classified as a small business, the firm provides its expertise to a wide variety of clients involved in virtually every sector of the energy industry, including public and federal agencies, individual commercial and industrial end users, aggregated groups of customers, public utility commissions, power plant owners and operators, wholesale suppliers, and utilities. The firm frequently provides expert testimony and reports on utility ratemaking issues throughout the country.

Our recent work in New Jersey has included assisting several of the State's electric and natural gas utility companies develop and design cost effective energy efficiency ("EE") programs. Specifically, we have worked or are currently working on EE related activities with Atlantic City Electric Company ("ACE"), Public Service Electric and Gas Company ("PSE&G"), Elizabethtown Gas Company ("Etown"), New Jersey Natural Gas Company ("NJNG"), and South Jersey Gas Company ("SJG"). It is our understanding that these companies will file supplemental comments as well.

Gabel Associates also provides extensive consulting services to customers in New Jersey including hundreds of school districts, counties, and business customers, as well as services to utility commissions and wholesale market participants. Because of the breadth of sectors where we provide our services, we have a deep and balanced sensitivity to the needs of all types of energy market participants. The principals of Gabel Associates include two individuals who served as senior managers at the BPU where they were both extensively involved in utility ratemaking, cost of service, and tariff design issues.

This set of comments focuses on three components: (1) reactions to the scenarios tendered by the BPU; (2) suggestions on a preferred cost recovery design to maximize EE achievement and protect ratepayers; and, (3) a discussion of other issues regarding cost recovery.

1. Prescribed BPU Cost Recovery Scenarios

At the second EE Technical Meeting focused on Cost Recovery BPU Staff provided two cost recovery scenarios and requested stakeholder input on the proposed solutions. Following that meeting, BPU also provided two additional scenarios for review by stakeholders. This section provides an overview of each scenario, as well as our comments on the reasonableness of the proposed scenarios. We do not address incentives/penalties as more information is needed to undertake such an analysis.

a. BPU Staff Scenario 1

Asset / Investment Treatment	Expense
Recovery Period	Annual
Lost Revenues	No Decoupling
Incentives/Penalties	% of Savings (Weighted by QPI Performance) / $ for Negative Benefits (Weighted by QPI Performance)
Carrying Cost on Over/Under Recovery	T-Bill
WACC	None
Rate Cap	2% annual increase of total customer bill

Scenario 1 illustrates a set of cost recovery elements that would severely restrict achieving the goals of the Clean Energy Act ("CEA"). Expensing program costs is problematic for three reasons: (1) the bill impacts of program recovery are very high in the early years because all costs would be recovered in a single year instead of spreading them across multiple years; (2) expensing costs disconnects benefits and costs – amortization would match cost recovery with receipt of benefits; and, (3) expensing costs without allowing utilities to earn a return on investment places EE investments at a financial disadvantage against traditional utility investments, which may result in capital allocations to other projects with higher earnings opportunities. Also, there is clear legislative intent supporting utilities ability to earn a return on these investments. EE initiatives are an alternative to investing in traditional assets and yield environmental and customer benefits. The rate recovery mechanism should not act as a disincentive.

In terms of lost revenue recovery, a scenario without decoupling does not remove the throughput incentive for utilities (i.e. the financial incentive to increase utility throughput as that will increase revenues and earnings), and encourages a culture of promoting higher sales, which is counter to the State policy goal of reducing energy consumption. Finally, a scenario without decoupling (or a lost revenue adjustment mechanism) is counter to the provisions in the CEA which explicitly allow utilities to recover lost revenues from programs.

The 2% rate cap will place a significant limit on EE spending, which will restrict the available energy savings opportunities. This is further compounded in a scenario that relies on expensing program costs in a single year. If BPU considers implementing a rate cap, it will likely need to reduce the energy savings targets as a cap will not allow the State to spend the necessary money to meet the goals and realize the associated benefits.

Most stakeholders active in the discussion at the December 13, 2019 Technical Meeting expressed concern that this Scenario would not achieve the desired outcome of the CEA.

b. BPU Staff Scenario 2

Asset / Investment Treatment	Amortization
Recovery Period	Weighted-Life
Lost Revenues	Full Decoupling
Incentives/Penalties	Fixed Dollar Incentive/ Fixed Dollar Penalty (Thresholds related to QPI performance)
Carrying Cost on Over/Under Recovery	2 Year T-Bill + 60bps
WACC	Base Rate Case
Rate Cap	No Cap

Scenario 2 contains critical elements that would foster an environment of EE achievement and priority for customer savings while protecting ratepayers. Amortization of costs at the WACC not only reduces rate shocks associated with single year expensing, but also aligns EE with traditional utility investments providing financial incentives (in conjunction with decoupling) for utilities to achieve the energy savings targets. In addition, by amortizing over the weighted average measure life, there is a matching of costs and savings.

Full revenue decoupling also provides ratepayer protections because it only allows utilities to earn authorized revenues.[1] In a scenario with a lost revenue adjustment mechanism (partial decoupling) and higher than average sales due to weather or other reasons, utilities will have significant opportunity to earn higher than authorized revenues and returns. This occurs because any time actual sales exceed authorized billing determinants, utilities recover above revenues authorized in their previous rate case. Full revenue decoupling effectively adjusts the billing determinants so

[1] Authorized revenues are set in a base rate case and represent the approved pro forma revenue requirement meant to capture all plant in service depreciation expense and other costs.

that only authorized revenues are recovered.[2] This protects customers from potential over recovery and allows utilities to remain financially healthy and avoid revenue erosion caused by sales losses. This Scenario is highly preferred as the approach to achieve the goals in the CEA, unlock the potential of EE in New Jersey, and protect ratepayers.

c. BPU Staff Scenario 3

Asset / Investment Treatment	Amortization
Recovery Period	Weighted-Life
Lost Revenues	Limited Decoupling
Incentives/Penalties	% of return (Weighted by QPI performance)
Carrying Cost on Over/Under Recovery	2 Year T-Bill
WACC	Base Rate Case
Rate Cap	No Cap

Scenario 3 is similar to Scenario 2, with the only difference being limited decoupling and a different incentive/penalty structure. It is unclear what BPU Staff means in its reference to the term "limited decoupling". This term could mean the use of a Lost Revenue Adjustment Mechanism ("LRAM") that requires periodic filings and calculation of all EE savings, or it could mean decoupling utility revenues from sales for some items but not others. Implementation of an LRAM is not preferred as it provides non-symmetric recovery of lost revenues and is administratively burdensome and the filing process is often contentious. Limiting decoupling to only certain aspects can also be very complicated and does not fully eliminate the throughput incentive faced by utilities. This uncertainty surrounding the meaning of limited decoupling makes it difficult to evaluate this scenario – however, many of the factors in this scenario support a dynamic EE marketplace in New Jersey and could be included in a workable configuration of cost recovery elements (utility decoupling is a preferred approach to assure that utilities are "all-in" on promoting EE).

d. BPU Staff Scenario 4

Asset / Investment Treatment	Amortization
Recovery Period	10 Years
Lost Revenues	No Decoupling
Incentives/Penalties	% of return (Weighted by QPI performance)
Carrying Cost on Over/Under Recovery	2 Year T-Bill + 60bps
WACC	Base Rate Case less 200BP
Rate Cap	3% annual increase of total customer bill

As with Scenario 1, Scenario 4 provides for no recovery of authorized revenues which are lost due to the implementation of EE. The comments regarding decoupling noted under Scenario 1 are equally applicable to Scenario 4 as well. This approach creates a perverse incentive for utilities because it threatens the ability of utilities to recover previously authorized expenses to maintain

[2] There are many forms of decoupling. For example, two gas utilities in New Jersey have a margin per customer model which establishes a baseline usage per customer and margin rates in periodic rate cases and adjusts sales for current customers to that baseline use per customer.

the safety and reliability of electric and gas distribution systems. The perverse incentive would encourage utilities to not invest in EE in order to avoid financial harm.

A structure without decoupling or lost revenue recovery also does not foster a culture of energy reduction at utilities, which is necessary for the wholesale sea change required to promote EE in New Jersey to meet the goals. As noted earlier, it is also inconsistent with the legislative intent of the CEA and the RGGI legislation.

Scenario 4 contains an arbitrary 10-year recovery period that is not directly linked to any depreciation or useful life measure. To the extent 10-years closely matches the weighted average measure life of the proposed EE portfolio it would be an appropriate recovery period; otherwise, it does not align costs with measure life and savings. Any adjustment of the WACC should also be considered in the context of the larger base rate process in which there are numerous factors considered when establishing utility rate of return. As such, this scenario would limit the utility's ability to reach CEA goals due to the financial harm caused from lack of lost revenue recovery and reduced interest in investing in substandard returns below that established in the base rate case.

2. Explanation of the Preferred Cost Recovery Scenario

The following sets forth an alternative scenario that would marshal all the State's resources toward achieving the goals of the CEA and would protect ratepayers. It would provide a strong signal to the market that investing in EE is a priority and would assure that all entities are incentivized to work toward the same singular objective – saving customers energy and money.

Asset / Investment Treatment	Amortization
Recovery Period	Weighted-Average Measure Life
Lost Revenues	Decoupling
Incentives/Penalties	TBD
Carrying Cost on Over/Under Recovery	Commercial Paper Rate
WACC	Base Rate Case
Rate Cap	No Cap

Each of the preferred cost recovery elements summarized above is explained in more detail below.

a. Asset / Investment Treatment

EE program investments should be amortized to prevent rate shocks and align costs with benefits.

b. Recovery Period

Amortization of EE program investments should occur over a period commensurate with the weighted-average useful life of the measures contained within the EE portfolio. This will properly align the recovery of costs with the realization of energy savings. Shorter recovery periods will result in larger rate shocks for customers and inequity between those saving energy and those paying for the EE measures.

c. Lost Revenues

Authorized base rate revenues should be fully decoupled as to remove the financial disincentive of reducing utility throughput and provide consumer protections against utility over recovery of revenues. This will assure that utilities are able to fund authorized base rate investments, and also insulate ratepayers from overcollection due to load growth, which could occur as a result of building electrification or electric vehicle proliferation. Full decoupling of authorized base rate revenues should be accompanied by consumer protections, such as earnings reviews, to provide additional transparency to the process and assure utilities do not earn above the authorized limits.

Decoupling is recognized as a leading mechanism to promote EE investments. As of January 2019, there are 26 states that have adopted decoupling for 64 gas utilities and 17 states that have adopted decoupling for 42 electric utilities. This is an increase from 2013, when 49 gas utilities in 20 states and 24 electric utilities in 14 states had decoupling in place.[3] In fact, even consumer friendly states and EE leaders such as New York, Massachusetts, and Rhode Island have decoupling mechanisms in place. Two utilities in New Jersey also already implement a form of decoupling in place for approximately 13 years and successfully implemented programs and protected ratepayers. This should be furthered to the balance of the State to assure all customers are benefiting from the advantages of decoupling.

d. Incentives/Penalties

As discussed in more detail below, incentives and penalties must be simple in order to provide clear signals towards preferred performance. In addition, it is vital that a 'dead-band' exist around the set goal value as to not reward or penalize fluctuations in performance out of the control of utilities. Given the challenges that face any energy efficiency programs during times of transition, the 'dead-band' should be wide enough to allow for performance toward CEA goals to be evaluated in the initial years. The exact incentive and penalty structure cannot be determined without first understanding the quantitative performance indicators that will be used to assess performance.

e. Carrying Cost on Over/Under Recovery

Carrying costs should be equal to actual utility carrying costs. At present, this is typically equal to the commercial paper rate.

f. WACC

The weighted average cost of capital is accepted cost of utility money and should be used for EE investments. Using the same WACC for EE investments and traditional utility investments puts EE on a 'level playing field' with traditional investments to help further incentivize the installation of EE in the state.

[3] Gas and Electric Decoupling. Natural Resource Defense Council. nrdc.org/resources/gas-and-electric-decoupling.

g. Rate Cap

Placing a cap on total customer bills will direct limit the ability of EE programs to achieve the goals set forth in the CEA. There are numerous benefits of EE that go beyond a simple bill or rate analysis and must be considered when evaluating EE. However, rate caps are one form of customer protection that may be included in a decoupling mechanism to limit decoupled collections.

3. Other Issues

Several key issues related to the components included in the cost recovery scenarios warrant further discussion and are highlighted below.

a. Performance Incentives

Performance incentives and penalties are one of several components of cost recovery under discussion in this stakeholder process. However, it is difficult to conduct detailed discussions about a cost recovery "package" when the details of performance incentives are undefined and unknown. That is, it is important that the "full package" be known and understood in order to judge its reasonableness. The four scenarios above contemplate general approaches to performance incentives and penalties, but the details of each approach are critical to understand the magnitude of this element of the cost recovery discussion.

The most significant undefined and unknown question related to performance incentives is related to the quantitative performance indicators ("QPIs"). The performance incentives and penalties would be issued based on the performance to the QPIs, but these are either unknown or undefined as of now. On Friday December 20, the BPU released a straw proposal for program administration, which proposed the following QPIs:

1. Annual energy savings
2. Annual demand savings
3. Lifetime energy savings
4. Lifetime of persisting demand savings
5. Utility cost test net present value of net benefits
6. Low income lifetime savings
7. Small business lifetime savings

These metrics are a good starting point, but the details are undefined. For example, to consider performance incentives, it will be necessary to understand several key questions, such as:

1. How will targets for each metric be established and updated?
2. How will performance be measured for each metric?
3. How frequently will the targets be assessed?
4. What the schedule is for recovery of rewards or penalties? Will it be in a single year or over a multiple year period?

There are also many other questions that are undefined related to the performance incentives. For example, for an adjustment to return on equity, what is the size of the adjustment? Would it be only applied to energy efficiency investments or to other authorized revenues as well? For the other two approaches (fixed dollar recovery and percentage of savings), how will the incentive pool be established? Will utilities be forecasting recovery of incentives in cost recovery mechanisms and then truing up based on actual results, or just recovering or returning dollars based on the results of the performance review.

Until the factors related to the QPIs and other targets are understood, it is premature to determine any performance incentive mechanism.

b. Rate Caps

Rate caps on total customer bills are an inexact tool that can disrupt the ability to achieve energy savings targets and reduce program performance. The CEA requires that all EE programs be cost-effective – therefore, rate caps may limit the delivery of cost-effective energy savings and carbon emissions reductions to New Jersey residents and businesses. The implementation of rate caps also produces perverse incentives for program implementers because the focus shifts from deeper energy savings to only trying to capture low cost first year savings that do not have a lasting impact. Because of this effect, rate caps will also make it difficult for utilities to meet the lifetime energy, demand, and program specific targets outlined in the proposed QPIs.

In addition, low-income programs are often the most expensive and could be severely limited as a result of capping customer rates or costs. Further, rate impacts are a key element of the minimum filing requirements, and the appropriate rate increase (if any) can and often is debated and determined in the filing process. As such, the program impacts on customer rates should be considered by the BPU in approving programs, not arbitrarily outside the context of reviewing a specific program plan.

Conclusion

Gabel Associates appreciates the opportunity to furnish these comments and provide the Board with insight into issues related to EE cost recovery.

We are happy to provide any supplementary information or answer any questions you may have regarding our comments. We look forward to continuing the open stakeholder process.

Sincerely,

Isaac Gabel-Frank
Vice President
Gabel Associates

Jersey Central Power & Light
A FirstEnergy Company

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February 6, 2020

VIA ELECTRONIC MAIL ONLY

Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, New Jersey 08625
EnergyEfficiency@bpu.nj.gov

Re: Cost Recovery Mechanism Comments

Dear Secretary Camacho-Welch:

On behalf of Jersey Central Power & Light Company ("JCP&L" or the "Company"), please accept this letter for filing as JCP&L's Comments on the energy efficiency ("EE") cost recovery mechanism straw proposal issued by the Staff of the New Jersey Board of Public Utilities ("Board" or "BPU") on January 22, 2020 (the "Proposal"). JCP&L thanks the Board for the opportunity to provide these comments.

A. The Board should promote greater flexibility by allowing each utility to propose a cost recovery framework that supports its offering of EE programs.

JCP&L appreciates the work that Board Staff has undertaken to develop the Proposal and Staff's interest in providing for a uniform cost recovery framework to aid in New Jersey's EE transition. However, JCP&L is concerned that a single mandated uniform approach to cost recovery (such as the one set forth in the Proposal) will result in the foregoing of numerous benefits associated with allowing each utility to propose its own framework for cost recovery in the context of a proceeding to establish its EE programs. These benefits include allowing each utility the flexibility to propose a cost recovery framework that will best support its offering of EE programs and providing stakeholders with the opportunity to evaluate each utility's proposed framework within the context of the utility's proposed program portfolio. Allowing each utility to propose the cost recovery mechanism for its programs will also provide the Board with an opportunity to experiment with various approaches to cost recovery for EE programs.

The Board allowing each utility the opportunity to propose its own cost recovery mechanism is also consistent with the language and intent of the Clean Energy Act (codified in relevant part as N.J.S.A. 48:3-87.9). The Clean Energy Act provides that "[e]ach electric public utility and gas public utility shall file annually with the board a petition to recover on a full and current basis through a surcharge all reasonable and prudent costs incurred as a result of [EE] programs and peak demand reduction programs required pursuant to this section . . ." N.J.S.A.

48:3-87.9(e)(1) (emphasis added). This provision requires that each utility make an annual filing for the recovery of its reasonable and prudent costs "on a full and current basis through a surcharge." As such, the Clean Energy Act clearly permits the expensing of program costs on an annual basis by each utility, as demonstrated by its recovery filing. In stark contrast, the Proposal mandates that each utility recover all program costs (other than those related to operations and maintenance) over a seven-year period. By mandating a specific form of cost recovery, especially one that does not provide for "full and current" recovery of a utility's EE program costs,[1] the Proposal violates the Clean Energy Act's mandate.

At minimum, the Board should provide each utility the option to file for recovery on a full and current basis through a surcharge if that is their preferred recovery approach. Alternatively, if the Board requires an amortization period for the recovery of certain EE program costs, it should also allow each utility flexibility to propose an amortization period that is appropriate considering the size and scope of its proposed programs. This will allow the Board to better tailor the solution to its concerns about rate impacts to each utility's customers and EE needs.

While the Company appreciates the work that Staff has undertaken to develop the Proposal, JCP&L continues to recommend that the Board not forego the benefits described above by prescribing a specific cost recovery mechanism. Instead, consistent with the language and intent of the Clean Energy Act, the Board should allow each utility the opportunity to propose a cost recovery framework as part of its initial EE program filing.

B. Board Staff should clarify what it deems to be operations and maintenance costs for the utilities' EE programs.

The Proposal distinguishes between the cost recovery treatment for what it describes as "program investments" and expenditures incurred for operations and maintenance. For "program investments," the utilities would be required to amortize those costs for recovery over a seven-year period. However, the utilities would be permitted to recover expenditures incurred for operations and maintenance contemporaneously. From the context of the Proposal, however, it is not clear which EE-related expenses would fall into each category. JCP&L respectfully requests that Board Staff clarify the specific costs that constitute "program investments" and the specific costs that constitute operations and maintenance expenditures in the context of the utilities' EE program offerings.

C. The EE risk environment does not support Board Staff's proposed 200 basis point reduction in each utility's return on equity for EE programs.

The Proposal requires that EE program costs (other than those related to operations and maintenance expense) be amortized for recovery over a seven-year period. The Proposal goes on to clarify that "[t]he carrying cost for these investments will utilize the capital structure established in each utility's most recent base rate case, incorporating both (a) the cost of debt and (b) the

[1] Indeed, the Proposal recognizes that the proposed recovery mechanism does not allow for current recovery of all of a utility's EE program costs, stating "[T]here is inherent reduction in risk associated with contemporaneous recovery available in this mechanism, where utilities are recovering a portion of costs as they are being incurred . . ."

[ROE] less 200 basis points." Staff reasons that "[t]here is an inherent reduction in risk associated with the contemporaneous recovery available in 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." Staff further argues that "[t]he energy efficiency programs are also less risky than traditional infrastructure investments found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful." Finally, Staff concludes with its belief that "[i]f these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced."

As JCP&L has detailed in prior comments, the Proposal's assertion that EE investments are inherently less risky than other investments is not supported by the EE risk environment. The utilities are essentially being ordered to implement a different business model by investing in EE and PDR programs instead of utility infrastructure and operations. And, further, the utilities are being tasked with achieving some of the most aggressive energy savings goals in the country and may be subject to penalties (reducing the ROE even more) based on program performance. As a result, there is increased executional risk in implementing EE programs. The results of EE programs are also much more dependent on actions of consumers and, accordingly, the utilities have less control over the success or failure of the investment as compared to traditional utility infrastructure investments. Additionally, many of the business risks associated with investing in EE programs are also comparable to the risks associated with investing in utility infrastructure and operations. As addressed in more detail below, the utilities also face increased risk as a result of the "EE as a Resource" requirement contemplated by the Proposal. Finally, and perhaps most importantly, the utilities' underlying cost of capital does not change as a result of the investment being made in EE programs rather than in utility infrastructure. Rather, the utility's cost of financing these investments will continue to be its Weighted Average Cost of Capital ("WACC"), as determined in its most-recent rate case. As a result, the utilities will not be made whole for the reasonable and prudent costs that it is incurring for its EE programs unless the carrying cost on any unrecovered balance is at their WACC. Board Staff's belief that the utilities' ROEs would be lower if these EE investments were accounted for in rate base is unsupported and without merit.

Moreover, Staff's reasoning that a reduction is warranted because recovery is through a surcharge (instead of base rates) is flawed for several reasons. First, the Proposal allows for contemporaneous recovery of only a portion of each utility's EE program costs as opposed to the "full and current" recovery of all reasonable and prudent EE program costs as contemplated by the act. Second, the Clean Energy Act permits adjustments to a utility's ROE on EE investment only in the event of an incentive and/or penalty issued pursuant to the act and not because of some generalized belief that a utility's ROE would be different if these costs were included in base rates. *See* N.J.S.A. 48:3-87.9 (e)(4). Third, and finally, the Clean Energy Act provides that any such adjustments "shall not be included in a revenue or cost in any base rate filing and shall be adopted by the board pursuant to the 'Administrative Procedure Act.' *Id.* As such, the Clean Energy Act makes clear that the consideration of how these costs would impact the utility's overall ROE (if at all) is not appropriate.

For these reasons, Board Staff should reconsider, and the Board should ultimately refuse to adopt, the proposed 200 basis point ROE reduction on the utilities' investments in EE programs.

D. Utilities should be permitted lost revenue recovery based on the revenue impact of lost sales resulting from gross energy efficiency savings.

In the Proposal, Board Staff recommends that utilities "be able to recover lost revenues in the amount that they can demonstrate attributable to the utility-run energy efficiency and peak demand reduction program(s)." The Proposal also provides that lost revenues will be reviewed and recovered annually. The proposed mechanism is inconsistent with the Clean Energy Act, which contemplates that the gross savings from all EE programs offered in the State will be eligible for lost revenue recovery.

The Clean Energy Act provides that:

> Each electric and gas public utility shall file annually with the board a petition to recover on a full and current basis through a surcharge all reasonable and prudent costs incurred as a result of energy efficiency programs and peak demand reduction programs required pursuant to this section, including but not limited to . . . the revenue impact of sales losses resulting from implementation of the energy efficiency and peak demand reduction schedules . . . N.J.S.A. 48:3-87.9(e)(1).

To implement this provision in accordance with language and intent of the Clean Energy Act, JCP&L recommends that the Board calculate lost revenues associated with energy savings by using the verified gross savings resulting from all programs implemented under the Clean Energy Act – not just those run specifically the utility. The revenue impact of these programs can then be determined by multiplying the amount of these verified lost sales by the applicable retail rate that would have applied. This is the true revenue impact of lost sales resulting from the EE programs being implemented under the Clean Energy Act and should be recoverable by the utilities.

The Proposal also recommends that the Board require the utilities to pass an "earnings test" to receive recovery of their lost revenues. Requiring the utilities to pass such an earnings test is inconsistent with the Clean Energy Act, which recognizes the revenue impact of lost sales as a reasonable and prudent cost of the State's EE program offerings. The Board should refuse to consider such a proposal.

E. The Proposal's incentive and penalty mechanism is not linear, and the Board should consider alternative options.

The incentive mechanism set forth in the Proposal is inconsistent with the Clean Energy Act. In the Proposal, Board Staff recommends an incentive mechanism that can be summarized as follows:

- Carrying cost on unrecovered costs is the utility's cost of debt plus ROE less 200 basis points;
- For Quantitative Performance Indicator ("QPI") achievement between 50-90%:

    - ROE on EE investment scales linearly downward to zero;
- For QPI achievement between 110-150%:
    - ROE scales linearly upward to the ROE determined in the utility's most recent base rate case;
- For QPI achievement less than 50%:
    - Utility is assessed penalty of 0.75% of the base distribution revenue in the previous year.

As an initial matter, the incentive mechanism recommended in the Proposal is not an incentive at all. Rather, it's merely an opportunity for the utility to earn back all or a portion of its BPU-approved WACC on these investments. As discussed above, a utility's WACC will be its cost of making these investments in the first instance and the utility is accordingly entitled to recovery at its WACC based on the Clean Energy Act. Thus, the proposed "incentive" mechanism should be reconsidered.

The proposed penalty mechanism similarly does not comply with the Clean Energy Act. The act states that "adjustments [*i.e.* incentives and/or penalties] made pursuant to this subsection may be made through adjustments of the electric public utility's or gas public utility's [ROE] related to [EE] or peak demand reduction programs only, or a specified dollar amount, reflecting the incentive structure as established in this subsection." N.J.S.A. 48:3-87.9(e)(4) (emphasis added). Accordingly, the act permits two alternatives for the Board to provide incentives and penalties: (1) an adjustment to the ROE on EE investments; or (2) a specified dollar amount. The Proposal's mechanism, however, utilizes both a ROE adjustment and a dollar penalty. This is not permitted under the terms of the Clean Energy Act.

As discussed in prior comments, JCP&L recommends that the Board consider an incentive mechanism modeled after shared savings mechanisms utilized in other jurisdictions that support efforts to maximize net program benefits. The performance incentives under a shared savings mechanism can be scalable using a tiered structure tied to the percentage attainment of the QPIs, similar to the following table. With a top incentive percentage of fifteen percent (15%) of net benefits, customers would be ensured to receive no less than eighty-seven percent (85%) of the net benefits generated by the programs. This tiered structure aligns the interests of the utilities with the interests of customers as it incents the utilities to maximize program savings and minimize program cots in order to maximize the programs' net benefits to customers. If necessary, the Board can also impose a cap on the total amount of incentive the utility is allowed to recognize based on its annual performance. The Board should also keep in mind that it has authority under the Act to set QPIs at "reasonably achievable" levels, including at levels below the minimum annual savings contemplated by the Act. It is common industry practice when using a shared net benefit mechanism (such as shared savings) to provide incentives by rewarding achievement of threshold savings that are below statutory savings targets. Consistent with the above, the utilities recommend that the Board adopt QPIs and an incentive mechanism that allows utilities to begin receiving incentives once a certain threshold percentage of their savings targets (>80%) are achieved.

Incentive Tier	Compliance Percentage	Incentive Percentage
1	>80-100%	3.0%
2	>100-105%	5.0%
3	>105-110%	7.5%
4	>110-115%	12.5%
5	>115%	15.0%

Finally, JCP&L recommends that the Board consider adopting a penalty structure that gives it discretion to determine when to assess a penalty and the just and reasonable amount of any penalty taking into account the utility's incentive structure and the specific circumstances contributing to non-compliance. This approach is consistent with the Clean Energy Act's mandate that the Board consider appropriate factors to "ensure that the public utilities incentives or penalties . . . are based upon performance" (*see* N.J.S.A. 48:3-87.9(c)) and can address concerns that factors outside the utilities' control may influence their ability to achieve aggressive targets.

F. The Board should consider a revenue sharing mechanism for the use of EE as a capacity resource.

At the end of the Proposal, Board Staff recommends that the utilities be required to "use their best efforts to register, nominate, and/or bid each year's expected megawatt ("MW") reduction resulting from the [EE] programs into any and all PJM market(s) and/or programs for which the [EE] transition program(s) are eligible during the life of the [EE] transition program(s)." JCP&L has previously encouraged the Board to adopt a PJM revenue sharing mechanism, whereby customers receive a potion of the revenues from PJM reliability pricing model auction activity for qualified EE and peak demand reduction resources. Accordingly, JCP&L supports the concept of using EE as a resource as envisioned by the Proposal.

However, the Board should recognize that the utilities face increased risks by participating in such a venture. As the entity bidding in the projected savings from their EE programs into the PJM market, the utilities are responsible for delivering the resources. If they do not materialize, the utilities would be responsible for either purchasing the resources or paying penalties. Through its cost recovery mechanism, and in recognition of this risk, a utility should be made whole for any costs it incurs by covering such a shortfall and should also be permitted to receive a percentage of the revenues resulting from the PJM reliability pricing model auction activity.

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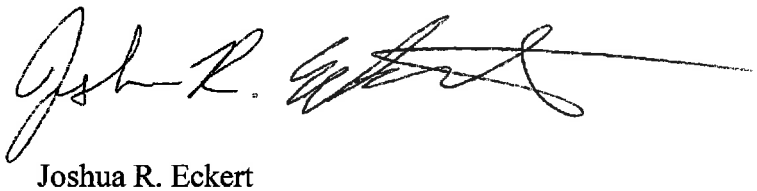
JCP&L again thanks the Board for the opportunity to provide these comments. Please do not hesitate to contact me if you have any questions.

Very truly yours,



Joshua R. Eckert
Counsel for Jersey Central Power & Light Company

New Jersey Energy Efficiency Transition—Staff Proposal for Cost Recovery

Comments of the New Jersey Large Energy Users Coalition

February 6, 2020

The New Jersey Large Energy Users Coalition ("NJLEUC") appreciates the opportunity to provide these comments regarding Staff's Draft Proposal for Cost Recovery in the Energy Efficiency Transition stakeholder process.

NJLEUC congratulates staff for producing a proposal that represents a viable and properly balanced solution to utility cost recovery for energy efficiency initiatives undertaken pursuant to the Clean Energy Act ("CEA"). To insure the success of these programs, it is critical that a proper balance be struck between utility cost recovery and financial incentives on the one hand and the cost reduction benefits actually obtained by customers to incentivize them to participate in the programs on the other. NJLEUC believes the Draft Proposal achieves this delicate balance and we strongly support it.

At the end of the day, it is vitally important that ratepayers receive an appropriate share of the savings that result from the State's energy efficiency initiatives. Given the broad range of financial benefits, regulatory perks and incentives sought by certain utilities in this proceeding, there is reason to doubt whether ratepayers would be left with a fair share of the anticipated savings if the utilities get what they seek.

It is an old adage that "it takes two to tango" and this thought applies with full force to the Board's proposed energy efficiency and conservation initiatives. These stakeholder proceedings tend to focus largely on what utilities purport to require to "align their interests" with the State and secure their cooperation with OCE programs and CEA initiatives. However, to state the obvious, for the State's aggressive energy conservation goals to be achieved, it is essential to assure ratepayer buy-in. For the energy efficiency programs at issue to be considered "successful", customers must significantly reduce their energy consumption. To achieve this result, those same customers must also receive clear and tangible benefits to align *their* interests with these programs and secure their active participation in them.

Ratepayers will have every right to ask "where's the beef?"—i.e. what makes participation in energy efficiency projects worthwhile for them? If there isn't a good answer to that question from the customer's perspective, they will not participate. Many ratepayers simply lack the disposable income or resources to engage in transactions that do not provide a clear and quantifiable financial reward and will not do so, regardless of how much they otherwise support climate change initiatives. This has certainly been the case in the past. In the absence of customer buy-in, the State's energy conservation goals will not be achieved and the utilities will be penalized for non-performance under the CEA. Ironically, under the general decoupling regime sought by the utilities, in these circumstances ratepayers could be rewarded with a future rate cut if their collective non-participation results in increased energy usage on the utility systems. Such a

result—which could easily occur if cost recovery and incentives are not handled properly--is in the interest of no one and must be avoided.

In this stakeholder group and elsewhere, certain utilities have demanded a cornucopia of financial and regulatory perks supposedly needed to align their interests with the OCE and CEA programs. These utilities have set a very high bar for their cooperation, demanding that they receive, among other things, accelerated cost recovery, a return of and on their considerable investments, a high return on equity that does not reflect the low-risk nature of these investments, administrative and management fees, and a "general" form of rate decoupling that would credit the utilities for all reductions in usage on their systems, whether or not caused by the utility's energy efficiency efforts. Under such a general decoupling regime, the utilities would be fully credited for declines in energy usage associated with, among others, economic downturns, changed weather patterns, customer migration, business closures, bankruptcies, customer self-directed conservation efforts, and the conservation efforts of unaffiliated third parties. These utilities argue that all of these perks are appropriate and necessary incentives to secure their active participation in the State's energy conservation programs.

Apart from the obvious overreach involved, a topic addressed in our prior comments, it should be evident that if all of the considerable concessions sought are given to the utilities, these programs will become inordinately expensive to customers and reduce their incentive to participate in them. As a threshold matter, the energy efficiency programs proposed by certain utilities would be expensive in their own right. PSE&G's proposed Clean Energy Future program alone sported a price tag of more than $2.5 billion. These costs will increase the total monthly bill to be paid by all customers, and significantly so for large energy users because program costs would be assessed on a usage basis.

In addition to these significant program costs, the other financial perks such as decoupling that have been sought by certain utilities have the clear potential to dissuade customers from pursuing energy efficiency projects. To illustrate the point, consider the procedure typically used by energy managers for large commercial and industrial customers to propose potential projects to their managements. Energy managers typically prepare a presentation that proposes the introduction of clearly defined efficiency measures, projects the anticipated savings and other benefits expected to be derived from the measures, and estimates the payback period in which the investment is expected to be recouped. These projections, which are generally highly accurate, are relied upon by management and provide the basis for their determinations.

If adopted as proposed, the utility cost recovery proposals would upend this process. For example, should the utilities' proposed general decoupling regime be adopted, energy managers could no longer assure their managements that the projected savings would be achieved over time. This is so because, as a result of the decoupling mechanism, the company's rates could increase in subsequent years to offset utility losses attributable to the diminished usage caused by the implementation of the conservation measures. Without the certainty that a company's energy efficiency efforts would be rewarded by decreased energy costs, the company would be expected to forego, rather than pursue the opportunity. Conversely, businesses could easily elect to forego costly investments in conservation measures entirely once they understand that, under general decoupling, *increases* in their usage could result in rate *decreases* in subsequent years.

In a word, the utility cost recovery proposals have the potential to remove or significantly limit the incentive for C&I customers—whose energy efficiency investments provide the biggest bang for the buck--to engage in these projects. Indeed, if adopted as proposed, those proposals likely would create a disincentive that actively discourages customer participation.

NJLEUC offers the following comments with regard to specific Staff proposals.

Carrying Costs for Investments

NJLEUC agrees that the return on equity applicable to the investments should reflect a 200 basis point adjustment to the ROE approved in a utility's last base rate case. There should be no issue that the availability of accelerated rate recovery should dramatically decrease the risk of recovery normally associated with utility investments that await recovery and prudence review in rate cases that can occur years after the investments are made. Under the accelerated rate regime, utilities are able to recover their investments as they are made, with little risk that an after-the-fact prudence review in the utility's next rate case will result in disapproval of the investments. To our knowledge, this simply has not occurred to date in any utility investment filing.

Given this, no reasonable argument can be made that the utilities should receive a large "risk premium" for what are essentially no-risk investments. We agree with Staff that the risk argument is further undermined by the fact that energy efficiency programs are less risky than traditional infrastructure investments that involve construction-related risks and concerns whether the assets will ultimately be deemed to be used and useful.

Finally, the fact that New Jersey law permits utilities to provide and invest in energy efficiency and conservation programs on a regulated basis and include these investments in rate base—which enables utilities to earn a full return of and on the invested capital--distinguishes New Jersey from other states that do not afford similar treatment to utility investments. Therefore, as Staff notes, it is important that limitations such as the reduction in ROE be implemented to prevent potential over-earning on these investments.

Rate Caps

NJLEUC agrees that the rate impacts associated with energy efficiency and conservation investments should be closely monitored. We have already noted the clear potential for these programs to be very costly to ratepayers. While we understand Staff's concern about achieving program goals as a reason to delay the imposition of rate caps, we would encourage Staff not to establish artificial time deadlines for potential imposition of caps and react quickly to rate increases that exceed agreed thresholds. Given the other expensive programs being implemented, which will have the effect of "pancaking" these increases, we urge the Board to consider establishing an appropriate cap on distribution rate increases associated with the energy efficiency programs. The cap should be based on the distribution rate rather than the total bill in order to avoid establishing an unnecessarily high bar for increases based on charges that are completely unrelated to the delivery of energy.

Rate caps should be acceptable to all stakeholders, given the arguments regarding the reductions in rates that are projected to occur as a result of the implementation of energy efficiency and conservation measures. Curiously, the same stakeholders heralding the energy usage and rate reduction potential of these programs have opposed rate caps that would lend credence to these representations and require the proponents to assume some needed skin in the game. As discussed earlier, ratepayers must realize some quantifiable, tangible benefit from curtailing their energy consumption, otherwise the utilities' energy efficiency programs will wither on the vine. Rate caps represent one means of preventing utility incentives under "successful" programs from having the perverse effect of wiping out any consumption-related cost savings for consumers.

Lost Revenue Treatment

NJLEUC strongly supports the Staff lost revenue proposal. The proposal demonstrates that Staff has heard and responded appropriately to the concerns expressed by ratepayers regarding the clear potential for over-compensation under the lost revenue/rate decoupling proposals that have been advanced by certain utilities and their supporters. We fully agree with the underlying premise of the Staff proposal that utilities should be compensated only for revenues lost as a direct result of their energy efficiency and peak reduction programs. We incorporate by reference our past comments regarding the undesirability of rate decoupling and will not repeat those comments here.

As businesses, we understand the disincentive that exists for utilities to implement programs that are designed to reduce customer purchases of energy. However, the Staff proposal is designed to eliminate this disincentive by making the utilities whole for all provable losses directly attributable to the utilities' conservation efforts. To guard against these losses and remove the utilities' disincentive, it is appropriate for the utilities to be afforded the lost revenue protection proposed by Staff—but only this level of lost revenue protection. It bears noting that the lost revenue treatment should not be viewed in isolation, but rather as a part of the overall package of financial benefits and incentives available to the utilities under the Staff proposal and existing law, which, as noted, allows utilities to include their energy efficiency investments in rate base. See, N.J.S.A. 48:3-98.1. This generous rate treatment is unavailable to utilities in other states that have instead adopted more generalized forms of rate decoupling.

The fact that the CIP program has achieved its desired effects and has successfully transformed the behavior and culture of the two participating gas utilities provides a strong basis to assume that the proposed limited form of decoupling, when combined with the other proposed financial and regulatory benefits, would be successful in this context as well. It is unnecessary and unjustifiable to compensate utilities for all reductions in usage that occur in their service territories, regardless of their cause. However, this is precisely what utilities request when they seek general rate decoupling, a mechanism that would, for the first time, provide guaranteed annual revenues to the utilities while bypassing the century-old ratepayer protections that have been the hallmark of the Public Utility Law.

To New Jersey's business community, the concept of guaranteed revenues is completely alien to the competitive world in which we operate, and is one that is singularly inappropriate for the State's profitable utilities. If businesses pursue their own self-directed energy efficiency

projects without utility involvement, why should the utilities be credited for lost sales that result from these efforts? If the economy experiences a recession, why should utilities be held harmless for losses sustained due to decreased energy usage that is attributable solely to the downturn in the business cycle? The short answer is they shouldn't. Just as we would not be expected to pay commissions to salespeople who are not involved in our product purchases, we should not be expected to compensate utilities for reductions in energy usage that are wholly unrelated to their efforts. Yet this would be the effect of the generalized form of rate decoupling that has been sought by the utilities. The Staff is right to reject the utilities' attempted regulatory over-reach.

NJLEUC supports the proposed requirement that utilities file rate cases no later than five years after the commencement of an approved energy efficiency transition program to reset lost revenue calculations. We also support the requirement that earnings tests occur on a regular, ongoing basis. Given the multiplicity of utility programs currently in place and in the pipeline, and the "innovative" rate treatments that have been authorized for many of them, it is imperative that the Board actively monitor utility earnings to assure that the ROE calculated in these periodic reviews does not exceed the utility's allowed rate of return from its previous rate case. To state the obvious, a utility that is over-earning has no incentive to bring a rate case that will reveal the extent of its earnings, so it is important that the Board require rate reviews to occur on a regular basis. The proposal to prevent the recovery of lost revenues where the allowed ROE is exceeded by 50 basis points or more is an appropriate and thoroughly defensible condition to impose in these circumstances. A utility that is already over-earning its allowed rate of return clearly should not be eligible to receive lost revenue recovery.

The proposal to review the cost recovery mechanism three years after the commencement of the energy efficiency transition programs should provide comfort to the utilities and ratepayers that the recovery mechanism will be re-examined to assure that it appropriately balances the interests of all stakeholders and provides the necessary incentives to all parties to insure a successful program. If the mechanism is found to be deficient in any respect, the review would afford the parties an opportunity to take a timely second look and make mutually acceptable adjustments as are deemed necessary and appropriate.

Performance Incentive and Penalty Treatment

NJLEUC does not have independent knowledge regarding incentive and penalty regimes that have proven successful elsewhere in motivating utilities to devote their best efforts to support energy efficiency programs. That said, it appears that the Staff proposal has merit and we support the general approach that is presented.

The proposal to rely primarily on adjustments to the risk-adjusted ROE provided on program-related investments appears to be a valid approach to utility over and under-performance within the established ranges of performance. We agree that the penalty for non-compliance should be more stringent and support the use of a 0.75% or other percentage-based penalty assessed against a utility's base rate distribution revenue, recognizing that this could be a considerable sum. It is assumed that a penalty assessed against a utility's base rate distribution revenues will motivate utilities to comply with the energy usage reduction targets established by the CEA.

The bottom line issue is whether the proposed system of incentives and penalties will be sufficient to change utility behaviors in the desired manner. This can only be known with certainty after the program has been implemented and these behaviors can be observed and assessed. If adopted, the Board should actively monitor the initial incentive/penalty structure that Staff has proposed and, should Staff's approach prove to be overly generous or unduly punitive, the Board should not hesitate to make appropriate adjustments in the context of an appropriate stakeholder process.

NJLEUC appreciates the opportunity to provide these comments and looks forward to continued participation in this process.

Respectfully submitted,

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Attorneys for the New Jersey
Large Energy Users Coalition

February 6, 2020

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VIA ELECTRONIC MAIL (energyefficiency@bpu.nj.gov)

February 6, 2020

Honorable Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, NJ 08625-0350

Re: IN THE MATTER OF THE IMPLEMENTATION OF P.L. 2018, c. 17 REGARDING THE ESTABLISHMENT OF ENERGY EFFICIENCY AND PEAK DEMAND REDUCTION PROGRAMS BPU DOCKET No. QO19010040

Dear Secretary Camacho-Welch:

New Jersey Natural Gas Company ("NJNG") looks forward to working with the Board of Public Utilities' ("BPU") on the implementation of P.L. 2018, c. 17 regarding the establishment of energy efficiency and peak demand reduction programs ("Clean Energy Act"). NJNG participated in October 31, 2019 and December 13, 2019 Technical Working Group meetings on Cost Recovery and the Public Stakeholder meeting on January 23, 2020. NJNG has also previously submitted written comments on November 14, 2019 and January 3, 2020. Through this submission, we are responding to the BPU's January 22, 2020 Cost Recovery Mechanism Draft Proposal ("Draft").

NJNG supports the comments filed today by Gabel Associates in this matter as well as the general comments filed today by the New Jersey Utilities Association. In the interest of streamlining the public record, NJNG will not readdress the content covered within those responses. However, NJNG is compelled to continue to emphasize the importance of decoupling and the effect it can have on an organization.

In 2006 NJNG worked collaboratively with the BPU and the Division of Rate Counsel to develop the Conservation Incentive Program ("CIP"), a modified form of decoupling. It has been reviewed in numerous regulatory proceedings since that time and we believe it has proven that companies can successfully embrace strategies that help reduce customer energy usage and

advance public policy. I have shared our experience throughout this proceeding and in many regulatory proceedings over the past decade- providing both the perspective of the Company and my own as an employee with nearly 27 years of service. My tenure at NJNG is nearly equally divided into two periods- before CIP and after CIP. There is absolutely no question in my mind that we are a different company because CIP removed the throughput incentive and helped align our interests with customers and with state policy. Just a few examples that I can share regarding how it can change the culture of the company:

- Management is focused on reliability and delivering outstanding customer service, instead of obsessing over variations in usage patterns.

- Departments that fall within our service company recognize the importance of our energy efficiency and energy conservation efforts and prioritize our needs. Our energy efficiency department receives outstanding supporting service from our Corporate Communication, Information Technology, Purchasing and Legal teams, among others.

- There are no marketing efforts devoted to encouraging our customers to increase their energy usage (e.g. no promotion of pool heaters or "outdoor rooms").

- All employees receive updates on new energy efficiency programs and special promotions to engage customers on energy conservation. Employees are encouraged to be champions for energy efficiency. We have strong examples of employees engaging customers to participate in programs by leveraging their personal networks, including advocating for participation in conservation related education and efforts at their children's schools.

- New employees are made aware of our energy efficiency and energy conservation programs and encouraged to serve as champions to help with outreach to customers, as well as friends and family in our territory.

- Our call center has performance metrics for proactively sharing energy saving tips.

NJNG appreciated that the Draft recognized this incredibly important point regarding the potential to shift corporate culture. However, based on our experience the proposed limited lost revenue adjustment mechanism (which is not limited decoupling) will not achieve Staff's hope to "provide all utilities similar freedom to aggressively pursue and endorse energy efficiency". By its very nature it would only incentivize utilities to promote certain energy efficiency programs and would still leave a structure in place that would encourage utilities to increase throughput with additional burner tips and not be aggressive about promoting energy conservation tips.

NJNG continues to be willing to share more details about our experience to highlight how the alignment of priorities can be transformative. If New Jersey is going to be successful in

reaching the aggressive clean energy goals and seeks to rejoin the ranks of other states leading on clean energy, the state must support and approve strategies like decoupling.

NJNG appreciates the opportunity to provide comments on these topics. We look forward to working with the Board and other stakeholders as the State considers how to restructure the approach to energy efficiency as to enable the utilities to reach the aggressive clean energy goals established by Governor Murphy's administration. Please feel free to contact me if you need any additional information regarding these issues.

Respectfully submitted,

Anne-Marie Peracchio
Director- Conservation and Clean Energy

NJUA
NEW JERSEY UTILITIES ASSOCIATION

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February 6, 2020

VIA ELECTRONIC MAIL
Aida Camacho-Welch
Secretary of the Board
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Trenton, NJ 08625
energyefficiency@bpu.nj.gov

The New Jersey Utilities Association ("NJUA") represents investor-owned utilities that provide electric, natural gas, telecommunications, water and wastewater services to residential and business customers throughout the State. I am writing on behalf of the electric and natural gas companies ("the utilities") that are members of the NJUA in response to the Energy Efficiency ("EE") Transition Cost Recovery Mechanism Draft ("Draft") that was released on January 22, 2020 and reviewed at a public stakeholder meeting on January 23, 2020. These comments represent the consensus views of NJUA energy member companies in response to the Draft and each member company reserves the right to submit comments on an individual basis.

Before addressing the specifics of the Draft, the NJUA notes our disappointment regarding the mechanism proposed as a starting point for discussion. The utilities were active participants in the October 31, 2019 and December 13, 2019 technical meetings on this topic and have reviewed the written comments submitted in response to those sessions. Additionally, they all actively participated in the other Public Stakeholder meetings on the Energy Efficiency Transition. Most stakeholders and industry experts supported policies that would encourage utilities to embrace energy efficiency as a core part of their business. Unfortunately, this current Draft does not propose a structure that would do so, and it was clear in the discussion at the January 23, 2020 meeting that many other stakeholders have similar concerns, especially in light of New Jersey's interest in being a leader on energy efficiency.

Investment Treatment

The utilities recognize the importance of considering the rate impacts associated with the significant ramp up in energy efficiency activity that will be necessary to meet Clean Energy Act ("CEA") targets. However, the Draft includes both factual errors and flawed logic, including the following:

- The Draft inaccurately states that the mechanism is modeled on other jurisdictions such as Maryland and Washington DC. Two New Jersey multi-state utilities operate in Maryland and are intimately familiar with the EE structure there. Utility run programs in Maryland earn the applicable utility's full Weighted Average Cost of Capital ("WACC") on the unrecovered portions of both program investments and related operations and maintenance expenses for those programs. Additionally, there currently are not any utility-run programs in Washington

D.C. Accordingly, there is no comparable structure to compare for utility investments in energy efficiency.

- The proposed modified ROE that reflects a 200-basis point reduction off the utility's allowed ROE is completely unreasonable and is unprecedented. Collectively, the utilities are not aware of, and our research did not reveal, any regulatory proceeding, including punitive actions, where such a dramatic reduction in ROE was imposed**.** Throughout the stakeholder sessions in this docket, there have been passing references to other jurisdictions that offer utilities the opportunity to earn on their energy efficiency investments. In all instances, the ROE on their energy efficiency programs are identical to their overall allowed ROE, some with opportunities for increased ROE based on performance.
- The Draft also claims "[i]f these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced." This is incorrect. Utility ROEs are determined by reviewing cost of equity models on proxy groups that include all risk attributes of every rate-making mechanism for each company in the group, including formula rates, decoupling, clauses and trackers. There are no cost of equity models that evaluate the risk specific to just a clause for a utility. The ROE reduction proposed by Staff is completely arbitrary and unsubstantiated-
- The Draft also claims "energy efficiency programs are less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful". This logic is flawed for a number of reasons. For example, energy efficiency programs that support the needs of larger commercial customers are likely to be multi-year projects. Spending related to energy efficiency programs is very closely monitored by regulators and other stakeholders and will still be subject to prudency reviews.
- Any investment forced by the regulator below the utility's allowed return is punitive. The Draft approach penalizes the utility for all performance below the maximum incentive. As stated in the January 23, 2020 NJUA comments, the electric utilities would need to increase energy reductions by over five times and gas utilities would need to achieve more than twice what was achieved in the 2019 ACEEE Scorecard. If the utilities are able to achieve those targets, cost-effectively, as well as meeting all other Quantitative Performance Indicator proposed by Staff, they would receive no incentive while being penalized a 200-basis point reduction on their ROE. This structure is inappropriate and far worse than the cost recovery mechanism that exists in New Jersey today.
- The WACC is the appropriate return for energy efficiency investments that are not concurrently recovered for multiple reasons including: 1) utilities finance their business as a whole, and not in part; 2) the WACC represents the utility's costs to finance its distribution investments; 3) using the WACC ensures that the energy efficiency investments (and the savings they produce for customers) are on a level playing field with all other distribution investments; and 4) the WACC used by each New Jersey public utility has been determined by the Board and is a just and reasonable rate. Furthermore, by setting the rate of return for the energy efficiency and demand response investments at the WACC, the New Jersey Board of Public Utilities would be sending a clear message that these investments are just as important as all other distribution system investments. It would also send a strong message in support of the State's Energy Master Plan. The Draft further suggests that part of the rationale for a

reduced ROE was a concern about the potential for over-earning. A test could be used to ensure that utilities do not over earn without reducing the ROE.

- The use of a drastically reduced ROE relative to other investments that would by default earn a higher ROE, such as the Infrastructure Improvement Program (IIP) or base rates, creates an inherent disincentive to invest in EE in New Jersey. Also, accelerated recovery mechanisms found in New Jersey regulations, the IIP and Distribution System Improvement Charge (DSIC) regulations for example, rightfully include no ROE penalty and thus the recovery for EE would be inconsistent with existing Board practice.
- Regarding the proposed amortization period of 7 years for program investments, there is no supporting rationale provided for why this term was selected.

The utilities are not opposed to the proposed treatment for over and under recoveries but recommend that a commercial paper or short-term debt rate be used instead, consistent with the rate used for recovery of existing utility-run energy efficiency programs. Additionally, while the utilities have strong concerns that the potential for a rate cap on energy efficiency investments could impair the ability to meet the CEA goals, they do not have a concern about monitoring the impacts in the two-year period after the transition of the programs.

Finally, to best encourage and reward individual utility performance, it may be necessary to consider flexible cost recovery and incentive options to best align with individual utility circumstances.

Lost Revenue Treatment

It is important to consider that New Jersey's energy utilities recover the cost of their investments in the distribution system largely through volumetric rates, charged per kWh or per therm. There is thus, as currently structured, a fundamental disincentive in New Jersey's ratemaking process and rate designs to invest in energy efficiency programs. Implementation of energy efficiency programs result in lower throughput (sales) on the distribution system, while the costs of providing electric and gas distribution service (*e.g.* capital investment, and operation and maintenance expense) of the electric and gas distribution systems do not decrease. The proposed mechanism does not adequately align with the State's goals regarding the implementation of energy efficiency. The State has already recognized the need to incentivize energy efficiency investments in law through the language and structure of the Clean Energy Act and section 13 of the Regional Greenhouse Gas Initiative ("RGGI") (N.J.S.A.48-3-98.1).

The Draft's proposed lost revenue treatment approach contains several concerning elements. First, the proposal would only allow for the recovery of revenues that can be demonstrated to be attributable to utility-run programs. All lost revenues associated with energy efficiency and peak demand reduction efforts should be recoverable, regardless of who administers the programs. This is especially important to consider in the context of the approach to program administration proposed in the December 20, 2019 Straw Proposal for Program Administration, which proposed that key energy efficiency programs remain under the control of the state or be co-managed. Given that the Draft proposal would only allow recovery of lost revenues directly attributable to utility administered programs, this would set up a situation where a utility would have a disincentive to encourage customers to participate in state-run or co-managed programs. All stakeholders should recognize that it is challenging to get customers interested in pursuing energy efficiency. From practical experience, NJNG and SJG note that outreach regarding their own programs has occasionally led to customers pursuing other energy efficiency strategies like an Energy Savings Improvement Program ("ESIP"). Both companies actively supported customers pursuing the path

that best fit their objectives and did not have to consider the potential for any negative impacts because the design of the CIP program made them neutral to changes in customer usage regardless of the program pursued by the customer. Having the utilities suffer financial harm when customers pursue other energy efficiency strategies will not result in the cultural shift to allow the state to become a national leader and reach the CEA goals.

While the utilities strongly oppose the proposed mechanism, we do support the concept of truing up recoveries on an annual basis and are open to considering an ROE test requirement. Any mechanism should be formulaic to ensure resources are not wasted debating the outcomes in future regulatory proceedings.

Performance Incentive and Penalty Treatment

The utilities note that the proposed structure for performance incentives and penalties is not balanced. On the surface, a structure with equivalent bands for performance on either end of a dead band may seem fair, but in reality, it is not because of the likelihood of the outcome. Given the aggressiveness of the proposed historic goals, it would be nearly impossible to reach the high ends of the incentives given that the budgets will be fixed, and it would be highly unusual to extract that much more energy savings from approved programs. In addition, many stakeholders will be seeking to keep the budgets for programs as tight as possible to minimize consumer rate impacts.

The proposal is also not symmetrical in terms of the magnitude of the proposed adjustments. Even if a utility could theoretically achieve the maximum level for the performance incentive, they would receive an incentive of 1% on the already-reduced value of their investment (an increase from 5.5% to 6.5%). However, in the event that a utility falls at the bottom of the performance range, they would face a penalty that is 2% lower (decrease from 5.5% to 3.5%). As noted by a commenter at the stakeholder meeting, the graphical representation is misleading, and the proposal certainly does not reflect a fair approach. This disparity is only exacerbated by the clear fact that it is much easier to underperform than overperform that is noted in the prior paragraph.

The utilities strongly encourage a wider dead band, especially for the first few years after the transition, to ensure that BPU, utility and stakeholder resources are not wasted debating performance incentives and penalties that are near the targets. Further, the utilities emphasize that the legislation does not hold the utilities accountable for the targets until after five years of implementation. Accordingly, the utilities should not be penalized for performance during this transition period, which will likely present unforeseen challenges in achieving the energy saving targets in the short term.

As it relates to performance penalties under the Act, it is important that the Board have discretion in the assessment of penalties to ensure that utilities are not penalized for factors beyond their control. This is consistent with the Clean Energy Act's requirement that the Board consider appropriate factors to "ensure that the public utilities incentives or penalties . . . are based upon performance." N.J.S.A. 48:3-87.9(c). This is intended to allow for reasonable consideration of extenuating circumstances that severely limits a utility's ability to hit its savings target. As an example, NJNG notes that after Superstorm Sandy, they had to suspend their behavioral program for a period of time to avoid providing misleading comparison data to some customers and out of sensitivity to some customers who lost their homes. There should be a

path to allow for fair consideration of extreme circumstances that create unforeseen barriers to achieving the performance targets.

Thank you for the opportunity to comment on this very important matter.

Sincerely,

Thomas R. Churchelow
President

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February 6, 2020

Ms. Aida Camacho-Welch
Secretary of the Board of Public Utilities
44 South Clinton Avenue, 9th Floor
PO Box 350
Trenton, New Jersey 08625-0350

Re: Cost Recovery Mechanism Comments

Dear Secretary Camacho-Welch:

I am writing on behalf of the members of the New Jersey Utility Shareholders Association (NJUSA). NJUSA is a not-for-profit association of New Jersey residents who are investors in one or more of the publicly traded entities that have a subsidiary providing essential utility service in New Jersey. Our members choose to join NJUSA to learn more about and advocate with other interested New Jersey utility investors on issues that can affect the value of their investments. NJUSA membership is extended only to individual investors residing in the State; institutional investors are not eligible to be NJUSA members.

NJUSA members come from all regions of the State and from many walks of life. Many NJUSA members are senior citizens who rely on their utility investments to supplement their often limited income in retirement. As New Jersey residents and utility shareholders, NJUSA members are directly invested in New Jersey through their ownership of utility stock—utility shareholders essentially are the owners of the "rate base" assets through which service is provided and upon which a fair return on investment is expected. It is through these investments that utility shareholders make possible the essential electric, gas, water and wastewater utility services upon which New Jersey's health, quality of life and economy depend. It is these same shareholders who, if appropriately incentivized, can help provide the financial wherewithal for New Jersey's electric and gas utilities to make the all-important energy efficiency investments required by the Clean Energy Act of 2018 (CEA).

As shareholders, NJUSA members are often misunderstood to be among the most privileged and wealthy citizens. The truth is, NJUSA members are average New Jerseyans; many, although not all, are senior citizens. Some are former utility employees--retired secretaries, linemen and women, managers, customer service representatives and meter readers, among others. Some never worked for a utility, but have retirement funds in a pension or 401(k) plan that contain utility stocks. Or, as often happens, heard from a family member years ago that utility stocks are a good, stable investment that offer the opportunity to earn a fair return on the dollars invested with the possibility of dividend payments—a potential source of income in later years. Contrary to common perception, utility shareholders are not corporate "fat cats" feeding off the last dollar of others.

As residents, NJUSA members have the same needs for a healthy environment for themselves and their prodigy as all other residents. As utility ratepayers, they also care about the cost and reliability of their utility services. *Unlike other New Jerseyans, however, through utility stock ownership, NJUSA members provide in advance the financial resources necessary for the ongoing provision of safe and reliable utility service.*

The ability of New Jersey's utilities to meet their most fundamental obligation—to provide safe, adequate and proper service—would not be possible without utility shareholders. Utility shareholders are akin to a bank that gives loans. Instead of charging interest for the use of money, like a bank, when utility investors purchase utility

shares, they are making cash available for the utility to meet its service obligations. They do so without a guarantee that they will make money on their investment, and without knowing if they are able to earn a return on their investments, how much of a return the Board of Public Utilities (the Board) will allow and whether it will be sufficient to make the investment worthwhile.

It is the potential disruption of this longstanding rate-base/rate-of-return rubric that makes the Energy Efficiency Transition (the Transition) of great interest and, in some respects, great concern, to NJUSA members. While the CEA laudably seeks to stem the effects of climate change, it radically shifts the energy utility regulatory framework in ways that could put shareholder investment at risk. As the Cost Recovery Proposal states:

> *"The CEA calls for a significant overhaul of New Jersey's energy system while growing the economy, building sustainable infrastructure, creating strong local jobs, reducing carbon emissions, and improving public health through a cleaner environment and better air quality."*

The Transition proposals for both EE performance targets and cost recovery appear to overlook or overestimate the critically important role of utility shareholders. The following excerpt from the Cost Recovery Proposal is illustrative:

> *"The proposal is intended to provide an opportunity for stakeholder feedback, with the goal of creating an equitable cost recovery framework that enables the State to reach its ambitious efficiency goals while being protective of ratepayers."*

This excerpt raises concern that the needs of shareholders are not among those to be considered in developing an equitable cost recovery framework. The Board has the obligation to balance the needs of utility shareholders with those of ratepayers in its decisions. However, the assumed reduction in risk upon which the proposed reduction in the ROE of 200 basis points identified in the Cost Recovery Proposal clearly demonstrates that the role of shareholders in making both traditional utility service and energy efficiency program delivery possible is not well understood, or is inadvertently undervalued.

<u>The Role of Utility Shareholders</u>

The choice shareholders make to invest in New Jersey utilities relies on the traditional rate-base/rate-of-return regulatory system, which is predicated on the paradigm that: it is in the public interest to make universal service available; the sizeable capital needed to deliver utility service and the ability to achieve economies of scale support allowing utilities to operate as "natural monopolies" by necessity attracting and relying upon private investment; in the absence of market competition, a regulatory authority (in New Jersey, the Board) sets utility rates taking into account the need for utilities to provide safe, adequate and proper service balancing the needs of ratepayers and shareholders.

It is under this system that NJUSA members choose to hold shares in, for example, New Jersey Resources and/or Public Service Enterprise Group, with the understanding that the capital contributed through their shareholder equity will be available for investment in subsidiary utilities New Jersey Natural Gas or PSE&G's rate base, and on those investments the opportunity to earn a fair rate of return is possible. Under this regulatory system, it follows that the allowed rate of return is a critically important, albeit not exclusive, determinant of whether investment in companies with operating utility subsidiaries makes financial sense. Uncertainty around the economics of utility regulation under the CEA's new and very aggressive mandates that shift the core mission and customer relationships away from selling (delivering) safe and reliable service to helping customers reduce

energy use with specific performance targets and penalties, has the potential to put at risk the attractiveness of investments in New Jersey's energy utilities.

All aspects of the Transition, including program administration, cost recovery, performance targets and incentives and penalties must be carefully designed to ensure that the role of utility investors is recognized and rewarded and that the delivery of safe and reliable service is not compromised, while also ensuring that ratepayers' interests are protected. If in the interest of fulfilling the mandates of the CEA the role of shareholders is overlooked, or unintended negative consequences of the Transition's design result, the continued and increased investments needed to meet both the traditional service obligations and new clean energy mandates will be compromised.

Risk/Reward Construct of the Cost Recovery Proposal

The Cost Recovery Proposal states:

> *"The energy efficiency programs are also less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful. If these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced."* (Emphasis added.)

With respect to risk, the Cost Recovery Proposal further states:

> *"There is an inherent reduction in risk associated with the contemporaneous recovery available in 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. The energy efficiency programs are also less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful. If these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced."*

These assumptions neglect the fact that cost recovery is not delayed for years for all other utility investments. When the Board has determined that it wants to encourage and accelerate utility investment as a policy priority, it has allowed contemporaneous cost recovery or cost recovery between rate cases, such as infrastructure upgrades. Given the many policy priorities already being implemented, clearly the Board will have to determine which are the most critical to achieve and in what order since there are clearly cost implications for ratepayers. However, given the speed with which the goals of the CEA are to be achieved, at a minimum, contemporaneous cost recovery is necessary if the capital is to be acquired and invested as desired. NJUSA does not view contemporaneous cost recovery in and of itself to be an offset to risk sufficient to automatically assume a lesser ROE is appropriate. Energy efficiency programs with mandatory targets subject to penalties is a risk unlike any that electric and gas utility shareholders have had to evaluate. The extent to which these investments might be deemed by investors as *riskier* than others is entirely possible.

Given this reality, it is not clear upon what evidence the proposed ROE reduction of 200 basis points has been chosen. The experience of other states are important data points, but they are not dispositive of what would work best in New Jersey. Additionally, it is our understanding that there are factual errors about the

representation made in the proposal and that the referenced states do not in fact have a reduction in ROE for such investments. We strongly urge the Board to verify the ROE data cited. To build such an important new initiative on faulty premises will not only discourage investment in New Jersey, inappropriately penalize the utilities but also impede ultimate achievement of the energy efficiency goals.

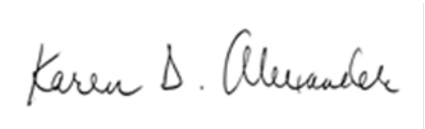
From the perspective of NJUSA members, while one year for cost recovery is "contemporaneous" as compared to a potential 3 year or more period between base rate cases, the factors that bring uncertainty into the evaluation of energy efficiency investments are not limited to time to recovery. The extent to which the gas and electric utilities will be able to achieve the mandated targets, whatever the ultimate targets might be, is a significant uncertainty, impacted by the behavior and predilections of customers, not controlled solely by the level of effort or design of the utility efficiency programs.

Individual utility shareholders typically invest in utilities not because they are among the most lucrative, but because they are among the most stable and least risky. If mandatory utility participation in energy efficiency is structured in a manner that increases shareholder uncertainty, notwithstanding the allowed contemporaneous cost recovery of efficiency investments, investors, who cannot earmark their dollars for specific investments, might be skittish and disincentivized to continue, much less increase, their investments in New Jersey utilities. Utility shareholders have other investment options, including investments in utilities in other states or in other sectors. The adage, money goes where it's treated best, which is a variation of "(c)apital goes where it's welcome and stays where it's well treated"[1] is no less true for New Jersey utility shareholders than those who make other investment choices.

While NJUSA does not have the expertise to specify a more workable cost recovery mechanism, we must caution that to overlook the intrinsic value of shareholders as the Transition is developed puts at risk not only the achievement of the CEA's important clean energy goals, but also the attractiveness of New Jersey utilities as an investment option. Increased uncertainty for investors can result in a perceived diminishment of the value of New Jersey's utility shares. Perception of a potential reduction in the value of utilities is a potential unintended consequence against which the Board should carefully guard. To do otherwise could reduce the availability of capital needed to ensure the financial integrity of the utilities, with resulting harm not only to the future provision of essential services at the core of their mission for over a century, but also harm their ability to perform well to meet the challenges of the new clean energy mandates.

We appreciate the opportunity to offer comments on this important issue.

Sincerely,



Karen D. Alexander
President

[1] Attribution from numerous sources, including Wikipedia https://en.wikipedia.org/wiki/Walter_Wriston#Quotes

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February 6, 2020

Via E-mail (EnergyEfficiency@bpu.nj.gov)

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Board of Public Utilities
44 S. Clinton Ave., 9th Floor
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Trenton, NJ 08625-0350

Re: Energy Efficiency Transition - Cost Recovery Proposal

Dear Secretary Camacho-Welch:

Please accept these comments on behalf of Public Service Electric and Gas Company ("PSE&G" or the "Company") in response to the cost recovery proposal issued by the Board Staff on January 22, 2020. PSE&G thanks the New Jersey Board of Public Utilities ("BPU" or "Board") for its initiation of the energy efficiency transition stakeholder process and the opportunity to provide these comments. These comments are being submitted by PSE&G in addition to the comments of the New Jersey Utilities Association, submitted on this date as well, which PSE&G also supports.

PSE&G notes its disappointment regarding the cost recovery mechanism in the January 22nd proposal. The proposal does not adequately incorporate the majority of stakeholder input that encourages utilities to embrace and implement cost effective energy efficiency; just the opposite, the proposal in its current state would discourage and in fact penalize utilities for using capital to invest in energy efficiency. In that regard, the State must significantly change the way it engages stakeholders if it is to meet the energy savings requirements of the Clean Energy Act ("Act") and become a national leader in energy efficiency. As we have stated previously, to meet these ambitious goals, it is imperative that the State partner with New Jersey's utilities, and align the State's goals with utilities' business objectives by adopting a cost recovery mechanism for utility energy efficiency programs that authorizes: (1) a return of and on utility costs at the utility's weighted average cost of capital; (2) the amortization of costs over the useful lives of the measures; (3) full revenue decoupling to break the link between utility sales and revenues; and (4) an incentive and penalty structure that is simple and transparent, and based on quantitative performance indicators.

Introduction

In the January 22, 2020 cost recovery draft proposal, Staff issued a Request for Comments, seeking feedback from stakeholders on the proposal. Staff's cost recovery proposal addressed:

- Return on Equity ("ROE") for energy efficiency investment;
- Asset/Investment treatment and recovery period;
- Lost revenue recovery;
- Performance incentives and penalties; and
- Other cost recovery components (rate caps, interest on over/under recoveries, and using energy efficiency as a resource).

In these comments, PSE&G will address each cost recovery attribute in the draft proposal. Consistent with the Company's January 3, 2020 written comments, PSE&G will again demonstrate that the approach taken in PSE&G's pending Clean Energy Future – Energy Efficiency ("CEF-EE") program (BPU Docket Nos. GO18101112 and EO18101113), implemented effectively, will achieve the State's energy efficiency goals in a manner that minimizes rate impacts, and that is just and reasonable to all stakeholders. We will specifically show that with: (1) PSE&G responsible for establishing, implementing, and operating the programs; (2) the Company earning on energy efficiency investments at its allowed rate of return; (3) amortization of the cost of the programs over the lives of the energy efficiency measures employed; and (4) rate decoupling, to properly align incentives to maximize energy savings, PSE&G will meet the energy efficiency objectives of the Clean Energy Act ("CEA") while providing significant bill savings to participating customers, with little to no impact on non-participating customer bills.

The comprehensive CEF-EE program contains several important, and undisputed, benefits for the State and its residents. First, it will reduce participating customers' bills by $5.7 billion through the implementation of a wide variety of energy efficiency measures. With its emphasis on engaging low income and other difficult to reach customer segments, as well as residential and commercial business communities, savings are created for all customers across the State's socioeconomic spectrum. Second, the CEF-EE Program will reduce harmful greenhouse gas emissions and put New Jersey on track to meets its emissions reduction goals. Third, it will help grow the "green economy" right here in New Jersey, including private sector, energy efficiency businesses. The CEF-EE investments will increase employment through the creation of over 3,600 clean tech jobs and facilitate associated economic activity over the proposed investment period. As part of the job creation associated with CEF-EE, PSE&G envisions a range of employment opportunities for unemployed, under-employed, low- and middle-income New Jersey residents. The utility has been engaged in ongoing, collaborative efforts with the New Jersey Department of Labor and various energy efficiency trade allies to discuss the full range of clean tech job opportunities that CEF-EE will provide, including job training programs throughout the State that will include specific programs to provide employment to residents in some of New Jersey's most vulnerable areas. These employment opportunities will include work with HVAC installation

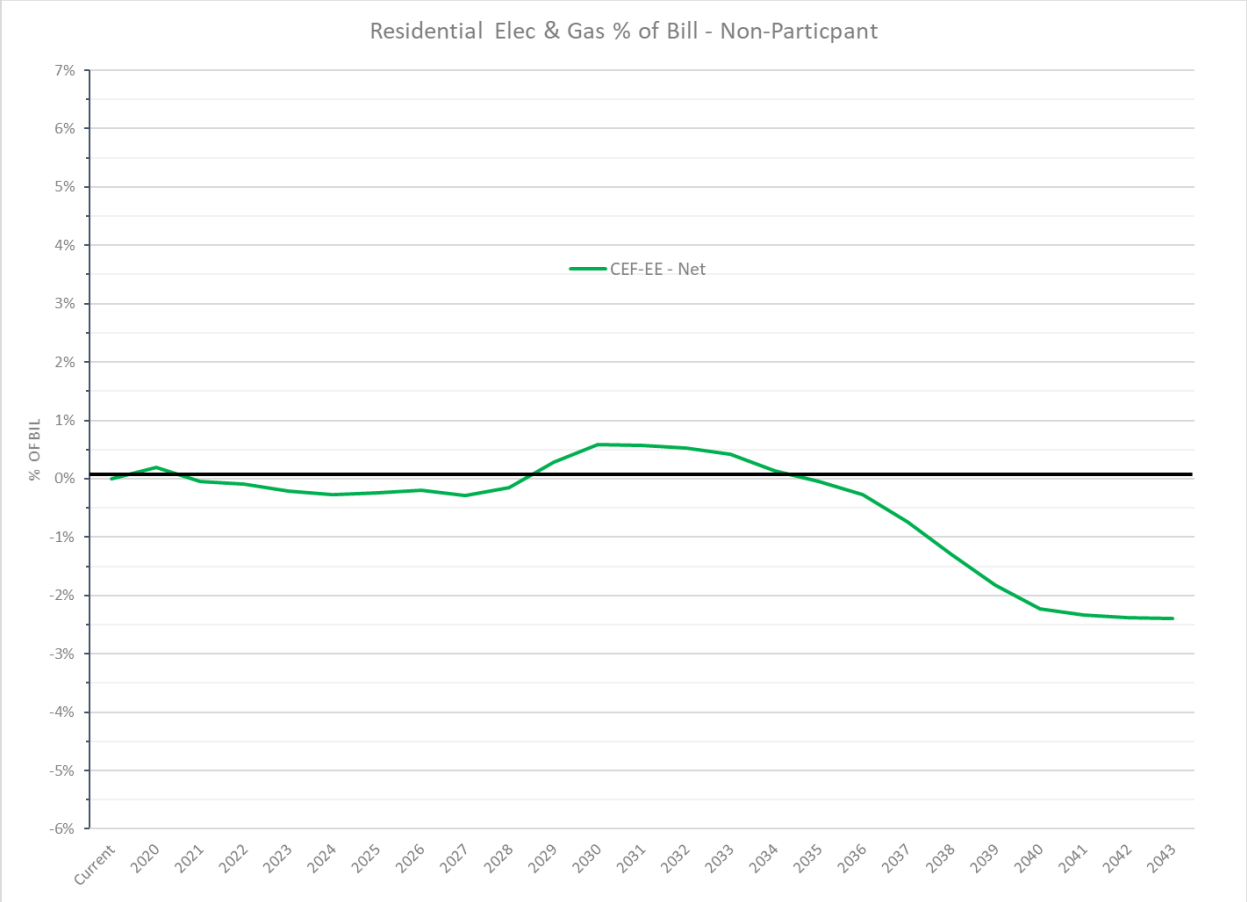
contractors, developers, engineers, plumbers, electricians, builders, retailers, and distributors of other energy efficiency service businesses.

In addition, as noted above, the CEF-EE program can help achieve these benefits with little to no impact on non-participating customers. Figure 1 below provides a graphic depiction of the residential non-participant bill impact for PSE&G's CEF-EE filing. Beyond the revenue requirement, the following energy efficiency program costs and benefits are incorporated into the CEF-EE net impact.

1) Societal Benefits Clause (SBC) savings – cost savings associated with significantly reducing the current energy efficiency component of the SBC;
2) Market based savings – cost savings associated with reduced wholesale power prices and lower Renewal Energy Certificate ("REC") obligations;
3) Transmission & distribution savings – cost savings associated with lower consumption over time which reduces the necessity, and the cost, of future system upgrades;
4) Existing energy efficiency program savings – cost savings associated with phasing out the Company's existing energy efficiency programs; and
5) Lost revenue recovery – costs shifted from EE program participants to non-participants to recover lost revenues associated with energy efficiency investments (whether through decoupling, lost revenue adjustment mechanism or annual rate cases) and under-recoveries for existing clauses due to lower overall sales recovered in subsequent years.

As can be seen in Figure 1, which shows the residential non-participant bill impact over the life of the program, the CEF-EE approach offers a cost recovery mechanism that aligns the goals of the Clean Energy Act with the utility's goals, with energy and cost savings to participating customers and little to no impact even to non-participating customers.

Figure 1



Attributes of the Draft Proposal

1. **WACC -- Utility Program Costs Should Be Allowed A Return On The Unamortized Balance Using A Rate Equal To The Utilities' Weighted Average Cost Of Capital ("WACC").**

Staff's proposal to reduce the ROE on energy efficiency investment by 200 basis points is not only unsupported, unnecessary, and [virtually] unprecedented in the United States; it is also punitive, and puts energy efficiency investment at a significant disadvantage compared to traditional investments. In these comments, we will address: (1) why the proposal is contrary to the intent of the CEA; (2) why any reduction in return on equity ("ROE") is punitive; (3) the flaws in the draft proposal's arguments for a reduction; and (4) cost recovery methodologies used in other states, such as Illinois, that can be used for guidance in this stakeholder process.

ROE Reduction Is Counter To The Intent Of The CEA

The Clean Energy Act states "[e]ach electric public utility and gas public utility shall file annually with the board a petition to recover on a full and current basis through a surcharge all reasonable and prudent costs incurred as a result of energy efficiency programs and peak demand reduction programs required pursuant to this section, including but not limited to recovery of and on capital investment, and the revenue impact of sales losses resulting from implementation of the energy efficiency and peak demand reduction schedules, which shall be determined by the board pursuant to section 13 of P.L. 2007, c. 340 (C.48:3-98.1)." This reference to "recovery of and on investment" is similar to language n section 13 of P.L. 2007, c. 340 (C.48:3-98.1) ("RGGI Statute") itself, which the utilities operate under today, and under which utilities earn a return on investment in renewable generation and energy efficiency at the utility's return on equity determined in the most recent base rate case.

The Clean Energy Act further provides: "If an electric public utility or gas public utility achieves the performance targets established in the quantitative performance indicators, the public utility shall receive an incentive as determined by the board through an accounting mechanism established pursuant to section 13 of P.L.2007, c.340 (C.48:3-98.1) for its energy efficiency measures and peak demand reduction measures for the following year. The incentive shall scale in a linear fashion to a maximum established by the board that reflects the extra value of achieving greater savings." Under the draft cost recovery proposal, utilities must exceed performance targets by 50% to earn their allowed ROE on investment, counter to the existing cost recovery mechanism today under the RGGI Statute where the utility earns its allowed return on all investment. In other words, utilities are not rewarded for exceeding the aggressive performance targets in the CEA, they are punished for not exceeding the targets by a significant amount, even achieving 149.9% of the targets. This is clearly not the intent of the CEA, which states the incentive is to reflect the "extra value of achieving greater savings."

Earning a rate of return that is lower than the utility's allowed rate is not a reward. Since capital to invest in projects is a scarce resource, utilities seek to invest in projects that earn at or above the allowed return. Investing in projects with low ROEs will lower the entire utility ROE. Consequently, utilities have a disincentive to invest in such projects.

The utilities are not alone in expressing the need to make energy efficiency investment as attractive as traditional investments. In the article "Penalties in Utility Incentive Mechanisms: A Necessary 'Stick' to Encourage Utility Energy Efficiency?", Rachel Gold of the American Council for an Energy-Efficient Economy ("ACEEE") states:

> "In the traditional business model, utilities have an inherent disincentive to promote energy efficiency because they are unable to recover fixed costs when sales of energy decline . . . . A ''three legged stool'' of policies is required in order to incentivize utilities to prioritize investments in energy efficiency over new power generation. These include policies that allow utilities to recover the costs of efficiency programs, or cost recovery; policies that

ensure that energy savings don't reduce utilities' authorized revenues, like decoupling and lost revenue adjustment mechanisms, and policies that permit utilities to earn a return on energy efficiency investments, like performance incentives."

Reduction In ROE For EE Investments Is Punitive

A utility's ROE is evaluated based on cost of equity models that include all of the risk attributes included in each proxy company's stock price. In PSE&G's 2018 base rate case, for example, an ROE evaluation was conducted by the Company, Rate Counsel and Overland Consulting Company on behalf of Board Staff, and as a result all parties agreed as part of a comprehensive settlement that the utility's allowed rate of return should be 9.60%. The Company should be given a reasonable chance to achieve this allowed rate of return, especially given the last rate case was settled just over a year ago.

The draft cost recovery proposal does not give the utility a reasonable chance to achieve this. If the Company is earning 7.60% on its energy efficiency investment, it will need to earn more than 9.60% on its base investment, cut operating costs or increase sales revenue just to equal its allowed rate of return. Therefore, even if the Company prudently invests in energy efficiency to further State goals and achieves all targets set by the Quantitative Performance Indicators or even exceeds those targets substantially, including cost-effectiveness, the Company will be punished with a lower overall ROE. This is inappropriate and puts investment in energy efficiency at a significant disadvantage versus traditional investments.

Staff defends the reduction in ROE by asserting that there is reduced risk for energy efficiency investments due to contemporaneous recovery. This argument is illogical. From a purely financial perspective, investing in a main or substation that will earn the utility's allowed ROE over a greater than 50 year period, even with lag between that investment going into service and the company's next base rate case, would be far more attractive than investing in energy efficiency for a return at 200 basis point less than the utility's allowed return over a 7 year period, even with contemporaneous recovery. That discrepancy is compounded by the fact that the energy efficiency investment has the potential to result in penalties and will reduce the utility's revenues.

While the proposal allows for a Lost Revenue Adjustment Mechanism ("LRAM"), it is unclear if that recovery will be lagged and how it will be calculated to ensure all lost revenue associated with the investment will be fully recovered. Moreover, any lag in the recovery of investment through base rates is offset in the company's next base rate case, whereas the ROE reduction proposed in the cost recovery proposal would reduce the company's return over the life of the investment, regardless of whether the company has a rate case.

It is inappropriate to assume the utilities can earn their allowed return through the incentive mechanism. The targets set in the CEA are already aggressive compared to current performance, so achieving 150% of all targets is highly unlikely. Further, the Board will establish a budget for the utilities to run the programs, which would likely be set to achieve 100% of the

targets, not 150%. Therefore, under the draft proposal, if the utilities were to achieve 100% of the aggressive targets and help New Jersey become one of the leading states in implementing energy efficiency and addressing climate change, they would be penalized 200 basis points on their investment for their efforts.

PSE&G fully supports the CEA and wants to partner with the State as a responsible company to address climate change. However, it also has a fiduciary responsibility to its shareholders. The Company recommends the Board not approve a cost recovery mechanism that puts those responsibilities at odds as the current proposal does.

The Proposal's Arguments Supporting An ROE Reduction Are Flawed

There are several flaws with the arguments set forth in the draft proposal in support of the ROE reduction.

Rate Case ROE factors in decoupling and clause mechanisms - Utility program costs should be allowed a return on the unamortized balance using a rate equal to the utilities' WACC, which is approved in base rate cases after BPU and Division of Rate Counsel review. The draft cost recovery proposal states that "[i]f these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced." This is incorrect. In a rate case the appropriate ROE is determined by applying cost of equity models, such as the discounted cash flow or capital asset pricing model, to proxy group data. The results derived from the cost of equity models do not distinguish the risk associated with those companies' base rates from the risk associated with rates attributed to the trackers, riders, and clauses that are part of those companies' rate structures. It is not possible to "decompose" investors' required returns. The proxy companies evaluated in establishing the base rate ROE for any New Jersey utility employ different clauses, trackers and riders that provide targeted cost recovery mechanisms. When applying standard cost of equity models, all the risk attributes of each rate-setting mechanism are "baked into" the stock prices that are used to measure the cost of equity. Because the impact of utility energy efficiency programs cannot be separated from composite cost of equity that is obtained from application of the cost of equity models, there is no basis for Staff's assertion that New Jersey utility ROEs would be reduced if energy efficiency programs were accounted for in the base ROE.

Any ROE reduction for clause mechanisms would be completely arbitrary - The draft cost recovery proposal states that a 200 basis point reduction for achieving the CEA targets "was selected because this number would result in the appropriate Weighted Average Cost of Capital ("WACC") for the return on these types energy efficiency programs recovered through a surcharge." However, there is no empirical evidence provided to differentiate the risk of cost recovery through a clause to the point where a separate, *i.e.*, lower equity

return can be quantified. No support was provided supporting the 200 basis point reduction, which appears to be completely arbitrary.

Claimed support from other states for the ROE reduction proposal is incorrect - The draft cost recovery proposal states that "[t]his proposed mechanism is modeled on other states and districts such as Maryland and Washington, D.C. which similarly allow for a return on energy efficiency investments, but modify that ROE based on the lowered risk." The Board Orders supporting the cost recovery mechanisms in those states show that this is incorrect. The Maryland and Washington, D.C. utilities are allowed to earn the same return on energy efficiency investments as they are on base investments. This was confirmed by Wayne Hudders of Atlantic City Electric at the January 23, 2020 cost recovery stakeholder meeting, who stated that Exelon's subsidiary companies in Maryland and Washington, D.C. have no ROE reduction on their energy efficiency investments in those states. "In fact," Mr. Hudders stated, "they actually earn that WACC on the entire investment, including O&M type of investments associated with energy efficiency." Under that regime, with utilities earning "the full WACC . . . on all of our costs, we've seen great [energy efficiency] results in Maryland." Again, there is simply no support for the proposed ROE reduction, which would undermine rather than support the State's goals.

ROE reduction is contrary to current New Jersey practice and precedent for clause recovery - Recovering investment on a contemporaneous or near contemporaneous basis is not new. New Jersey already has allowed for return on investment and contemporaneous recovery on energy efficiency investment for over 10 years under the RGGI statute. PSE&G has conducted six energy efficiency programs with approvals dating from 2009 to 2018, and all of these programs are currently earning at the Company's allowed rate of return set in its most recent base rate case (9.6%).[1] The same is true for the other New Jersey utilities that have invested in energy efficiency under the RGGI statue, where they earn a return at their latest allowed ROE determined in a base rate case. It is inexplicable why a 200 basis point reduction for contemporaneous recovery is being proposed now, when the State's commitment to achieving energy efficiency is demonstrably greater than it has been at any time in the past.

Recovery at the base rate WACC has also been implemented under the Board-approved Infrastructure Investment Program ("IIP") regulations, N.J.A.C. 14:3-2A, which allow for contemporaneous-like recovery of accelerated infrastructure programs. The ROE for this accelerated recovery is the same as approved in the latest base rate case. Therefore, the draft proposal to reduce the ROE for contemporaneous recovery is inconsistent with existing New Jersey precedent.

[1] While some programs were approved at a lower ROE between rate cases when market rates had changed significantly, all of the energy efficiency programs except Carbon Abatement, approved first in 2009, call for the return to be updated to the latest WACC approved in a base rate case.

EE Investment is riskier than traditional investments – The draft cost recovery proposal states that "[t]he energy efficiency programs are also less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful." This assessment is incorrect. First, while there are utility investments that can take several years of construction, particularly for electric distribution, there is still a significant amount of investment in the utility that does not span years. Further, the EE investments, particularly for more complex projects like those under PSE&G's proposed Engineered Solutions subprogram, can span several months or over a year, and the participant may at some point terminate the project before it goes into service. Most importantly, energy efficiency is the only investment subject to penalties. The targets set in the Clean Energy Act are aggressive compared to current savings levels and based on the draft program administration straw proposal, the utilities will not have full flexibility to meet those goals nor clarity at this time on how performance will be measured, making penalties a real possibility. The mere threat of penalties for non-performance will make investors view these investments as more risky than traditional assets, regardless of the timing on when the investment goes into service.

Other states can be used as a guide for a cost recovery mechanism:

In trying to balance the cost recovery components to maximize energy efficiency while limiting cost impacts to customers, the cost recovery mechanisms in other states are instructive. Rate Counsel has argued in this stakeholder proceeding that authorizing a return on investment plus lost revenue recovery plus incentives would be too favorable for utilities and burdensome to customers. It is important to note that recovery of lost revenues is not a "plus"; it is avoiding a loss to put energy efficiency investment on par with traditional investments, and the incentive is coupled with the asymmetric risk of a penalty. Further, this structure already exists today in leading states to incent energy efficiency investment, with no demonstrated hardship to customers. In Illinois, for example, utilities can earn a return on their energy efficiency investment at the utility WACC over the weighted average life of the measures, with decoupling and a symmetrical incentive and penalty at +/- 200 basis points. New York also allows for return on energy efficiency investment at the utility's WACC with decoupling and an incentive structure. Maryland allows for return on investment at the utility's WACC with decoupling, but no incentive or penalty mechanism.

With regard to customer impacts, it is important to note the societal benefits from energy efficiency, which is the impetus for the CEA legislation. As shown in Figure 1 above on the net impact of the Company's proposed CEF-EE filing, net bill impacts for non-participants peak at less than 1% and are beneficial to non-participants overall in later years. The impact to participating customers will be even greater.

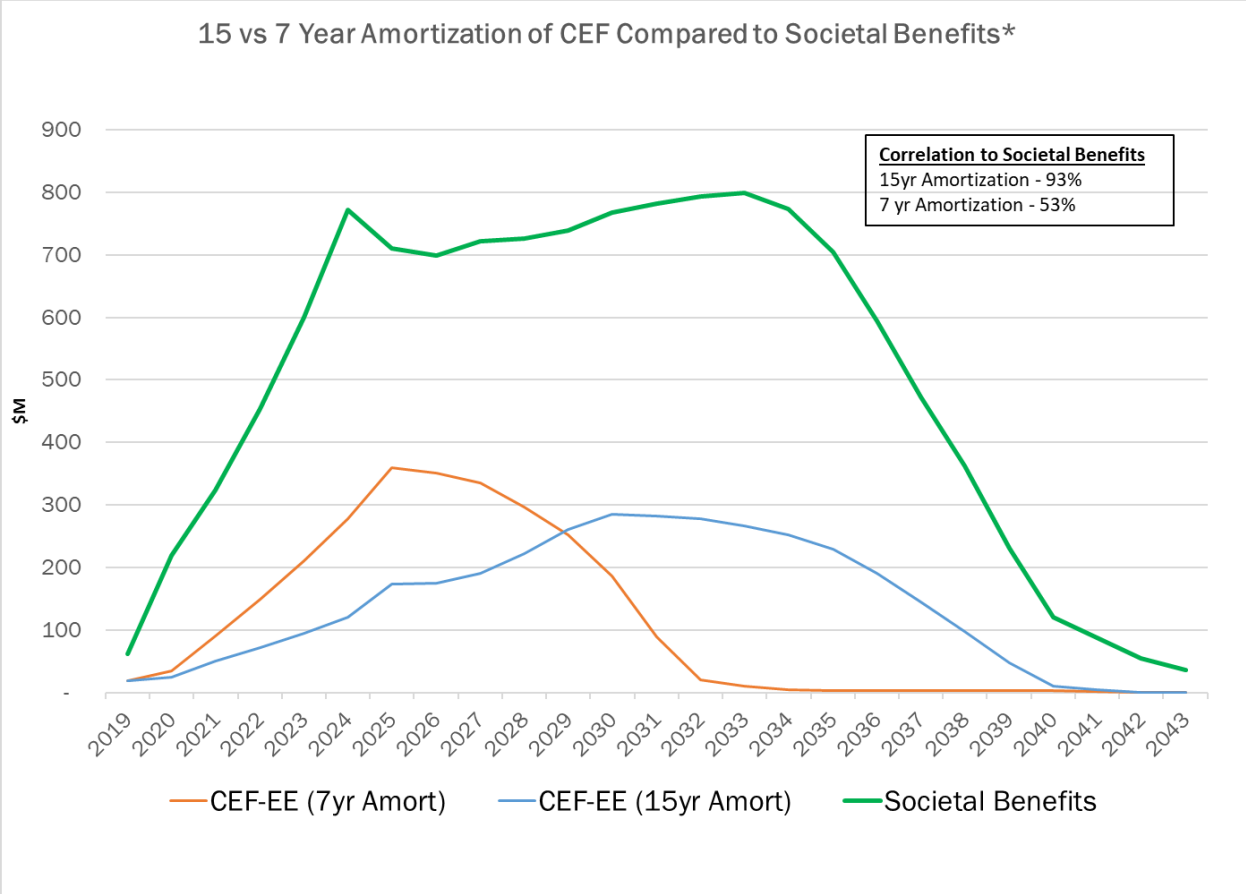
2. <u>Asset/Investment Treatment and Recovery Period -- Utility Program Costs Should Be Amortized Over The Useful Lives Of The Energy Efficiency Measures.</u>

PSE&G agrees with the Board's proposal to amortize non-O&M expenses and its rationale that "this treatment is necessary as it reduces potential rate shock associated with energy efficiency transition programs and spreads the cost of measures over a period of time to better match program costs with program benefits." However, PSE&G does not agree with the arbitrary seven-year period recommended in the proposal. Consistent with Staff's rationale for utilizing amortization, the amortization period should be the weighted average useful life of the investments. It is suboptimal to not use the best match of costs to benefits, which is to recover investment cost over the life of the benefits.

Amortizing costs over a 7-year period breaks the link between the bill impacts of the program and the benefits the program generates. Following ratemaking best practices, the benefits and costs should be matched as closely as possible. Using an artificially shorter time period, such as 7 years, will cause the bill impact to peak earlier in the program, reducing the near-term net benefits generated. In addition, benefits will continue to accrue beyond the recovery period, resulting in inter-generational inequity between customers who benefit from the measures and the customers who pay for them. Traditional infrastructure investments are recovered over their average useful lives as determined through a depreciation study. A gas main, for example, is not recovered over an arbitrary period, but rather over its expected life, so that all customers who benefit from the gas main contribute toward it. The same approach should be utilized for energy efficiency investments. The societal benefits of the installed measures will last over the life of the investment and, thus, costs should be recovered over that same period.

As shown in figure 2 below, amortizing over the average life of the measures results in the highest correlation of cost recovery to benefits.

Figure 2



3. **Lost Revenues -- New Jersey Should Join The Leading Energy Efficiency States In The Country And Adopt Full Revenue Decoupling.**

It is axiomatic that given their volumetric rate structure, utilities' revenues will decline if sales are reduced in the manner that the Clean Energy Act requires. Not permitting the utilities to recover those lost sales revenues would be unjust and unreasonable, and would contravene the express terms of the Clean Energy Act, which specifically authorizes utility recovery for, among other things, "the revenue impact of sales losses resulting from implementation of . . . energy efficiency." Section 13 of the RGGI Act also permits "rate mechanisms that decouple utility revenue from sales of electricity and gas" and states that the Board "shall allow the recovery of program costs", with "program costs" defined to include "foregone electric and gas distribution fixed cost contributions associated with the implementation of the energy efficiency [program]."

PSE&G supports the draft cost proposal's recognition that recovery of lost revenue is necessary, but recommends a decoupling mechanism such as the Green Enabling Mechanism ("GEM") proposed in the Company's CEF-EE filing or the New Jersey Natural Gas and South Jersey Gas Conservation Incentive Program ("CIP"). Anne-Marie Peracchio of New Jersey Natural Gas has spoken passionately throughout this stakeholder process about how the CIP was the impetus that changed the company culture from focusing on incremental load growth to promoting energy efficiency. Additionally, several environmental groups spoke convincingly on the benefits of a decoupling mechanism as opposed to the proposed LRAM at the January 23, 2020 stakeholder meeting. So while "Staff **hopes** (emphasis added) the limited decoupling mechanism [LRAM] below will provide all utilities similar freedom to aggressively pursue and endorse energy efficiency" according to the proposal, it is clear that decoupling **will** provide the ideal environment to achieve the State's savings goals.

Decoupling alone, unlike an LRAM, recovers lost revenue specifically from energy efficiency programs as proposed:

- removes the utility disincentive to promote energy efficiency in all forms, including State-run programs and activities whose impacts are not easily measured, and to promote distributed energy, which allows utilities to be more innovative; without decoupling, these disincentives still exist irrespective of the Act's mandates to reduce energy usage and associated program cost recovery and incentives/penalties;
- provides a method to return revenue increases to customers, which can occur, for example, due to weather impacts or increased electrification due to, for example, the penetration of electric vehicles (the latter being expected given the State's policy to promote electric vehicles); and
- is administratively simple for all stakeholders because it is agnostic as to the drivers of lost revenue, and simply adjusts revenues to levels agreed upon with regulators and other stakeholders.

Instead of recovering actual lost revenues, the calculation performed in implementing an LRAM will be a theoretical exercise to estimate the amount of lost revenues attributable to utility programs, a complex process ripe with technical and theoretical disputes that will burden all stakeholders, with the potential that certain lost revenues associated with the programs will not be identified or recovered.

It is disappointing that while Staff admits that "the CIP has contributed to shifts in utility behavior and culture, allowing for efficiency and conservation to be supported at all levels of utility management," it did not consider a replacement for the BGSS Savings Test embodied in the CIP or adopting the GEM. The Company is open to talking with Staff and other stakeholders to work on an alternative to the BGSS Savings Test. While PSE&G supports the GEM for the reasons

stated in the CEF-EE proceeding, the GEM is very similar to the existing CIP. As we have demonstrated before, the CIP and the GEM are calculated in the same manner as both:

- Are calculated on a per-customer basis, maintaining the utilities' incentives to spur economic growth and serve new customers;
- Are applied on a rate class-by-rate class basis and applied only to customers in those rate classes that account for large amounts of distribution base rate revenues, ensuring that individual customers will experience de minimis bill impacts due to recovery of lost revenue, thereby not impacting their decision to conserve;
- Employ an earnings test that mirrors the test under the Infrastructure Investment Program requirements; and
- Employ a soft rate cap to ensure modest customer rate increases.

While the draft proposal includes an earnings test consistent with the IIP requirements, it does not include any reference to a soft cap on customer rate increases. The CIP BGSS savings test is a soft cap that limits annual recovery up to permanent, historic capacity savings with an adjustment factor. A customer rate increase cap on lost revenue recovery can achieve the same goal.

Given the benefit of the existing CIP acknowledged in the draft cost recovery proposal, the Board should adopt the GEM as proposed, which is significantly similar to the existing CIP, with an additional soft cap to ensure customer benefits if necessary, rather than simply abandoning the CIP and reimposing the throughput disincentive on NJNG and SJG with an LRAM.

Finally, PSE&G does not object to the following lost revenue components included in the draft cost recovery proposal, which can be applied to a decoupling mechanism as well as an LRAM:

- Stakeholder review after 3 years;
- Rate case requirement every 5; and
- Earnings test that mirrors IIP

4. <u>Incentives/Penalties -- The Incentive and Penalty Structure Should Be Simple, Scalable, Symmetrical, Capped, And Recovered Over Time</u>

PSE&G supports the use of performance incentives and penalties to promote State policy goals and reach the targets outlined in the Clean Energy Act. Performance should be determined based on the results of the QPIs, which should contain the following elements:

- **Simple and transparent**. The mechanism must be as simple as possible, to translate performance on QPIs into incentives and penalties.

- **Dead band**. There should be a dead band around the targets in which no incentive or penalty is incurred.

- **Cap and floor**. The existence of a cap and floor serves to limit exposure of both customers and utilities in the event of significant under- or over-performance.

- **Linear scaling.** The incentives and penalties should scale linearly between the floor and the dead band, as well as between the dead band and the cap.

- **Recovered over time**. As does amortization of program costs, this approach aligns the incentive or penalty with the time over which customers receive the benefit from EE investment. It will also minimize the rate volatility that could flow from awarding the entire incentive or imposing the entire penalty in a single year.

PSE&G supports the draft cost recovery proposal's incentive and penalty structure of an ROE adjustment mechanism on energy efficiency investment, which will naturally satisfy the principle to recover the incentive/penalty over time and will keep the mechanism simple and transparent by tying it to the utility's existing ROE. This aligns with practices in both Illinois and New York, leading EE states that have both rate-of-return on EE investment and performance incentives. The Company also agrees with the inclusion of a deadband around which no incentive or penalty will be incurred and scaling the incentive and penalty linearly from the deadband to a pre-established cap and floor. We also do not object to reviewing the mechanism in three years.

However, PSE&G does not agree with the size of the penalty, which is disproportionately high compared to the incentive. The cap and floor were set symmetrically at 150% and 50%, respectively. The proposed incentive scales up 200 basis points from achieving targets from 110% to 150%, or 5 basis points per percent. The penalty scales down to the cost of debt, which is approximately 4% for PSE&G. Therefore, the penalty scales from 7.6% to 4%, or by 9 basis points per percent, or more than twice the incentive scaling. This is on top of the 200 basis point reduction already applied on the base ROE in the draft proposal.

The disproportionately high penalty is overly punitive on its own, but the draft cost recovery proposal also adds on an **additional** penalty below the floor of 0.75% of the prior year's distribution revenue. This aspect of the proposal clearly violates the CEA, which provides that penalties should not impact the Company's base distribution ROE. Specifically, the CEA states:

> The adjustments made pursuant to this subsection may be made through adjustments of the electric public utility's or gas public utility's return on equity *related to the energy efficiency or peak demand reduction programs only*, or a

specified dollar amount, reflecting the incentive structure as established in this subsection.

Given the language highlighted above, the proposal to apply a penalty beyond the return on the energy efficiency investment is not within the language of the law.

Additionally, the proposed penalties are not appropriate given that the requirements of the CEA represent a significant change, with little certainty about the utilities' role and requirements. While all utilities will likely target achieving the QPIs, it is important to remember the aggressive targets being set. If an electric utility were to achieve an energy reduction just under 1%, it would represent savings of almost three times that achieved last year according to ACEEE, and would exceed the savings achieved by more than half of the states in the country. It would also represent less than 50% of the energy savings targets and could result in the utility not only receiving no ROE (since at the 50% level the utility can only recover its debt costs), but also incurring onerous penalties that would violate the CEA language quoted above. While PSE&G anticipates achieving the QPI targets, the penalties are simply too high considering the dramatic nature of the transition underway. To that end, the Company recommends the Board not adopt an incentive or penalty structure for at least the first two years of the program, and consider more flexibility during the transition period.

Finally, it is important to note that penalties are rare around the country. As noted by Rachel Gold from ACEEE, "[n]egative penalties in utility performance incentives are infrequently applied in policy design, as only seven of 25 states with energy efficiency mandates have included them in legislation or rules. In fact, two states, California and New York, recently reapproved their EE incentive mechanism without the explicit penalty element in their original policies." Some of the issues that led New York to abandon its penalty structure were noted in the article:

> Staff [in New York] further suggested that utilities were incentivized to shift their staff resources away from underperforming programs toward more effective programs. While this can maximize total short-term savings, it can also shift resources from programs that needed restructuring or more resources to succeed. It can also shift utility focus away from difficult-to-serve sectors like residential and low-income, which can decrease the equity of the EE portfolio. Finally, staff claimed that the penalties undermined broader long-term program goals by focusing utilities on the proximate need to avoid negative adjustments, shifting attention away from time-consuming exercises in problem-solving. Further, staff believed that incentives undermined their working relationship with the utilities and affected the collaboration between the New York State Energy Research and Development Authority (NYSERDA), which offers statewide DSM programs, and the utilities, because of questions of how credit for energy savings would be divided.

Finally, Ms. Gold noted that "[i]ncentive policy design is asymmetrical in most states, as most states include positive but not negative incentives for energy efficiency performance against goals." The policy in the Staff's cost recovery proposal is the reverse, with asymmetrically large penalties compared to the incentives. A symmetrical incentive and penalty approach can be implemented to reward utilities exceeding targets and punishing those that fall short, but there is no need for those amounts to be significant to motivate behavior. To that end, a significant penalty, or even the risk thereof, can negatively impact shareholders views of the utility and increase its credit risk and borrowing costs, which will ultimately be paid by customers. Conversely, a significant incentive can result in higher costs to customers than needed to motivate energy efficiency investment.

5. **Other – There Should Be No Rate Cap On Energy Efficiency Investment, Over/Under Interest Should Be At Commercial Paper, And The Company Agrees With EE As A Resource**

The draft cost recovery proposal also addresses three other cost recovery components. First, the Company agrees with the draft cost recovery proposal's recommendation of no rate cap on the energy efficiency investment recovery. A cost recovery mechanism that includes a rate cap would undermine the state's energy efficiency requirements expressed in the Clean Energy Act. We have no objection to monitoring rate impacts over the first two years of the program.

Second, the proposal recommends interest on any over or under-recoveries at two-year treasuries plus 60 basis points. While the Company does not object to this rate, it proposes using a commercial paper rate as an alternative. The recovery mechanism will likely be a component of the Company's existing Green Programs Recovery Charge and all other components have interest at commercial paper.

Finally, the proposal requests bidding MW reductions into PJM. PSE&G agrees that the utilities should use their best efforts to participate in the PJM capacity market with capacity reductions created though its EE programs, consistent with PJM rules regarding EE participation. PSE&G recommends that utilities should integrate PJM capacity market participation into their respective EM&V plans, but with the acknowledgement that the utilities cannot guarantee any particular level of cleared EE resources or revenue resulting from its participation. PJM capacity market rules continue to evolve, which could affect future eligibly, revenues, or level of EE resources bid and cleared in the market. Any PJM revenues should be given back to customers by reducing the revenue requirements of the program that generated the revenues.

Conclusion

Energy conservation is the most cost-effective way to reduce energy usage; the Clean Energy Act recognizes this and seeks to make New Jersey a leader in addressing climate change. The draft proposal appears to value limiting the cost to comply with the CEA targets. PSE&G

understands the desire to minimize rate impacts for a significant ramp up in energy efficiency expenditures. However, the cost recovery proposal undervalues the benefits of energy efficiency. One of the requirements of the CEA is that the investment be cost-beneficial after factoring in the environmental benefits of reduced consumption. The goal should be to maximize cost-effective energy reductions as much as possible. As shown in Figure 1 above, a cost recovery approach that allows for amortizing investment over the weighted average life of the measures installed, earning a return at the utility's WACC and implementing a decoupling mechanism will align the utilities' and the State's goals to combat climate change at a negligible net impact to customers.

Respectfully submitted,

Joseph F. Accardo, Jr.

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STEFANIE A. BRAND
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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: _____
Kurt S. Lewandowski, Esq.
Assistant Deputy Rate Counsel

Enclosure

cc: EnergyEfficiency@bpu.nj.gov
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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 not 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 any 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

[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. <u>Lost Revenue Treatment</u>

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

[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 all 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] 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).

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

[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. General Comments

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

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

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

NJBPU Staff Energy Efficiency Transition
Cost Recovery Mechanism Proposal
Rockland Electric Company Comments
February 6, 2020

Executive Summary

By Notice dated January 9, 2020, the New Jersey Board of Public Utilities ("NJBPU") requested that interested stakeholders provide comments on NJBPU Staff's Energy Efficiency Transition Cost Recovery Mechanism Proposal ("Proposal") dated January 22, 2020. Rockland Electric Company ("RECO" or the "Company") submits these Comments in response to the Notice. These comments supplement the comments that the Company submitted on November 14, 2019 ("RECO November Comments").

As an initial matter, RECO reiterates the essential requirement that utilities' energy efficiency ("EE") investments must be treated in the same fashion as traditional utility rate base investment if New Jersey is to accomplish the exceedingly ambitious goals of the Clean Energy Act.[1] Establishing such a level playing field requires that EE investments be amortized over the actual useful lives of the EE measures, carrying costs on EE measures should reflect a utility's current capital structure, utilities should be allowed a realistic opportunity to earn meaningful incentives, and robust revenue decoupling mechanisms should be implemented. Numerous stakeholders have advocated that some, or all, of these components be in place to support a robust energy efficiency program and broader state decarbonization goals in their comments filed in response to the Board's Cost Recovery Scenario notice.[2] Unfortunately, as discussed in detail below, the Proposal fails in a number of critical ways to establish the regulatory framework necessary to meet the Clean Energy Act's, as well as the Governor's, aggressive energy efficiency goals. The Company urges the NJBPU to amend the Proposal as discussed below.

RECO's Specific Comments

Investment Treatment

Amortization Period

The Proposal provides that EE program investments will be amortized over a seven-year period.[3] As the Company noted in the RECO November Comments, the amortization period of EE program investments should be based on the average life of the portfolio of EE measures. Amortization of EE investments over the life of a portfolio of EE measures allows customers to

[1] P.L. 2018, Chapter 17. The EE portion of the CEA is codified at N.J.S.A. 48:3-87.9.
[2] *See* Joint Comments filed by the Energy Efficiency Alliance of New Jersey, NRDC, New Jersey Sustainable Business Council, and US Green Business Council (January 3, 2020); Comments filed by Gabel Associates Inc. (January 3, 2020); Comments filed by New Jersey Energy Coalition (January 3, 2020); and Comments filed by Uplight (January 3, 2020) accessed at https://njcepfiles.s3.amazonaws.com/Comments+Cost+Recovery+II.pdf
[3] Proposal at 5.

contribute to program costs according to the benefits they receive. This approach eliminates the shifting of these costs between current customers and future customers, reduces the customer bill impact in any given year, and aligns the costs incurred with the benefits received in the same year. Given this approach, the Company recommends that EE program investments be amortized over a ten-year period. Such a ten-year period is more in line with the average lives of the portfolio of EE measures that the Company expects to implement, and provides the additional benefit of reducing the customer bill impacts.[4]

Carrying Costs

The Proposal provides that the carrying cost for EE investments will employ a modified version of the capital structure established in each utility's most recent base rate case.[5] Specifically, such capital structure will incorporate both (a) the cost of debt and (b) the return on equity ("ROE") less 200 basis points. According to the Proposal, the 200 basis points discount reflects the alleged risk reduction associated with the contemporaneous recovery provided for by the cost recovery mechanism. The Proposal provides three reasons for this structure that are without support. First is the assertion, that there is an inherent reduction in risk associated with the contemporaneous recovery available in this mechanism, as compared to recovery in base rates where the utility may not be able to recover costs for years after they are incurred. Second, is the assertion that EE programs are less risky than traditional infrastructure investment. Third, the Proposal speculates that if EE programs were accounted for in base rate ROE, a utility's base rate ROE would be reduced.

The NJBPU should not be swayed by any of these unsupported assertions. With regard to the first assertion that EE investment is inherently less risky, this argument fails to recognize that because EE programs are subject to penalties, they are inherently risky for a utility. In addition, the current Cost Recovery proposal suggests that rate caps may be imposed. Rate caps create a risk for the utility that the utility's EE investments will not be recovered in a timely manner. The

[4] For example, the BPU's Clean Energy Protocols list the useful lives of forty or more energy efficiency measures. Only a few of the forty measures have useful lives less than ten years, and the majority of the measures have useful lives of ten to twenty years. *See New Jersey Board of Public Utilities Clean Energy Program Protocols to Measure Resource Savings*, pages 180-182, Revisions to FY2016 Protocols, Release Date: June 22, 2018 Board Approval Date: June 22, 2018 ("NJ Clean Energy Protocols"). Available at https://njcleanenergy.com/files/file/Board%20Orders/FY19/1g2%20-%20NJCEP%20Protocols%20to%20Measure%20Resource%20Savings%20FY19%20%20v3a.pdf. The NJ Clean Energy Protocols frequently cite to the protocols of the New York Public Service Commission ("NYPSC"). Similar to the NJ Clean Energy Protocols, of the eighty or more listed measures in the NYPSC protocols, less than a quarter have useful lives less than 10 years, and the remaining measures have useful lives of ten to twenty or more years. See New York Standard Approach for Estimating Energy Savings from Energy Efficiency Programs –Residential, Multi-Family, and Commercial/Industrial Measures Version 5.2. Issue Date – April 10, 2018, Effective Date – January 1, 2018. Available at http://www3.dps.ny.gov/W/PSCWeb.nsf/96f0fec0b45a3c6485257688006a701a/72c23decff52920a85257f1100671bdd/$FILE/TRM%20Version%205.2%20-%20April%202018.pdf

[5] Proposal at 5.

second assertion, that EE investments carry less risk than infrastructure investments, is not supported by factual examples. Again, EE investment carries the risk of penalties, and infrastructure investments are not exposed to potential penalties. EE programs also experience delays and events beyond the utility's control, such as storms and economic downturns. Other sources of risk to EE programs are large commercial and industrial EE projects. These programs can take multiple years to complete and are sensitive to the budgetary constraints of these large customers. A vendor can fail to perform, potentially preventing the utility from achieving its NJBPU-established quantitative performance indicators ("QPIs").Regarding the third assertion that Staff " expects" a utility's ROE would be reduced if EE programs were included in base rates, no authority or examples are provided for this statement. The success of New Jersey's energy reduction goals should be grounded in the actual experience of other states and utilities, or industry studies.

As noted in the RECO November Comments, the carrying charge rate for EE investments should be the Company's pre-tax overall weighted cost of capital ("WACC") as ordered by the NJBPU in the Company's last base rate case.[6] Importantly, using the Company's WACC places utility EE and utility non-EE investments on an equal footing, and therefore eliminates the disincentive to invest in EE. The Company would note that the Clean Energy Act refers to Section 13 of the RGGI Act,[7] and the carrying charge on RGGI Act investments is based on the utility's WACC established in its last rate case.

Rate Caps

The Proposal recommends that initially, in order to encourage reaching EE goals, there will not be a cap, or a constraint, on the customer distribution rate or customer bill.[8] The NJBPU will monitor rate impacts closely; a cap on either rates or on customer bill impacts may be instituted two years after the approval of EE transition programs.

The Company agrees with the Proposal's recommendation that the NJBPU not implement a cap on either rates or customer bills in order to encourage the achievement of the Clean Energy Act's EE goals. Based upon the Company's initial projections, the bill impact resulting from RECO's EE program should be modest.

Below the Company provides an example of a potential EE program, with customer bill impacts.

<u>Example of bill impact for a potential RECO EE program</u>

[6] For RECO, the after-tax WACC would be 7.11 percent as ordered by the NJBPU in RECO's recently concluded electric base rate case. *I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Its Electric Rates, Its Tariff for Electric Service and Its Depreciation Rates; and for Other Relief*, BPU Docket No. ER19050552, Decision and Order Adopting Initial Decision and Stipulation of Settlement (dated January 22, 2020). The pre-tax WACC is 8.91 percent.

[7] L.2007, c. 340, § 13 codified at N.J.S.A. 48:3-98.1

[8] The Proposal at 5.

Assumptions for potential RECO program:

- Program costs of $4 million each year for the next 5 years starting in 2021
- 10-year life for regulatory assets
- Assume immediate tax deduction for all incurred costs.[9]
- Assume no property taxes applicable.
- Assume 21% federal income tax rate and 9% NJ state income tax.
- Assume the $4 million in program costs is spent evenly throughout the year.
- Finally, the example assumes there are no incentives for reaching targets.

Annual Revenue Requirement Based on the Above Assumptions (in '000s)

	2020	2021	2022	2023	2024	2025
At full authorized WACC	322[1]	954	1,560	2,141	2,695	2,902
WACC less 200bps of equity	304[1]	901	1,476	2,029	2,561	2,767

1 Each row represents the revenue requirement.

Bill Impact of the Above Program Costs

	2020	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025
At full authorized WACC	0.16%	0.31%	0.32%	0.31%	0.33%	0.15%

Over/Under Recoveries

The Proposal provides that any over and under recoveries will have a carrying cost of the two-year Treasury bill rate plus 60 basis points.[10] According to the Proposal, this will correct for errors in sales projections. RECO has no objection to this proposal as such interest rate is consistent with other RECO surcharge mechanisms such as RGGI and the SBC.

Lost Revenue Treatment

Revenue Decoupling Mechanism

The Proposal recommends that the NJBPU allow utilities to recover lost revenues in the amount that they can demonstrate were attributable to the utility-run EE and peak demand reduction program(s).[11] These lost revenues are to be reviewed and recovered annually. Only lost revenues associated with the utility's distribution base rates will be recoverable. Utilities will be

[9] This an assumption that the energy efficiency costs are treated for federal tax purposes as an expense rather than subject to depreciation as a capital expenditure and therefore deductible over time.
[10] The Proposal at 5.
[11] The Proposal at 6.

required to file a base rate case no later than five years after the commencement of an approved EE transition program, so that usage projections are updated and to reset lost revenues.

The Proposal does not explain, either generally or specifically, how a utility is to demonstrate that lost revenues are attributable to the utility-run EE and peak demand reduction programs. Similarly, the Proposal does not discuss how utilities are to track lost revenues resulting from the Office of Clean Energy's ("OCE") programs. By attempting to tie lost revenue directly to efficiency measures, taking into account other factors that may reduce energy use (*e.g.*, weather or other economic factors such as energy prices), the revenue decoupling mechanism recommended by the Proposal resembles a lost revenue adjustment mechanism ("LRAM"). As the Company noted in the RECO November Comments, an LRAM requires a complicated evaluation, measurement and verification process to review energy savings achieved.[12] In particular, the NJBPU, utilities, and other stakeholders would be tasked with linking energy reductions to specific measures or events, whether its EE, adoption of distributed generation, or weather. The development of such a process that attempts to measure accurately the energy reductions linked to EE measures can be costly, administratively burdensome, and increase the likelihood of contentious administrative proceedings. The fact that the Proposal omits entirely any detail regarding its recommended revenue decoupling mechanism implicitly bears witness to its inherent complexity.

An LRAM also still ties, to an extent, utility profit to sales. Therefore, the adoption of such a mechanism may inadvertently frustrate other efforts that reduce demand pursued by the utility, such as behind the meter renewables. This is due to the fact that utilities will still lose the revenue necessary to operate due to other market efforts. This may consequently discourage the advancement of other state goals that reduce energy usage.

The Proposal recommends that its proposed revenue decoupling mechanism be reviewed three years after the approval of utility EE transition programs to verify that this method is appropriately incentivizing EE programs. RECO has no objection to such a filing and review requirement. Similarly, RECO has no objection to the requirement that utilities must file a base rate case no later than five years after the commencement of an approved EE transition program.

Finally, the Proposal would impose an earnings test on the utilities. Specifically, on an annual basis, a utility would be required to calculate its ROE based on the actual net income of the utility for the most recent 12-month period, divided by the average of the beginning and ending common equity balances for the corresponding period.[13] For any EE transition program approved by the NJBPU, if the calculated ROE exceeds the allowed ROE from the utility's last base rate case by 50 basis points or more, recovery of lost revenues would not be allowed for the applicable filing period. For example, based on its current ROE of 9.5 percent, if in the most

[12] Lost Margin Recovery, American Council for an Energy Efficient Economy, accessed at https://aceee.org/sector/state-policy/toolkit/utility-programs/lost-margin-recovery
[13] The Proposal at 6.

recent 12-month period RECO earned more than a 10.0 percent ROE, it would be precluded from recovering lost revenues. RECO does not object to this restriction.

Performance Incentive and Penalty Treatment

The Proposal provides that performance incentives and penalties will both take the form of ROE adjustments applied to a utility's EE transition program investment.[14] The ROE adjustments are tied directly to a utility's performance regarding NJBPU established QPIs. These QPIs will measure a utility's achievement of energy use reduction targets. The utility will be awarded a performance incentive, calculated on a sliding scale, if it achieves between 110% and 150% of its QPIs. The utility will be assessed a performance penalty, calculated on a sliding scale, if it achieves between 50% and 90% of its QPIs. Performance below 50%, will further penalize the utility at the rate of .75% of base rate distribution revenues. There will be a neutral area, or buffer, within which a utility will not be awarded an incentive or assessed a penalty. This buffer applies if a utility achieves between 90% and 110% of its QPIs.

The Company has several objections to the Proposal's performance incentives and penalties recommendations. As noted in the RECO November Comments, conceptually the Company supports the linear scalability of incentives and penalties, however incentives and penalties should not be symmetrical, particularly in the early stages of EE implementation. In particular RECO recommended that penalties should be minimal to non-existent in the early ramp up years. The Proposal put forth by staff fails to provide the utilities with a realistic opportunity to earn meaningful incentives, (statement summarizing our objection to penalties), and contravenes the dictates of the Clean Energy Act.

Specifically, the Company objects to the scalability framework recommended by the Proposal. Requiring a utility to achieve 110 percent of its QPIs before it can earn an incentive is wholly unrealistic. As a general matter, a utility's EE transition program budget is structured so as to achieve 100 percent of its QPIs. Given the aggressive energy savings goals of the Clean Energy Act, and the need for the utilities to ramp up their EE efforts, RECO expects that it will be very challenging to achieve 100 percent of its QPIs. If a utility is to achieve results greater than 100 percent of its QPIs, it will need to increase its EE transition program spending (*i.e.*, budget). Budgets and energy targets are established to minimize spending and maximize energy savings. To achieve a realistic balance of these two goals, an average spending target must be established for the entire portfolio which incorporates a combination of higher cost measures which often produce higher/longer term savings along with lower cost measures that produce less/short term energy savings. At the point utility energy savings targets exceed the average $/MWh portfolio spending levels, targets and budgets become misaligned. Utilities are forced to utilize least cost portfolio measures, with a shorter life, to achieve savings targets above 100%. Given these

[14] The Proposal at 6-7.

circumstances, a utility should be able to begin earning incentives once it achieves 80 percent of its QPIs. Incentives would be scaled upward from this 80 percent achievement threshold.

The Company also strongly recommends calculating incentives and penalties on a monetary basis. The Proposal acknowledges that several other states, such as Pennsylvania, employ this approach. The Proposal rejects this approach on the grounds that it is more appropriate, with the great size disparity among New Jersey utilities, to pursue a mechanism able to incent larger utilities while not capriciously punishing smaller ones. This penalty will scale to utility size in a way that a set monetary penalty could not. This purported justification does not bear even casual scrutiny. Monetary penalties can readily be adjusted among the State's utilities to reflect their relative size. No stakeholder has suggested that the monetary value of incentives and penalties be uniform across utilities (*e.g.*, that PSE&G and RECO be able to achieve the same absolute incentive amounts). In the RECO November Comments, the Company recommended that incentives and penalties be established on a monetary basis. RECO remains convinced that using specific dollar amounts allows for a simple and transparent determination of credits to customers. It also establishes more effective incentives than adjustments to earnings. From an administrative perspective it has the benefit of avoiding the complications inherent in the Proposal's sliding scale ROE approach.

The Proposal also provides that the performance incentive and penalty structure will be reviewed three years after the approval of utility EE transition programs, along with the utility's QPIs. The Company has no objection to this three-year review process, so long as any adjustments are prospective.

Energy Efficiency as a Resource

The Proposal (p. 9) states that:

> utilities will use their best efforts to register, nominate, and/or bid each year's expected megawatt ("MW") reduction resulting from the energy efficiency transition program(s) into any and all PJM market(s) and/or programs for which the energy efficiency transition program(s) are eligible during the life of the energy efficiency transition program(s).

RECO would note that, to date, it has not engaged in such activity. To become an active participant in these PJM markets, RECO will need to ramp up a number of activities (*e.g.*, risk assessment, coordination with PJM, trading capability) which will require increased staffing. Given RECO's size, particularly compared to the other New Jersey electric utilities,

participation in these markets may not be cost effective. At a minimum, the Board should engage stakeholders further before blindly pursuing this quest.

Conclusion

For the above reasons, RECO requests that the Board issue an Order incorporating thee Comments.

NJBPU Staff Energy Efficiency Transition
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February 6, 2020

Executive Summary

By Notice dated January 9, 2020, the New Jersey Board of Public Utilities ("NJBPU") requested that interested stakeholders provide comments on NJBPU Staff's Energy Efficiency Transition Cost Recovery Mechanism Proposal ("Proposal") dated January 22, 2020. Rockland Electric Company ("RECO" or the "Company") submits these Comments in response to the Notice. These comments supplement the comments that the Company submitted on November 14, 2019 ("RECO November Comments").

As an initial matter, RECO reiterates the essential requirement that utilities' energy efficiency ("EE") investments must be treated in the same fashion as traditional utility rate base investment if New Jersey is to accomplish the ambitious goals of the Clean Energy Act.[1] Establishing such a level playing field requires that EE investments be amortized over the actual useful lives of the EE measures, carrying costs on EE measures should reflect a utility's current capital structure, utilities should be allowed a realistic opportunity to earn meaningful incentives, and robust revenue decoupling mechanisms should be implemented. Numerous stakeholders have advocated that some, or all, of these components be in place to support a robust energy efficiency program and broader state decarbonization goals in their comments filed in response to the Board's Cost Recovery Scenario notice.[2] Unfortunately, as discussed in detail below, the Proposal fails in a number of critical ways to establish the regulatory framework necessary to meet the Clean Energy Act's, as well as the Governor's, energy efficiency goals. The Company urges the NJBPU to amend the Proposal as discussed below.

RECO's Specific Comments

Investment Treatment

Amortization Period

The Proposal provides that EE program investments will be amortized over a seven-year period.[3] As the Company noted in the RECO November Comments, the amortization period of EE program investments should be based on the average life of the portfolio of EE measures. Amortization of EE investments over the life of a portfolio of EE measures allows customers to

[1] P.L. 2018, Chapter 17. The EE portion of the CEA is codified at N.J.S.A. 48:3-87.9.
[2] *See* Joint Comments filed by the Energy Efficiency Alliance of New Jersey, NRDC, New Jersey Sustainable Business Council, and US Green Business Council (January 3, 2020); Comments filed by Gabel Associates Inc. (January 3, 2020); Comments filed by New Jersey Energy Coalition (January 3, 2020); and Comments filed by Uplight (January 3, 2020) accessed at https://njcepfiles.s3.amazonaws.com/Comments+Cost+Recovery+II.pdf
[3] Proposal at 5.

contribute to program costs according to the benefits they receive. This approach eliminates the shifting of these costs between current customers and future customers, reduces the customer bill impact in any given year, and aligns the costs incurred with the benefits received in the same year. Given this approach, the Company recommends that EE program investments be amortized over a ten-year period. Such a ten-year period is more in line with the average lives of the portfolio of EE measures that the Company expects to implement, and provides the additional benefit of reducing the customer bill impacts.

For example, the BPU's Clean Energy Protocols list the useful lives of forty or more energy efficiency measures. Only a few of the forty measures have useful lives less than ten years, and the majority of the measures have useful lives of ten to twenty years. Further, the NJ Clean Energy Protocols frequently cite to the protocols of the New York Public Service Commission ("NYPSC"). The protocols of the New York Public Service Commission ("NYPSC") are similar to the NJ Clean Energy Protocols: of the eighty or more listed measures in the NYPSC protocols, less than a quarter have useful lives less than 10 years, and the remaining measures have useful lives of ten to twenty or more years.[4] Further, the NJ Clean Energy Protocols frequently cite to the protocols of the New York Public Service Commission ("NYPSC"). The protocols of the NYPSC are similar to the NJ Clean Energy Protocols: of the eighty or more listed measures in the NYPSC protocols, less than a quarter have useful lives less than 10 years, and the remaining measures have useful lives of ten to twenty or more years.[5]

Carrying Costs

The Proposal provides that the carrying cost for EE investments will employ a modified version of the capital structure established in each utility's most recent base rate case.[6] Specifically, such capital structure will incorporate both (a) the cost of debt and (b) the return on equity ("ROE") less 200 basis points. According to the Proposal, the 200 basis points discount reflects the alleged risk reduction associated with the contemporaneous recovery provided for by the cost recovery mechanism. The Proposal provides three reasons for this structure that are without support. First is the assertion, that there is an inherent reduction in risk associated with the contemporaneous recovery available in this mechanism, as compared to recovery in base rates

[4] *See New Jersey Board of Public Utilities Clean Energy Program Protocols to Measure Resource Savings*, pages 180-182, Revisions to FY2016 Protocols, Release Date: June 22, 2018 Board Approval Date: June 22, 2018 ("NJ Clean Energy Protocols"). Available at https://njcleanenergy.com/files/file/Board%20Orders/FY19/1g2%20-%20NJCEP%20Protocols%20to%20Measure%20Resource%20Savings%20FY19%20%20v3a.pdf

[5] *See New York Standard Approach for Estimating Energy Savings from Energy Efficiency Programs – Residential, Multi-Family, and Commercial/Industrial Measures Version 5.2. Issue Date – April 10, 2018, Effective Date – January 1, 2018.* Available at http://www3.dps.ny.gov/W/PSCWeb.nsf/96f0fec0b45a3c6485257688006a701a/72c23decff52920a85257f1100671bdd/$FILE/TRM%20Version%205.2%20-%20April%202018.pdf

[6] Proposal at 5.

where the utility may not be able to recover costs for years after they are incurred. Second, is the assertion that EE programs are less risky than traditional infrastructure investment. Third, the Proposal speculates that if EE programs were accounted for in base rate ROE, a utility's base rate ROE would be reduced.

The NJBPU should not be swayed by any of these unsupported assertions. With regard to the first assertion that EE investment is inherently less risky, this argument fails to recognize that because EE programs are subject to penalties, they are inherently risky for a utility. In addition, the current Cost Recovery proposal suggests that rate caps may be imposed. Rate caps create a risk for the utility that the utility's EE investments will not be recovered in a timely manner. The second assertion, that EE investments carry less risk than infrastructure investments, is not supported by factual examples. Again, EE investment carries the risk of penalties, and infrastructure investments are not exposed to potential penalties. EE programs also experience delays and events beyond the utility's control, such as storms and economic downturns. Other sources of risk to EE programs are large commercial and industrial EE projects. These programs can take multiple years to complete and are sensitive to the budgetary constraints of these large customers. A vendor can fail to perform, potentially preventing the utility from achieving its NJBPU-established quantitative performance indicators ("QPIs").Regarding the third assertion that Staff " expects" a utility's ROE would be reduced if EE programs were included in base rates, no authority or examples are provided for this statement. The success of New Jersey's energy reduction goals should be grounded in the actual experience of other states and utilities, or industry studies.

As noted in the RECO November Comments, the carrying charge rate for EE investments should be the Company's pre-tax overall weighted cost of capital ("WACC") as ordered by the NJBPU in the Company's last base rate case.[7] Importantly, using the Company's WACC places utility EE and utility non-EE investments on an equal footing, and therefore eliminates the disincentive to invest in EE. The Company would note that the Clean Energy Act refers to Section 13 of the RGGI Act,[8] and the carrying charge on RGGI Act investments is based on the utility's WACC established in its last rate case.

Rate Caps

The Proposal recommends that initially, in order to encourage reaching EE goals, there will not be a cap, or a constraint, on the customer distribution rate or customer bill.[9] The NJBPU will

[7] For RECO, the after-tax WACC would be 7.11 percent as ordered by the NJBPU in RECO's recently concluded electric base rate case. *I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Its Electric Rates, Its Tariff for Electric Service and Its Depreciation Rates; and for Other Relief*, BPU Docket No. ER19050552, Decision and Order Adopting Initial Decision and Stipulation of Settlement (dated January 22, 2020). The pre-tax WACC is 8.91 percent.
[8] L.2007, c. 340, § 13 codified at N.J.S.A. 48:3-98.1
[9] The Proposal at 5.

monitor rate impacts closely; a cap on either rates or on customer bill impacts may be instituted two years after the approval of EE transition programs.

The Company agrees with the Proposal's recommendation that the NJBPU not implement a cap on either rates or customer bills in order to encourage the achievement of the Clean Energy Act's EE goals. Based upon the Company's initial projections, the bill impact resulting from RECO's EE program should be modest.

Below the Company provides an example of a potential RECO EE program, with revenue requirements and customer bill impacts. The customer bill impacts show that even when the full WACC is included, the customer impacts are modest. For Tables 1 and 2 below, which illustrate the customer bill impacts are modest, the following assumptions were made:

- Program costs of $4 million each year for the next 5 years starting in 2021
- 10-year life for regulatory assets
- Assume immediate tax deduction for all incurred costs.[10]
- Assume no property taxes applicable.
- Assume 21% federal income tax rate and 9% NJ state income tax.
- Assume the $4 million in program costs is spent evenly throughout the year.
- Finally, the example assumes there are no incentives for reaching targets.
- Table 2 assumes a typical residential customer using 1,150 kWh per summer month, 813 kwh per winter month (11,100 kWh on an annualized basis).

As Table 1 and Table 2 on the following page demonstrate, the customer bill impact of changes in program revenue requirement are modest.

[10] This an assumption that the energy efficiency costs are treated for federal tax purposes as an expense rather than subject to depreciation as a capital expenditure and therefore deductible over time.

Table 1. Annual Revenue Requirement Based on the Above Assumptions

(in '000s)

	2021	2022	2022	2023	2024	2025
At full authorized WACC	322	954	1,560	2,141	2,695	2,902

Each row represents the revenue requirement of the RECO program.

Table 2. Bill Impact of the Above Program Costs

	2021-2022	2022-2023	2023-2024	2024-2025
At full authorized WACC	0.32%	0.31%	0.33%	0.15%

For a typical residential customer using 1,150 kWh per summer month, 813 kwh per winter month (11,100 kWh on an annualized basis).

Over/Under Recoveries

The Proposal provides that any over and under recoveries will have a carrying cost of the two-year Treasury bill rate plus 60 basis points.[11] According to the Proposal, this will correct for errors in sales projections. RECO has no objection to this proposal as such interest rate is consistent with other RECO surcharge mechanisms such as RGGI and the SBC.

Lost Revenue Treatment

Revenue Decoupling Mechanism

The Proposal recommends that the NJBPU allow utilities to recover lost revenues in the amount that they can demonstrate were attributable to the utility-run EE and peak demand reduction program(s).[12] These lost revenues are to be reviewed and recovered annually. Only lost revenues associated with the utility's distribution base rates will be recoverable. Utilities will be required to file a base rate case no later than five years after the commencement of an approved EE transition program, so that usage projections are updated and to reset lost revenues.

The Proposal does not explain, either generally or specifically, how a utility is to demonstrate that lost revenues are attributable to the utility-run EE and peak demand reduction programs. Similarly, the Proposal does not discuss how utilities are to track lost revenues resulting from the Office of Clean Energy's ("OCE") programs. By attempting to tie lost revenue directly to

[11] The Proposal at 5.
[12] The Proposal at 6.

efficiency measures, taking into account other factors that may reduce energy use (*e.g.*, weather or other economic factors such as energy prices), the revenue decoupling mechanism recommended by the Proposal resembles a lost revenue adjustment mechanism ("LRAM"). As the Company noted in the RECO November Comments, an LRAM requires a complicated evaluation, measurement and verification process to review energy savings achieved.[13] In particular, the NJBPU, utilities, and other stakeholders would be tasked with linking energy reductions to specific measures or events, whether its EE, adoption of distributed generation, or weather. The development of such a process that attempts to measure accurately the energy reductions linked to EE measures can be costly, administratively burdensome, and increase the likelihood of contentious administrative proceedings. The fact that the Proposal omits entirely any detail regarding its recommended revenue decoupling mechanism implicitly bears witness to its inherent complexity.

An LRAM also still ties, to an extent, utility profit to sales. Therefore, the adoption of such a mechanism may inadvertently frustrate other efforts that reduce demand pursued by the utility, such as behind the meter renewables. This is due to the fact that utilities will still lose the revenue necessary to operate due to other market efforts. This may consequently discourage the advancement of other state goals that reduce energy usage.

The Proposal recommends that its proposed revenue decoupling mechanism be reviewed three years after the approval of utility EE transition programs to verify that this method is appropriately incentivizing EE programs. RECO has no objection to such a filing and review requirement. Similarly, RECO has no objection to the requirement that utilities must file a base rate case no later than five years after the commencement of an approved EE transition program.

Finally, the Proposal would impose an earnings test on the utilities. Specifically, on an annual basis, a utility would be required to calculate its ROE based on the actual net income of the utility for the most recent 12-month period, divided by the average of the beginning and ending common equity balances for the corresponding period.[14] For any EE transition program approved by the NJBPU, if the calculated ROE exceeds the allowed ROE from the utility's last base rate case by 50 basis points or more, recovery of lost revenues would not be allowed for the applicable filing period. For example, based on its current ROE of 9.5 percent, if in the most recent 12-month period RECO earned more than a 10.0 percent ROE, it would be precluded from recovering lost revenues. RECO does not object to this restriction.

<u>Performance Incentive and Penalty Treatment</u>

[13] *Lost Margin Recovery*, American Council for an Energy Efficient Economy, accessed at https://aceee.org/sector/state-policy/toolkit/utility-programs/lost-margin-recovery
[14] The Proposal at 6.

The Proposal provides that performance incentives and penalties will both take the form of ROE adjustments applied to a utility's EE transition program investment.[15] The ROE adjustments are tied directly to a utility's performance regarding NJBPU established QPIs. These QPIs will measure a utility's achievement of energy use reduction targets. The utility will be awarded a performance incentive, calculated on a sliding scale, if it achieves between 110% and 150% of its QPIs. The utility will be assessed a performance penalty, calculated on a sliding scale, if it achieves between 50% and 90% of its QPIs. Performance below 50%, will further penalize the utility at the rate of .75% of base rate distribution revenues. There will be a neutral area, or buffer, within which a utility will not be awarded an incentive or assessed a penalty. This buffer applies if a utility achieves between 90% and 110% of its QPIs.

The Company has several objections to the Proposal's performance incentives and penalties recommendations. As noted in the RECO November Comments, conceptually the Company supports the linear scalability of incentives and penalties, however incentives and penalties should not be symmetrical, particularly in the early stages of EE implementation. In particular RECO recommended that penalties should be minimal to non-existent in the early ramp up years. The Proposal put forth by staff fails to provide the utilities with a realistic opportunity to earn meaningful incentives, (statement summarizing our objection to penalties), and contravenes the dictates of the Clean Energy Act.

Specifically, the Company objects to the scalability framework recommended by the Proposal. Requiring a utility to achieve 110 percent of its QPIs before it can earn an incentive is wholly unrealistic. As a general matter, a utility's EE transition program budget is structured so as to achieve 100 percent of its QPIs. Given the aggressive energy savings goals of the Clean Energy Act, and the need for the utilities to ramp up their EE efforts, RECO expects that it will be very challenging to achieve 100 percent of its QPIs. If a utility is to achieve results greater than 100 percent of its QPIs, it will need to increase its EE transition program spending (*i.e.*, budget). Budgets and energy targets are established to minimize spending and maximize energy savings. To achieve a realistic balance of these two goals, an average spending target must be established for the entire portfolio which incorporates a combination of higher cost measures which often produce higher/longer term savings along with lower cost measures that produce less/short term energy savings. At the point utility energy savings targets exceed the average $/MWh portfolio spending levels, targets and budgets become misaligned. Utilities are forced to utilize least cost portfolio measures, with a shorter life, to achieve savings targets above 100%. Given these circumstances, a utility should be able to begin earning incentives once it achieves 80 percent of its QPIs. Incentives would be scaled upward from this 80 percent achievement threshold.

[15] The Proposal at 6-7.

The Company also strongly recommends calculating incentives and penalties on a monetary basis. The Proposal acknowledges that several other states, such as Pennsylvania, employ this approach. The Proposal rejects this approach on the grounds that it is more appropriate, with the great size disparity among New Jersey utilities, to pursue a mechanism able to incent larger utilities while not capriciously punishing smaller ones. This penalty will scale to utility size in a way that a set monetary penalty could not. This purported justification does not bear even casual scrutiny. Monetary penalties can readily be adjusted among the State's utilities to reflect their relative size. No stakeholder has suggested that the monetary value of incentives and penalties be uniform across utilities (*e.g.*, that PSE&G and RECO be able to achieve the same absolute incentive amounts). In the RECO November Comments, the Company recommended that incentives and penalties be established on a monetary basis. RECO remains convinced that using specific dollar amounts allows for a simple and transparent determination of credits to customers. It also establishes more effective incentives than adjustments to earnings. From an administrative perspective it has the benefit of avoiding the complications inherent in the Proposal's sliding scale ROE approach.

The Proposal also provides that the performance incentive and penalty structure will be reviewed three years after the approval of utility EE transition programs, along with the utility's QPIs. The Company has no objection to this three-year review process, so long as any adjustments are prospective.

Energy Efficiency as a Resource

The Proposal (p. 9) states that:

> utilities will use their best efforts to register, nominate, and/or bid each year's expected megawatt ("MW") reduction resulting from the energy efficiency transition program(s) into any and all PJM market(s) and/or programs for which the energy efficiency transition program(s) are eligible during the life of the energy efficiency transition program(s).

RECO would note that, to date, it has not engaged in such activity. To become an active participant in these PJM markets, RECO will need to ramp up a number of activities (*e.g.*, risk assessment, coordination with PJM, trading capability) which will require increased staffing. Given RECO's size, particularly compared to the other New Jersey electric utilities, participation in these markets may not be cost effective for our customers. As a result, RECO supports language regarding this effort that *permits* utilities to do so, but does not require them to do. RECO would also suggest that the Board should further engage stakeholders regarding this request

Conclusion

For the above reasons, RECO requests that the Board issue an Order incorporating these Comments.

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February 6, 2020

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Honorable Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
44 S. Clinton Ave., 9th Floor
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Trenton, NJ 08625-0350

Re: Energy Efficiency - Cost Recovery Proposal

Dear Secretary Camacho-Welch:

These comments are being respectfully submitted on behalf of South Jersey Gas Company ("SJG") and Elizabethtown Gas Company ("ETG") (collectively, the "Companies") in response to the Energy Efficiency ("EE") Transition Cost Recovery Mechanism Draft ("Draft") that was released on January 22, 2020 and reviewed at a public stakeholder meeting on January 23, 2020. Through these comments, the Companies incorporate and support by reference the comments submitted by Gabel and Associates, Inc. ("Gabel Comments") and the New Jersey Utilities Association ("NJUA") on this same day.

As consistently indicated previously, SJG and ETG remain committed to supporting the State's energy efficiency goals and appreciate the key role they play in achieving the energy consumption reduction targets contained in the New Jersey Clean Energy Act of 2018 (the "Act"). The Companies have been regularly engaged in the promotion of energy efficiency in New Jersey for many years with much success and will continue to support programs that encourage a reduction in energy consumption. Beginning well before the promulgation of the Act, energy efficiency programs at SJG and ETG have saved customers money while reducing greenhouse gas emissions. To date, SJG and ETG have accomplished the following through BPU-approved energy efficiency programs:

- Served over 30,000 customers
- Invested $113 million in energy efficiency measures
- Achieved 880,000 metric tons of lifetime CO2 emissions reductions
- Achieved 24 million dekatherms of lifetime gas savings and
- Assisted 18,000 low-income families through the Comfort Partners Program

At the same time, SJG and ETG have considerable concerns about the cost recovery proposal reflected in the Draft. While SJG and ETG are deeply committed to embracing the State's goals, the cost recovery proposal reflected in the Draft has not been designed in a manner that is consistent with the robust goals set forth in the Act. Nor does it align with the intent of the Act (N.J.S.A. 48:3-87.9.e.(1)) which provides that utilities are entitled to recover on a full and current basis all reasonable and prudent energy efficiency program costs, including a return of and on capital investments, as well as the impact of lost sales revenues.

The objectives of the Act can only be achieved by, at a minimum, (a) amortizing program costs over the weighted-average measure life of the energy efficiency portfolios, (b) fully decoupling utility

distribution revenues from sales volumes, (c) ensuring that utilities earn their full allowed return on equity on energy efficiency without any basis point adjustment, (d) avoiding the imposition of rate caps, and (e) implementing incentive and penalty structures that are simple and provide clear signals to maximize energy savings. For the reasons contained in the Gabel and NJUA Comments, in its current form, the Draft does not satisfy the intent of the Act or establish ratemaking principles that help to ensure that utilities are positioned to facilitate the maximum feasible level of energy efficiency.

As it relates to lost revenue, the Draft includes a very positive outlook regarding New Jersey's experience with the Conservation Incentive Program ("CIP"), a form of decoupling, that has been in place for more than 13 years for SJG and New Jersey Natural Gas Company ("NJNG") It acknowledges stakeholder input regarding how "CIP has contributed to shifts in utility behavior and culture, allowing for efficiency and conservation to be supported at all level of utility management". This is exactly the type of fundamental change the state indicates it is hoping to achieve, yet the Draft then proposes a dramatically different mechanism that would not lead to a full commitment to maximize energy efficiency. The proposal reflected in the Draft would only allow for the recovery of revenues that can be demonstrated to be attributable to utility-run programs. That approach does not break the fundamental link between energy usage and utility earnings because utilities would not be appropriately positioned to decrease load. Additionally, it would not help to encourage energy conservation messages to customers. Finally, it would not account for lost revenue resulting from BPU operated energy efficiency programs. Energy conservation is the most cost- effective way to reduce energy usage because it does not involve additional investment from customers or the utilities so the state should establish a mechanism that encourages it.

Further, it is important to consider this proposal in the context of the approach to program administration proposed in the December 20, 2019 Straw Proposal for Program Administration, which proposed that key energy efficiency programs remain under the control of the state. Given that the proposed limited lost revenue mechanism would only allow recovery of lost revenues directly attributable to utility administered programs, this would set up a situation where a utility would have a disincentive to encourage customers to participate in state-run programs. All stakeholders should recognize that it is challenging to get customers interested in pursuing energy efficiency. From practical experience, SJG notes that outreach regarding its own programs has occasionally led to customers pursuing other energy efficiency strategies like an Energy Savings Improvement Program. SJG has actively supported customers pursuing the path that best fit their objectives and did not have to consider the potential for any negative impacts because the design of the CIP program made them neutral to changes in customer usage regardless of the program pursued by the customer. Having the utilities suffer financial harm when customers pursue other energy efficiency strategies will not result in the cultural shift to allow the state to become a national leader and reach the Act's goals.

New Jersey's well established decoupling success which has been achieved through the SJG and NJNG CIP programs demonstrates that these programs can be effective and can support the Board's mandate to protect customers. Adoption of the limited mechanism described in the Draft would be a considerable step backwards at time when the State's goals require taking a dramatic step forward towards achieving its energy efficiency targets. SJG and ETG respectfully urge the Board not to take any action that would displace or undercut the long history of success of the CIP. SJG and ETG respectfully request that the Board not endorse the mechanism contained in the Draft and instead adopt a mechanism that fully decouples utility distribution revenues from sales volumes.

SJG and ETG appreciate the opportunity to submit these comments and look forward to continued collaboration with all stakeholders.

Respectfully submitted,

Deborah M. Franco

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February 6, 2020

Secretary of the Board of Public Utilities
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Re: New Jersey Energy Efficiency Transition Cost Recovery Mechanism, Written Comments

Uplight is a nationwide software-as-a-service ("SaaS") company that helps utilities engage their residential and business customers in a decarbonized energy future that is efficient, equitable, and resilient. Our 400 employees serve our 93 energy provider clients, including PSE&G, Exelon, First Energy, Orange & Rockland, New Jersey Natural Gas, and South Jersey Gas / Elizabethtown Gas, to provide connected customer journeys to over 100 million energy customers in North America and Europe. As a certified B-Corp, we share the NJ BPU's commitment to providing consumer energy savings while reducing energy and associated greenhouse gas emissions to build a more sustainable future.

We appreciate the opportunity to share our perspective and expertise with the New Jersey Board of Public Utilities ("BPU") on the Energy Efficiency Transition Cost Recovery Mechanism Draft ("Cost Recovery Draft") through these written comments, which are meant to build upon in-person engagement during technical meetings and previous comment submissions.

We applaud the BPU and its staff for outlining the elements of cost recovery and for continually seeking input from subject matter experts to ensure best-in-class program implementation. In the spirit of this forward-looking process, we present three suggestions that will ensure implementation of best practices, provide the most benefit to ratepayers, and achieve the energy savings and societal benefits outlined in the Clean Energy Act ("CEA") and Energy Master Plan ("EMP"). The BPU should:

(1) consider energy efficiency and peak demand programs as a strategic imperative,

(2) institute full decoupling to provide the most value to ratepayers, and

(3) establish a review mechanism for adequate oversight.

Any cost recovery mechanism should also be integrated with the discussion on utility targets. We encourage the BPU to consider these comments together.

Energy efficiency and peak demand programs are a strategic imperative, not compliance-driven

In order to achieve the goals laid out in the CEA and EMP, implementing utility programs with appropriately aligned incentives can create a system in which energy efficiency is a strategic focus for the utility. The State's clean energy goals, including significant decarbonization, cannot be achieved by targeting the minimum amount of annual energy savings through compliance-driven, siloed programs.[1] The BPU's assertion that a penalty-based investment treatment would "protect against potential over-earning" remains unclear and insufficiently detailed. Several studies have shown best practices in leading states; the most recent of these by ACEEE shows that incentives - more than penalties - ensure appropriate earning.[2] Based on this, we suggest the BPU remove the "200 less base points" from the investment treatment. Removing this penalty will incentivize utilities to invest in energy efficiency and peak demand at the level that is required to meet the State's policy goals.

Full decoupling provides the most value to ratepayers

The Energy Master Plan predicts that "New Jersey's electricity load [will double] by 2050, due to building and vehicle electrification."[3] If the lost revenue adjustment mechanism (LRAM) proposed in the Cost Recovery Draft is implemented, ratepayers will not be able to benefit from this expected increase. Full decoupling, however, allows customers to see its benefits. The Regulatory Assistance Project® describes this in their primer on Revenue Regulation and Decoupling:

> Although prices go up when sales go down, they do so simultaneously, so that customer bill volatility is reduced, a benefit to consumers attempting to live within a budget. In addition, when sales go up, prices come down, thereby mitigating the bill's impacts. In this sense, decoupling mitigates earnings risk for utilities and expense risk for consumers, making both better off — and in the process, it creates the earnings stability to justify a lower overall cost of capital, which reduces absolute costs to consumers.[4]

The straw proposal is worse for ratepayers, especially in light of expected significant transportation electrification.

In November 2019, the Brattle Group released research on the performance of energy efficiency programs across the country, including a quantitative regression analysis on what mechanisms result in

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[1] American Council for an Energy-Efficient Economy (ACEEE), *Integrated Energy Efficiency and Demand Response Programs*, September 2019. Accessed online here.
[2] ACEEE, *Leading states have designed new ways to help utilities fight climate change*, February 2020. Accessed online here.
[3] *2019 New Jersey Energy Master Plan: Pathway to 2050*, January 2020. Accessed online here.
[4] Regulation Assistance Project, *Revenue Regulation and Decoupling: A Guide to Theory and Application*, November 2016. Accessed online here.

the greatest energy savings.[5] As shown in Figure 1 below, full decoupling with performance incentives provides statistically significant energy savings over performance incentives alone, partial decoupling, and lost revenue adjustment mechanism (LRAM). In fact, the top performing states utilize full decoupling and performance incentives.[6]

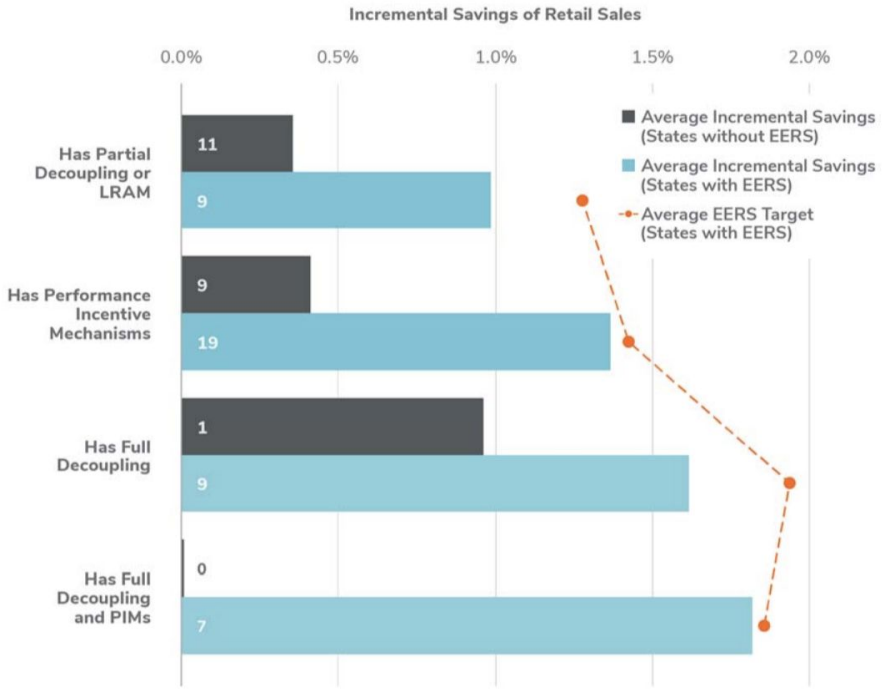

Figure 1. Average Incremental Savings by Incentive Mechanism
Source: *Energy Efficiency Administrator Models: Relative Strengths and Impacts on Energy Efficiency Program Success*. Prepared for Uplight by Sanem Sergici and Nicole Irwin, The Brattle Group, November 2019. Accessed online here.

A newly established review mechanism will ensure adequate oversight on spending

With full decoupling, utilities would be approved to spend on programs. We recognize the concern that this spending could go unchecked and current procedures may not adequately review cost recovery. In order to mitigate this risk, we suggest that the BPU establish a cost recovery review mechanism that manages for demand-related factors that are not efficiency related. Ultimately this review mechanism would allow for the BPU to ensure adequate oversight on approved efficiency spending.

As demonstrated by The Brattle Group's research, full decoupling and performance incentives result in the greatest energy savings. In this paradigm, cost recovery and quantitative performance indicators are

[5] *Energy Efficiency Administrator Models: Relative Strengths and Impacts on Energy Efficiency Program Success.* Prepared for Uplight by Sanem Sergici and Nicole Irwin, The Brattle Group, November 2019. Accessed online here.
[6] *Ibid.* The states with the highest annual energy efficiency savings include RI, MA, VT, CA, CT, HI, and WA.

inextricably linked. Thus, we encourage the BPU to consider the comments on Utility Targets together with Cost Recovery Mechanism comments.

Thank you once again for the opportunity to share our insights and perspectives. We look forward to continuing these conversations as part of the BPU's continued efforts to develop a sustainable and cost-effective energy system for the people and businesses of New Jersey.

Sincerely,
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