

2013-2015
Energy Efficiency Plans:
Performance Incentive
Mechanism

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Outline

Intent: background and review

- Statutory and regulatory guidance
- MA performance incentives
- *Level* of the performance incentive
- Performance incentive *mechanism*
- Next steps and schedule

EEAC Consultant Observations and Initial Recommendations

- Performance incentives can be very effective in supporting achievement of goals and objectives
- Such incentives have been effective in MA
- Perf. incentives are an extremely important part of Plans; design, level, and balance are crucial
- Perf. incentives should focus on key objectives:
 - Higher savings, more benefits for MA
 - Value and cost-effectiveness (net benefits)
 - Deeper savings (first), reaching broader; & others

Statutory and Regulatory Guidance

The Green Communities Act, in its directives on the three year statewide plans, states in Section 21 (b)(2):

“A plan shall include...(v) a proposed mechanism which provides performance incentives to the companies based on their success in meeting or exceeding the goals in the plan;...”

Statutory and Regulatory Guidance

The DPU, in its order in DPU 08-50-A, states:

In reviewing the performance incentive mechanism included in an energy efficiency plan, the Department will rely on the following principles:

- Performance incentive mechanisms should be designed to encourage distribution companies to pursue all available cost-effective energy efficiency.
- The amount of funds available for performance incentive mechanisms should be kept as low as possible, in consideration of the other principles adopted herein, in order to minimize the costs to electricity and gas customers.
- Performance incentive mechanisms should be designed in such a way as to encourage energy efficiency program designs that will best achieve the Commonwealth's energy goals, particularly with regard to the goals stated in the Green Communities Act.
- Performance incentives should be based on clearly-defined goals and activities that can be sufficiently monitored, quantified and verified after the fact.
- Performance incentives should be available only for activities where the distribution company plays a distinct and clear role in bringing about the desired outcome.
- Performance incentive mechanisms should be as consistent as possible across all electric and gas distribution companies. Any deviations across distribution companies should be clearly justified.
- Performance incentive mechanisms should be created in such a way to avoid any perverse incentives.
- Any modifications to a previously approved performance incentive mechanism should be fully justified at the time they are proposed to the Department.

Two Key Topics

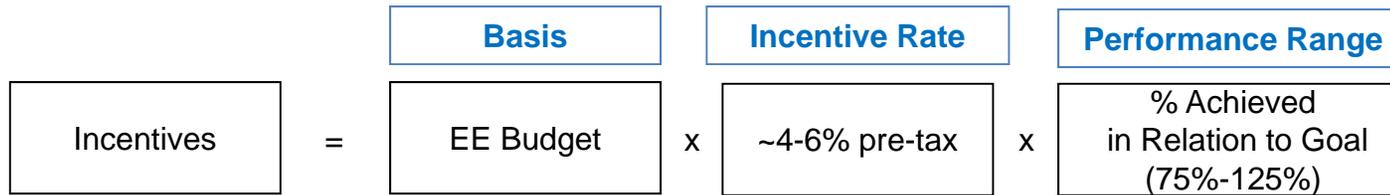
- *Level* of performance incentive
- Incentive *mechanism* (and its components)

Terminology

- Incentives: amount of money, pre-tax (the amount in the Plan budgets)
- Earnings: amount of PA earnings, after-tax (utility tax rate = ~40%)

Recommendation: focus the discussion regarding the level of performance incentive on the *incentive* amount (the pre-tax amount contained in the budgets), not the utility *earnings* (after-tax amount)

The MA Performance Incentive



Three Components to Earn Performance Incentives

Savings Component	Value Component	Performance Metrics
<p>Goal: Maximize savings (benefits in \$)</p>	<p>Goal: Maximize net benefits (benefits minus costs)</p>	<p>Goal: Focus PAs on specific outcomes</p>
<p>Rewards PAs for acquiring additional lifetime energy and demand savings and project-associated non-energy benefits</p>	<p>Rewards PAs for seeking additional cost effective savings and non-energy benefits, and doing so cost-efficiently (from TRC perspective)</p>	<p>Enables the PAs and stakeholders to highlight elements of the EE Plan which might not receive the attention they merit from the other two components</p>

Structure and key content adopted from PA slides

2012

Electric:

Summary of 2012 Performance Incentives by Program Administrator

National Grid	Threshold	Design	Exemplary
Savings	4,730,178	6,306,904	7,883,630
Value	3,164,833	4,219,777	5,274,721
Metrics	<u>1,175,509</u>	<u>1,567,346</u>	<u>1,959,182</u>
Total	9,070,520	12,094,027	15,117,534

NSTAR	Threshold	Design	Exemplary
Savings	4,335,000	5,780,001	7,225,001
Value	2,909,466	3,879,288	4,849,110
Metrics	<u>1,080,659</u>	<u>1,440,878</u>	<u>1,801,098</u>
Total	8,325,125	11,100,167	13,875,208

WMECO	Threshold	Design	Exemplary
Savings	838,320	1,117,760	1,397,200
Value	597,835	797,114	996,392
Metrics	<u>222,053</u>	<u>296,071</u>	<u>370,089</u>
Total	1,658,209	2,210,945	2,763,681

Unitil	Threshold	Design	Exemplary
Savings	118,706	158,274	197,843
Value	73,581	98,107	122,634
Metrics	<u>27,330</u>	<u>36,440</u>	<u>45,550</u>
Total	219,616	292,822	366,027

Note: Threshold = 75% of design value and exemplary = 125% of design value

Gas:

National Grid	Threshold	Design	Exemplary
Savings	1,210,507	1,614,009	2,017,512
Value	596,723	795,631	994,539
Metrics	<u>298,362</u>	<u>397,815</u>	<u>497,269</u>
Total	2,105,592	2,807,455	3,509,319
NSTAR	Threshold	Design	Exemplary
Savings	469,201	625,601	782,002
Value	275,928	367,903	459,879
Metrics	<u>137,964</u>	<u>183,952</u>	<u>229,940</u>
Total	883,092	1,177,456	1,471,821
Columbia	Threshold	Design	Exemplary
Savings	388,899	518,532	648,165
Value	241,103	321,471	401,838
Metrics	<u>120,552</u>	<u>160,735</u>	<u>200,919</u>
Total	750,553	1,000,738	1,250,922
Unitil	Threshold	Design	Exemplary
Savings	21,460	28,614	35,767
Value	13,325	17,766	22,208
Metrics	<u>6,662</u>	<u>8,883</u>	<u>11,104</u>
Total	41,447	55,263	69,079
Berkshire	Threshold	Design	Exemplary
Savings	61,709	82,279	102,848
Value	47,451	63,268	79,084
Metrics	<u>23,725</u>	<u>31,634</u>	<u>39,542</u>
Total	132,885	177,180	221,475
NEG NA &FR	Threshold	Design	Exemplary
Savings	32,425	43,234	54,042
Value	16,853	22,471	28,089
Metrics	<u>8,427</u>	<u>11,236</u>	<u>14,044</u>
Total	57,705	76,940	96,175

Note: Threshold = 75% of design value and exemplary = 125% of design value

**Incentive Level
and the
Performance Incentive
Mechanisms
for the 2013-2015
Three-Year Plan**

Performance Incentives: PAs

- Statewide incentive pool for design level performance:
 - Proposed statewide incentive pool of nearly \$86.0 million for electric PAs.
 - Proposed statewide incentive pool of \$16.7 million for gas PAs.
 - 2010-2012 pools were \$65 million electric and \$14 million gas.
- Proposed incentive pool is proportional to savings targets and incentive pool supported by the Council in first three-year plan.
- Current system is working well and was heavily negotiated.
- Performance incentive recovery is fundamentally linked to all PA proposals.

Performance Incentive Level

- Generally compared as % of program cost
- MA design, about 4-6% of costs (pre-tax)
 - The electric statewide incentive pool goals equal \$22 million in 2011 and \$25.7 million in 2012 (original target of \$65 million for 2010-2012).
 - The gas statewide incentive pool goals equal \$4.3 million in 2011 and \$5.3 million in 2012 (original target of \$14 million for 2010-2012).
- Nationally, incentive levels range from 1-2% (management fees) to over 20% of program cost

Incentive Level – Other Issues

- Impact of performance range: performance at threshold and cap
- The policy environment evolves
- Legislation: statutory requirement
- Decoupling and lost base revenues: how do these impact the incentive level?
- Interaction of incentive level and saving goals: relationship between goals (benefits) and level
- Level *proportional* to 2010-2012 levels

**Performance Incentive
Mechanism:
Analysis and Suggestions**

Build on the Current Approach

- Build upon the current performance incentive mechanism with its three components: savings (benefits), value (net benefits), and performance metrics
- Three components focus on key objectives:
 - Higher savings, more benefits for MA
 - Value and cost-effectiveness (net benefits)
 - Metrics for other objectives: deeper savings, etc.
- Retain the performance metric component for other objectives, deeper savings, broader reach

Performance Incentive Mechanism (based on PA ppt)

- Continuation of the well-functioning performance incentive mechanism applicable to initial three-year plans as a basis for the 2013-2015 performance incentive model and allocations.

PI Component	Calculation	Impact of Incentive
Savings Mechanism	<p>Payout rate for each \$ value of benefit achieved</p> <p>Range: 75% to 125% of design</p>	<ul style="list-style-type: none"> Rewards deeper savings, “all cost effective savings” Common payout rate ensures fairer incentives across the state Dollar value ensures all benefit types are counted
Value Mechanism	<p>Payout rate for each \$ value of <u>net</u> benefit achieved (benefits-costs)</p> <p>Range: 75% to 125% of design</p>	<ul style="list-style-type: none"> Rewards good budgetary management Rewards focus on cost-efficiency of TRC costs (program and customer costs) Common payout rate ensures fairer incentives across the state
Performance Metrics	<p>Incentives for specific actions. Actions to be negotiated for 3 yrs prior to filing.</p> <p>Range: 75% to 125%</p>	<ul style="list-style-type: none"> Rewards specific initiatives and goals that require more focus or that don't fit in well with the savings or value mechanisms (e.g., future strategies)

Performance Incentive Mechanism (based on PA ppt)

- Performance Incentive Focus remains primarily on savings

Electric	Mechanism	2010	2011	2012	2013 - 2015
	Savings	45%	48%	52%	52%
Value	35%	34%	35%	35%	
Perf. Metrics	20%	18%	13%	13%	

Gas	Mechanism	2010	2011	2012	2013 - 2015
	Savings	45%	46%	55%	55%
Value	35%	26%	30%	30%	
Perf. Metrics	20%	28%	15%	15%	

* Source: 3 yr plan compliance filing (March 12, 2010), 2011 mid-term modification settlement filed (October 29, 2010), 2012 mid-term modifications filed (October 28, 2011)

** Note for 2013-2015 year by year components may vary slightly from average

2012 MTMs – Performance Incentives

Revised Allocation Methodology - Electric

2012	State	National Grid	NSTAR	WMECO	Unitil
Savings	52.0%	52.1%	52.1%	50.6%	54.1%
Value	35.0%	34.9%	34.9%	36.1%	33.5%
Performance Metrics	<u>13.0%</u>	<u>13.0%</u>	<u>13.0%</u>	<u>13.4%</u>	<u>12.4%</u>
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Revised Allocation Methodology - Gas

2012	State	National Grid	NSTAR	Columbia	Unitil	Berkshire	New England Gas
Savings	55.0%	57.5%	53.1%	51.8%	51.8%	46.4%	56.2%
Value	30.0%	28.3%	31.2%	32.1%	32.1%	35.7%	29.2%
Performance Metrics	<u>15.0%</u>	<u>14.2%</u>	<u>15.6%</u>	<u>16.1%</u>	<u>16.1%</u>	<u>17.9%</u>	<u>14.6%</u>
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Why Performance Metrics?

Identify and develop ways to motivate and incent the PAs' behavior related to some specific priorities or objectives, which (in our view) are not adequately or very effectively incented in the two overarching components of the performance incentive mechanism, either in the savings (achieve \$ benefits) or the value (achieve net benefits, i.e., achieve benefits cost-effectively from a TRC perspective) components of the performance incentive. These important priorities include:

- Achieving deeper savings and comprehensiveness
- Pursuing CHP
- Cost-efficiency in the use of ratepayer funding (which is not directly incented through the value component of the performance incentive)
- Low income objectives that are addressed in the performance metrics
- Focus on initiatives with longer time horizons, which will establish the foundation building blocks on which to build increased savings levels
- Others?

Why it is Important to Get Benefits, Costs, and Net Benefits “Right” in the Plan

- The “payout rates” (performance incentive earned per \$ of benefits, and incentive earned per \$ of net benefits) for the savings and value components are set based on the plan.
- For a given incentive level, lower benefits or higher costs (leading to higher net benefits) in the *plan* result in higher payout rates per unit. Then the higher payout rates are multiplied by *actual results*, resulting in higher total incentives for a given level of actual benefits or net benefits.
- (Potential) perverse incentive for PAs to use lower benefits or higher costs in the *plan*, resulting in higher payout rates, then multiplied by actual results → higher incentives and PA earnings.
- Possible change: payout rates determined before the plan is developed (but then the plan total incentive level would be determined by multiplying planned units times the payout rate)

Next Steps and Key Dates

- Ongoing discussions with PAs and EEAC consultants, with input from EEAC councilors
- Update on performance incentives at the August 10th EEAC meeting
- Following EEAC meeting is Sept 11th; next Plan is due from PAs on Sept. 6th
- Recommendation: EEAC Executive Committee should plan to continue working on proposed performance incentives for the 2013-2015 Plan during August/early Sept.