

Summary:

HPC - PA Compensation Discussions

While the current proposal from the PAs covers roughly 30% of the losses HPCs incur generating installs, HPCs cannot afford to push back any longer. The PAs have stated that they are not willing to negotiate further with HPCs, citing a mandate from the DPU to use competitive bidding processes. However, there is no competitive bidding process in place for the HPC/HEA portion of the program.

HPCs need to roll out the latest proposal as soon as possible should not be seen as agreement that the proposal is sufficient, and the \$1,000 job minimum is not in the best interests of all program stakeholders. The program needs HPCs now more than ever to achieve its goals, and the current pricing system is not enough to achieve that. The PAs have pointed to the Weatherization RFQ as a long-term solution, but the structure of the process raises serious concerns that may exacerbate an untenable situation.

Weatherization (Wx) RFQ

The PAs have made it clear they do not believe HPCs should be able to break-even on HEAs, and that HPCs should instead absorb losses from the HEA through profits from their Wx work. However, there are serious concerns with the Wx RFQ structure proposed.

It does not make sense for HPCs and IICs to bid on a single price when they are different parts of the program with different cost structures. Either HPCs need to break even on generation costs so that they approach the Wx RFQ pricing on the same footing as IICs, or HPCs need to be paid a different amount to complete the Wx work so that they are able to use the Wx work to cover the work generation costs.

The pricing methodology chosen does not make sense for this type of process, as the PAs expect 100% of contractors to continue operating in the program at a price only the lowest 20% of contractors submitted. The incentives to bid low encourage those contractors with the lowest quality scores to be the most aggressive, thereby setting the pricing for all contractors. Additionally, the structure makes no attempt to account for work volume or capacity.

If the RFQ returns a price that does not work for 80% of contractors in the program, what will happen? Any appeals process or continued negotiations after the fact will take too long to prevent a loss of install capacity at exactly the time when the program needs it the most. Efforts must be made now, before the process is completed, to amend the RFQ in a way that recognizes the differing economics of entities that have driven the success of Mass Save to date.

Since the RFQ will not solve these issues, HPCs either need an increased offer from the PAs on compensation for generating Wx work, or a different RFQ process that will account for the aforementioned issues.

Background:

Home Performance Contractors (HPCs) have become a driving force behind the success of the residential Mass Save Program, both in volume and cost efficiency to the ratepayer. Over half of all work is generated and performed by HPCs at a low cost per savings generated. With the ambitious goals of the new 3-year plan, HPCs will need to not only continue their positive impact on the program but grow their operations to meet state targets. However, the economic realities of operating in the program have changed significantly over the last decade with insufficient adjustments made to HPC compensation structures, leading to a situation where HPCs are struggling financially at the time when they are needed the most. To help solve this problem, the EEAC asked that the PAs work with the HPCs to amend the compensation structure and ensure the continuing success of the program.

HPC perspective on discussions to date:

The PAs are offering to increase the payment for HEAs performed by \$50 instead of the original \$25 increase, as well as pay a \$100 per install incentive, which comes out of the performance bonus pool. The remaining performance bonus will continue to be paid out as a yet-to-be determined quarterly quality and compliance bonus. Finally, the PAs will offer an additional \$75 per “priority install” defined as a Weatherization (Wx) install for a customer who qualifies under the Moderate Income program, or a renter in a building where the entire building is weatherized. All of these changes combined provide HPCs with roughly 30% of the amount they showed was necessary to operate sustainably, and thus still insufficient.

Furthermore, the PAs have limited these compensation changes to jobs greater than \$1,000, which would cause several issues. This change would create a negative customer experience for homeowners who have work below \$1,000, as they would get deprioritized. A disproportionate number of these homeowners are in small homes or individual units within a multifamily property, likely impacting lower-income residents. Multifamily homes where the total work scope is over \$1,000 but each individual unit is under that amount would not be eligible for either the Wx incentive or the quarterly quality bonus, negating the purpose of the priority install bonus for renters. Smaller jobs should still be held to the same quality and compliance standards, and therefore should still count towards the quarterly quality bonus, but would not under the current proposal. Finally, roughly 15% of all jobs performed are under \$1,000, significantly impacting the expected increase in HPC income these changes are designed to support. This change would counteract the intended purpose of the proposed changes in compensation, while disproportionately impacting lower income and multifamily customers, and thus should not be rolled out.

The PAs have made it clear they are not willing to negotiate any further with HPCs. Citing a mandate from the DPU that all pricing be determined through competitive processes, they believe it is inappropriate to continue discussions directly with HPC representatives any further. However, since there is currently no RFP process for HPCs to adequately price out their marketing and install generation activities, and there are no plans to institute one, HPCs maintain that direct discussions are the only appropriate means currently available to set pricing. The Wx RFQ only sets Wx install prices, and does not address any of the additional generation costs HPCs incur.

While the current proposal from the PAs is still insufficient, HPCs cannot afford to push back any longer. Every week that goes by while prices are being discussed is another week where HPCs are struggling, and the proposed changes will help keep HPCs afloat. HPCs greatly appreciate that the PAs have agreed to make these changes retroactive to the start of the 2022 calendar year. However, a desire to roll out the latest proposal as soon as possible should not be seen as an acceptance that the proposal is sufficient. The program needs HPCs now more than ever to achieve its goals, and the current pricing system is not enough to achieve that.

HPC Perspective on the RFQ:

In response to HPCs' need for additional compensation, the PAs have pointed to the Wx RFQ as a means to achieve that. However, there are serious concerns with the structure proposed, as well as issues with both IICs and HPCs bidding on the same price when they are different types of businesses with different cost structures.

Issues with addressing HPC and IIC pricing within a single RFQ

The PAs have made it clear that they do not believe HPCs should be able to break-even on HEAs, let alone make a profit, as they feel HPCs should cover the costs of performing HEAs through Wx work performed. However, this puts HPCs at a disadvantage compared to IICs. HPCs incur significant losses to generate Wx work, which they need to offset through Wx profit. However, HPCs get paid the same Wx rate as IICs, who do not have those same costs since they are performing work generated by Mass Save Marketing and the Lead Vendor (LV). The LVs are fully compensated for the services they provide and afforded to make a profit. The result is that the PAs will not pay enough for HPCs to break even on work generation costs, and then will pay HPCs for Wx work at the rate that makes sense for an IIC, resulting in HPCs operating on significantly lower margins than IICs. In the past, when the cost to generate work was smaller, this was sustainable for HPCs, but over the last 5 years it has become untenable.

The recent proposed changes in compensation have decreased the expected losses from generating Wx work by roughly one third, but still result in a significant cost per generated Wx install. Most Wx jobs achieve barely enough margin to cover this install generation cost, let alone the cost of general business overhead, and therefore provide little opportunity to generate a sustainable profit. Since HPCs need to approach Wx work as the vehicle to recover the expense of finding and generating Wx contracts, they cannot approach the RFQ with similar economics as IICs, who do not incur those same costs. The RFQ is asking two different business types to bid on two different processes in one RFQ, for one price. An HPC would bid a different price to complete LV-generated work than they would bid to complete HPC-generated work, but this RFQ provides no function to address that difference.

Either HPCs need to break even on generation costs so that they approach the Wx RFQ pricing on the same footing as IICs, or HPCs need to be paid a different amount to complete the Wx work (either through increased Wx pricing or Wx conversion bonuses) so that they are able to use the Wx work to cover the work generation costs as PAs say they want, without cutting their operating margins to unsustainable levels. There is no viable outcome available in the current RFQ process that will solve this issue.

Fundamental flaws in the proposed RFQ structure

In the upcoming RFQ "the lowest 3rd of prices per individual measure will be averaged to set that measure's price". This methodology does not work for this type of RFQ. If there are 100 contractors in the program, only the lowest 33 will have their prices taken into account, and then those prices will be averaged, resulting in a final price roughly around the 20% mark. How do the PAs expect 100% of the participating contractors to perform work at a price that only 20% of respondents said they could operate at? That leaves 80% of contractors needing to decide whether they can afford to continue to operate in the program or not, and even those who try to make it work will likely struggle. At a time when the program needs to increase capacity and volume to meet targets, this would result in the tragic decline of a skilled workforce.

To encourage lower bids, the RFQ institutes an amendment to the contractor scoring system that increases the contractor score the lower they bid. An increased contractor score could in turn improve their contractor "tier", which would allow them to receive a higher volume of LV-generated Wx installs. The result of this structure is that the contractors willing to bid the lowest are the contractors

who need the grade boost the most, i.e. Tier 3 contractors who wish to bump up into higher tiers based on price, not quality.

These are not the contractors who should be setting program prices. Quality costs money. To achieve top install and customer service quality scores, a company needs to pay more to retain top talent, invest in training and development, maintain a dedicated quality control staff, and much more. This structure will result in the PAs expecting 100% of contractors to operate at a level that the lowest 20% of contractors say they can operate at, regardless of quality.

It would only take a handful of contractors who are in dire need of increased workflow to make unsustainably low bids and skew the entire outcome low. Given how little work LVs are currently generating for IICs due to cuts in program marketing, there are a significant number of contractors who are desperate for more work. A case can be made that the cuts in marketing and the resulting drought in available work for IICs is an example of manipulation of the market, creating a situation where IICs are desperate for work and willing to bid unsustainably low prices.

Capacity concerns

The RFQ process does not account for install capacity. A contractor with 50 install crews, roughly 20% of the total program capacity, and a contractor with a single install crew would each provide one bid that would be equally weighted. If the 20% of contractors who bid prices that met the final RFQ result only have the capacity to perform 10% of the work, what is going to happen to this program?

Normally this type of RFQ calculation is used in processes where a few winning bids are selected from a larger pool. For example, if the final list of approved contractors was being limited to 30 contractors, but 100 respondents were expected. This structure would then make sense, as all winning contractors would have bid within range of the final price. However, that is not the case here. The PAs are expecting a majority of the respondents to continue operating in the program, but only paying what the lowest 20% agreed to.

If the PAs expect a majority of respondents to continue operating in the program, The RFQ should identify a price that this majority of respondents agree to. It would make more sense to do a capacity-based approach, where respondents submit a bid based on their capacity expectation, such as their current number of insulation trucks. The PAs then start from the lowest price and add up all the capacity commitments until they reach the install capacity the program requires, and then set the price at that bid amount. This would ensure the program has enough install capacity at sustainable price points to operate the program, while not paying more than required to fill the workload.

HPC-specific concerns

The differing nature of the HPC/IIC model presents another challenge given the current structure of the RFQ. Lower bids will increase the volume of LV-generated work for contractors, but HPCs are excluded from this benefit unless they bid in the lowest 3rd of prices. The PAs have acknowledged that this is not likely, since HPCs incur greater costs generating Wx installs and therefore need to make more money on the Wx work. HPCs will need to bid at prices that reflect the costs of self-generated work and forgo any opportunity to be a part of the LV-generated system, or they must bid as an IIC would and suffer the consequences of even lower margins on self-generated work, potentially making this work untenable. HPCs are also concerned that higher price bids will negatively impact their contractor tier scores, limiting their ability to earn the new bonuses that were just proposed by the PAs.

If the RFQ returns a price that does not work for 80% of contractors in the program, and likely does not work for more than 80% of the install capacity in the program, what will happen? Any appeals process or continued negotiations after the fact will take too long to prevent a loss of install capacity at exactly the time when the program needs it the most. Efforts must be made now, before the process is

completed, to amend the RFQ in a way that recognizes the differing economics of entities that have driven the success of Mass Save to date.