

MEMORANDUM

To: EEAC Councilors

From: Paul Horowitz
Jeff Schlegel

Date: November 9, 2009

Subject: Performance Incentive Mechanism: Consultant Memo and Proposed EEAC Resolution

This memo embodies comments and several recommendations from the consultants (Jeff and me) to the Council related to the performance incentive mechanism. They include:

- 1) Recommendation to approve the performance incentive mechanism as a methodology for allocating electric and gas performance incentives across the components and sectors.
- 2) Recommendation to support the application of the mechanism to the electric performance incentives across the PAs for 2010-2012;
- 3) Comments on the application of the mechanism to the gas incentives across the PAs;
- 4) Recognition that the results of the application of the mechanism across the PAs are dependent on the cost and other associated inputs and that changes to the costs and other inputs will affect the application of the mechanism.

Approval of the performance incentive mechanism

This past Saturday I sent you an email and an attachment related to the performance incentive mechanism that each PA would use to allocate the total incentive amount for each year 2010-2012 to the three PI components (savings, value/net benefits, metrics). Jeff and I have worked with the PAs to develop this mechanism, that can be applied to both the electric and gas statewide incentive target amounts (approved in the Council's October 6 and 13 resolutions) and over the three year period. As noted in the PI file, a key objective in the methodology supporting the performance incentive mechanism was to establish common "PI earnings rates" for all the PAs, so that each PA would earn its incentive at the same rate as the others. *We believe this method is an appropriate approach to allocating the total incentive amounts approved by the Council on Oct. 6 and 13, and recommend its adoption by the Council.*

Support for the application of the PI mechanism to the electric incentives across the PAs

The excel file forwarded to you on Saturday (also attached here) is a summary presentation of the application of the methodology to the electric PAs. Each PA has taken this approach and applied it to their own savings and costs, using their 08-50 data for the three year plan, to allocate monies to the three PI components and across the sectors. Jeff and I have reviewed and discussed the results of this application by the individual PAs. Some inputs to the mechanism are expected to be made in the near term (e.g., non-electric benefits) which will further align the results across the PAs. Based on our review of the results we find them to be reasonable. *We recommend that the Council support the application of the PI mechanism to the electric PAs' for determination of their individual PA component and sector allocations.*

Application of the PI mechanism to the gas incentives across the PAs

The Council's resolution approving the plans noted differences in gas costs that needed to be examined. In spite of further review and some adjustments by the PAs over the past ten days the

gap among the PA unit costs (\$/therm) across the programs remains significant, and continues to have deleterious impacts on the application of the PI mechanism. We thus cannot at this time recommend support for the application of the PI mechanism to the gas incentives.

Recognition that the results of the application of the mechanism across the PAs are dependent on the program and total costs and other associated inputs, and that changes to the costs and other inputs will affect the application of the mechanism.

The cost and savings inputs to the performance incentive mechanism have an inherent impact on the results. Wide variations across the PA data lead to similar variations across the PAs in the application of the common PI mechanism to derive the component and sector. Revised data that are expected to be prepared in late 2010 for an update to the filings for 2011 and 2012 will likely have an impact on the results of the application of the PI mechanism. In addition, revised data identified during the DPU review process may affect the application of the mechanism in 2010.

**Performance Incentive Mechanism - Methodology to Allocate Incentives
by Component and Sector - Electric**

A key objective in the methodology supporting the performance incentive mechanism was to establish common "PI earnings rates" for all the PAs, so that each PA would earn its incentive at the same rate as the others. These factors are shown in rows 36-37. They are derived from the data above: using PA data from the 08-50 tables, statewide benefits, costs, and net benefits (excluding CLC, as they do not earn incentives) were calculated.

- The percent allocations across the PI components reflect the approach we have suggested to the Council: declining emphasis on metrics over time with increases in the other components.
- Applying these percentages to the total PI yields the statewide incentive amounts for each component.
- Dividing the PI for each component by the total benefits (Savings) and net benefits (Value) produces the fixed PE earnings values used to develop the individual PA incentive component amounts.

Rows 41-43 show the allocation of the total incentives across the sectors. These were derived in the same way as the component amounts above: relying on the 08-50 data tables, benefits and net benefits were allocated across the sectors. Sector level incentives for performance metrics were the remainder of monies in the overall pool of PI.

We recognized that 2011 and 2012 cost and savings data are likely to be updated in a late 2010 filing, so did not focus on the performance incentives for those years at this stage.

	2010	2011	2012	Total 2010-12
Total Benefits	\$1,217,428,687	\$1,837,734,842	\$2,292,154,311	\$5,347,317,840
CLC Benefits	\$70,398,874	\$104,541,276	\$135,819,292	\$310,759,442
Total Benefits excluding CLC	\$1,147,029,812	\$1,733,193,566	\$2,156,335,019	\$5,036,558,398
Total Costs	\$344,479,566	\$571,639,059	\$720,800,546	\$1,636,919,171
CLC Costs	\$21,091,591	\$28,863,676	\$36,581,142	\$86,536,408
Total Costs excluding CLC	\$323,387,976	\$542,775,384	\$684,219,404	\$1,550,382,763
Total Net Benefits, excluding CLC	\$823,641,836	\$1,190,418,183	\$1,472,115,615	\$3,486,175,634
Performance Incentives (from statewide cost tables)	\$17,267,687	\$21,377,544	\$24,961,163	\$63,606,394
Total Net Benefits ex PI (also has no LBR)	\$840,909,523	\$1,211,795,727	\$1,497,076,778	\$3,549,782,028
Performance Incentives (from incentive tables)	\$17,267,687	\$21,088,935	\$24,294,386	\$62,651,008
Savings	45%	50%	52%	49%
Net benefits	35%	35%	35%	35%
Pef Metrics	20%	15%	13%	16%
Total Incentive Allocation by Component - State				
Savings Pool per stated allocation	\$7,770,459	\$10,544,467	\$12,633,081	\$30,948,007
Net benefits per stated allocation	\$6,043,690	\$7,381,127	\$8,503,035	\$21,927,853
Pef Metrics pool per stated allocation	\$3,453,537	\$3,163,340	\$3,158,270	\$9,775,148
	\$17,267,687	\$21,088,935	\$24,294,386	\$62,651,008
Savings incentive rate	\$0.0068	\$0.0061	\$0.0059	
Net benefits incentive rate	\$0.0072	\$0.0061	\$0.0057	
				<i>2010 Sector Allocation</i>
Total Incentive Allocation by Sector - State				
Residential	\$5,210,539	\$6,175,084	\$7,218,543	30.2%
Low Income	\$2,067,451	\$2,638,969	\$3,075,765	12.0%
C&I	\$9,989,697	\$12,274,882	\$14,000,078	57.9%
Total	\$17,267,687	\$21,088,935	\$24,294,386	

Proposed Resolution of the EEAC on the Performance Incentive Mechanism November 10, 2009

The Council has reviewed and discussed the consultant's report on the performance incentive mechanism and its application to electric PAs' incentives. Based on our review:

- 1) The Council approves the performance incentive mechanism as presented in summary form by the consultants on November 7, 2009 as an appropriate approach for the electric and gas PAs to allocate the total incentive amounts approved by the Council on Oct. 6 and 13 to the savings, value, and metric components and across the sectors.
- 2) The Council supports the application of the PI mechanism to the electric PAs' individual PI amounts as appropriate for determination of their individual PA component and sector allocations, subject to any plan revisions that may impact the underlying data, and subject to any plan revisions during mid-course adjustments for 2011 and 2012.
- 3) The Council recognizes that unit cost differences across the PAs, and changes in such factors over time, informed by program activity and planning during 2010, can affect the current results of the application of the PI mechanism. The Council expects further information to be available for re-examination of the proposed application of the performance incentive mechanism in 2011 and 2012. Revised data identified during the DPU review process may also affect the application of the mechanism in 2010.