

Remarks of:

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Thank you for the opportunity to be here to discuss the impact of energy efficiency efforts on revenue recovery by electric and gas utilities. Promoting more energy efficiency, including in the electricity sector, that reduces energy consumption and ratepayer's bills is one of the Administration's guiding principles on energy and the environment. Investing in energy efficiency will create jobs and help to transition the U.S. to a clean energy economy, it will help to secure our energy future and reduce energy bills, and it will be a key strategy in reducing our carbon emissions.

I want to make clear that I am here on behalf of the Department solely to provide information to inform the Commission's decision-making process, and not to state any Departmental policy or make recommendations on a specific course of action. Rather, I will outline different incentive options for the Commission as it considers rate making policies that align with the promotion of energy efficiency.

The Department recognizes that each state has its own unique set of circumstances and legal and regulatory frameworks. A policy or set of policies that works to support energy efficiency in one state, may not work in another state.

### The National Action Plan on Energy Efficiency Offers Guidance

The substance of the energy efficiency options that follow, are taken from publications of the National Action Plan for Energy Efficiency (Action Plan), a private-public initiative comprised of a “Leadership Group” of more than 60 leading electric and gas utilities, state regulators, energy consumers, environmental/energy efficiency advocates, and other related parties. The Action Plan, for whom the U.S. Department of Energy and the Environmental Protection Agency provides document writing, meeting and other facilitation services, was initiated in 2005 to create a sustainable, aggressive national commitment to energy efficiency.

The Department considers the Action Plan to have accomplished two main things. First, it is a major accomplishment that a group with such diverse interests came together in the first place, to make, in July of 2006, five main policy recommendations. Those five recommendations, targeted at themselves and their fellow state utility regulators, electric and gas utilities and others, were carefully negotiated and crafted by the Action Plan Leadership Group to show a strong, aggressive commitment, yet be respectful of the diversity in our states and the utility industry.

Those five recommendations, for your Commission to take note of, are:

- 1) Recognize energy efficiency as a high-priority energy resource.
- 2) Make a strong, long-term commitment to implement cost-effective energy efficiency as a resource.
- 3) Broadly communicate the benefits of and opportunities for energy efficiency.
- 4) Promote sufficient, timely, and stable program funding to deliver energy efficiency where cost-effective.

- 5) Modify policies to align utility incentives with the delivery of cost-effective energy efficiency and modify ratemaking practices to promote energy efficiency investments.

These five main recommendations from 2006 are still valid today.

The second main accomplishment of the Action Plan is the development, at the request of its Leadership Group, of a body of reports and other literature that summarize the best practices of the last several decades on ratepayer-funded energy efficiency in a number of areas, including utility incentives. I therefore commend your staff to make use of these resources, if it hasn't already.

While the remainder of this testimony focuses on policies for utility investment in energy efficiency programs, there are also two other mechanisms that are also used by some states to deliver energy efficiency to electric and gas ratepayers. Both of these approaches make the assumption that in some circumstances, it may be better not to involve utilities in the delivery of energy efficiency to ratepayers. Instead, the energy efficiency delivery, still using ratepayer funds, is done by the state itself, such as in New York or Vermont, or by third party administrators, such as in Hawaii.

Given that the Pennsylvania has enacted an energy efficiency resource standard-type law, along with specific statutory language about cost recovery and recovery of lost revenues for utility expenditures on energy efficiency, it would appear that such an approach is not germane to your state.

#### Aligning Utility Incentives with Investment in Energy Efficiency

The National Action Plan for Energy Efficiency's report with this same title has identified that utility spending on energy efficiency programs can affect an electric or gas utility's financial position in three ways: 1) through recovery of the direct costs of the programs; 2) through the impact on utility earnings of reduced sales between rate cases;

and 3) through the effects on shareholder value of energy efficiency spending versus investment in supply-side resources.

To address these three effects, the Action Plan's "Aligning Utility Incentives" report also notes there are at least six different regulatory approaches (and variations of each) to better align utility incentives which can be grouped into three general categories of 1) direct cost recovery; 2) fixed cost recovery, and 3) performance incentives.

Under traditional regulation, investor-owned electric utilities earn returns on capital invested in generation, transmission, and distribution. Similarly for gas utility investment in capital plant. Unless given the opportunity to profit from the energy efficiency investment that is intended to substitute for this capital investment, there is a clear financial incentive for utilities to prefer investment in supply-side assets, since these investments contribute to enhanced shareholder value.

#### Types of Energy Efficiency Cost Recovery Mechanisms

Some states have chosen to make energy efficiency for an electric or gas utility a break-even activity. That is done by some form of direct cost recovery and/or fixed cost recovery. Methods for direct cost recovery include rate cases, system benefit charges, and a tariff rider or surcharge. Fixed cost recovery, such as through decoupling or a lost revenue adjustment mechanism, mitigates under-recovery of fixed costs due to reduced sales between rate cases due to energy efficiency.

#### Types of Energy Efficiency Performance Mechanisms

Some states have gone further by providing financial incentives to a utility to modify its business model by making efficiency profitable rather than merely a break-even activity.

The three types of performance mechanisms that have been most prevalent include:

- Performance target incentives

- Shared savings incentives
- Rate of return adders

Performance target incentives provide payment for achievement of specific metrics, usually including savings targets. Most states providing such incentives set performance ranges; incentives are not paid unless a utility achieves some minimum fraction of proposed savings, and incentives are capped at some level above projected savings.

Shared savings incentives provide utilities the opportunity to share with ratepayers the net benefits resulting from successful implementation of energy efficiency programs. These structures also include specific performance targets that tie the percentage of net savings awarded to the percentage of goal achieved. Some, but not all, shared savings mechanisms include penalty provisions requiring utilities to pay customers when minimum performance targets are not achieved.

Rate of return adders provide an increase in the return on equity (ROE) applied to capitalized energy efficiency expenditures. This approach currently is not a common performance incentive for several reasons. First, this mechanism requires energy efficiency program costs to be capitalized, and there is debate on utilities' preference for this. Second, at least as applied in several cases, the adder is not tied to performance – it is simply applied to all capitalized energy efficiency costs as a way to broadly incent a utility for efficiency spending. On the other hand, capitalization, in theory, places energy efficiency on more equal financial terms with supply-side investments.

#### Other States Can Provide Valuable Lessons Learned

Many states and their utility commissions have approved some type of energy efficiency policy for their electric and gas utilities using the mechanisms discussed above or variations of them. There are other policies as well that are related, such as the energy efficiency portfolio standard that Pennsylvania now has, or complimentary, such as adoption of stronger building codes or appliance and equipment efficiency standards.

As you know, a policy can be effective or not, easy to administer and implement or not, match the business situation of an electric or gas utility or not, and can also be dialed up or down to achieve a desired level of energy efficiency. And of course, a state can determine how much energy efficiency it desires its ratepayers to obtain, relative to other resources that can be used to meet the same energy needs of electric and gas ratepayers. Your Commission has many examples to look at and consider from other states. Even states that have existing policies for ratepayer-funded energy efficiency are rethinking their current approaches and looking at new and innovative approaches that may be more suitable.

#### The Department of Energy Can Help

The Department this year, through its experts at the Regulatory Assistance Project and Lawrence Berkeley Laboratory, has given technical assistance this year to at least 23 state public utility commissions that asked for help on ratepayer-funded energy efficiency policies. Of those 23 state public utility commissions, we are providing more intensive assistance as requested on ratepayer-funded energy efficiency to the nine state utility commissions of Wyoming, Kansas, Hawaii, Illinois, Massachusetts, Maryland, Kentucky, Ohio, and your own Commission. We hope you are finding our current technical assistance of some use.

In addition, your Commission has received Recovery Act funds to hire additional staff for up to four years on any electricity-topic mentioned in the Recovery Act, including energy efficiency. Separately, the Department is currently in negotiation with the National Association of Regulatory Utility Commissioners (NARUC) for a \$4 million multi-year grant, also with Recovery Act funds, to allow NARUC to provide technical assistance and training to Commissions when requested, again, on any electricity topic mentioned in the Recovery Act, including energy efficiency.

The Department provides such assistance without advocating any particular policy for a state commission, instead, the Department's technical assistance provides suggestions on what may be appropriate given a commission's particular goals and situation.

### Conclusion

There are numerous regulatory methods to use electric and gas utilities to deliver energy efficiency to ratepayers. The statement presented today is meant to give you an overview of the different methods being used around the country as a way to encourage the Commission to consider broadly the ways it can incent more energy efficiency.

This concludes my statement.