



American Council for an Energy-Efficient Economy

529 14th Street, N. W., Suite 600 Washington, D.C. 20045 202.507.4000 202.429.2248 www.aceee.org

April 26, 2019

Terry J. Romine, Executive Secretary
Public Service Commission of Maryland
William Donald Schaefer Tower
6 St. Paul St, 16th Floor
Baltimore, MD, 212302-6806

Re: Case No. 9494: IN THE MATTER OF EMPOWER MARYLAND 2018 – 2020 ENERGY EFFICIENCY, CONSERVATION AND DEMAND RESPONSE PROGRAM PLANS PURSUANT TO THE EMPOWER MARYLAND ENERGY ACT OF 2008

Dear Ms. Romine:

In connection with the above-captioned matter, enclosed please find comments from the American Council for an Energy-Efficient Economy (ACEEE) on the EmPOWER Cost Recovery Work Group Report.

ACEEE is a nonprofit research organization that works on programs and policies to promote energy efficiency. ACEEE is one of the leading groups working on energy efficiency issues in the United States at the national, state, and local levels. We have been active on energy efficiency issues for more than three decades, collecting extensive best-practice information on topics including energy efficiency programs and utility business model design. In Maryland, ACEEE has actively followed the EmPOWER programs, producing a report assessing their results in 2017, and a report in 2008 that served as a roadmap for legislators drafting the EmPOWER Act of 2009.¹ We have also contributed to discussions on energy efficiency programs, including those targeting low-income households.

We applaud the Commissions' direction in its Letter Order² for parties to work together to meet two goals: appropriately incentivize the achievement of the goals of the EmPOWER Act while minimizing ratepayer impacts over the life of the EmPOWER Maryland surcharge. The Work Group report demonstrates a lack of consensus among parties on the appropriate rate of return and amortization period for cost recovery and does not provide a recommendation regarding performance-based incentives. It suggests the need for clarity moving forward in order to achieve both goals. Below, we characterize how Maryland's cost recovery structure fits into the policy landscape of other leading energy efficiency states and recommend steps the Commission and Work Group can take to meet its EmPOWER Act goals while minimizing ratepayer impacts.

¹ Baatz, B. and J. Barrett. 2017. *Maryland Benefits: Examining the Results of EmPOWER Maryland through 2025*. <https://aceee.org/research-report/u1701>; M. Eldridge, et al. 2008. *Energy Efficiency: The First Fuel for a Clean Energy Future; Resources for Meeting Maryland's Electricity Needs*. <https://aceee.org/research-report/e082>.

² Limited Income Program Cost Recovery Report. EmPOWER Maryland 2018-2020. Case No. 9494. (ML # 223596)

Maryland's Current Energy Efficiency Business Model

As Staff notes³ in the Work Group report, ACEEE's research finds that establishing energy efficiency savings targets and aligning utility ratemaking with energy efficiency are critical to delivering high utility sector energy efficiency savings. There are three components for aligning the utility business model: program cost recovery, full revenue decoupling, and shareholder (ideally performance-based) incentives.⁴

The report rightly notes that Maryland has both decoupling and utility cost recovery. Maryland utilities recover expenses over a 5-year time period and earn a return equivalent to the WACC determined by the Commission in a base rate case. While it is true that Maryland does not have performance-based earning opportunities for energy efficiency investments, it does have a shareholder "earnings opportunity" through the cost recovery mechanism itself. Because Maryland's cost recovery mechanism includes the opportunity for a return equivalent to utilities' other investments, the state effectively puts demand-side investments on an even playing field with supply-side investments.

Staff notes that the utilities have largely been successful in reaching their EmPOWER Maryland goals. Maryland performed well in the 2018 ACEEE's *State Scorecard*, ranking 16th in the utility sector component of the scorecard.⁵ We believe that is driven by the combination of clear goals and the cost recovery, revenue decoupling, and shareholder incentives embedded within the recovery structure. The proposals from OPC and Staff would eliminate the elements of the cost recovery mechanism which function like a shareholder incentive without replacing them with another way to incentivize Maryland utilities' continued energy efficiency performance. Without a full slate of energy efficiency incentives that address not just the disincentive to do energy efficiency but also the opportunity cost of energy efficiency relative to other investments, Maryland risks disinvestment and reduced attention to EmPOWER programs from utility management.

Below, we outline similar state cost recovery models from Illinois, New Jersey, Utah, and New York. The Commission and Work Group may find the details of these models useful to examine as they consider changes to Maryland's cost recovery mechanisms. In the short term, we recommend caution in reducing the rate of return or amortization period without reviewing the impact on utility attention to cost-effective energy efficiency relative to other investments. We also provide additional detail on Illinois, a state that embeds a performance basis into its cost recovery mechanisms by adjusting ROE based on efficiency program evaluations. This might be a method for Maryland to consider as it evaluates its EmPOWER Maryland incentives in the medium term.

Similar State Energy Efficiency Cost Recovery Models

³ Maryland Commission Staff, EmPOWER Cost Recovery Work Group Report EmPOWER Maryland Plans (ML# 224774) at pg. 23

⁴ Molina, M. and M. Kushler, 2015. "Policies Matter: Creating and Foundation for the Energy-Efficient Utility of the Future." <https://aceee.org/sites/default/files/policies-matter.pdf>

⁵ Maryland Commission Staff, EmPOWER Cost Recovery Work Group Report EmPOWER Maryland Plans (ML# 224774) at pg. 27 ; ACEEE, "The 2018 State Efficiency Scorecard," <https://aceee.org/state-policy/scorecard>.

Maryland is not the only state that allows for a return on cost recovery; Commonwealth Edison and Ameren in Illinois, PSE&G in New Jersey, and Rocky Mountain Power in Utah also do so for their efficiency investments, and Con Edison in New York does so for a portion of their efficiency incentives.⁶

As in Maryland, other states cite two primary reasons for cost recovery mechanisms that include a return on equity for demand-side investments in a manner similar to traditional infrastructure investment: leveling the playing field for demand-side investments and smoothing the bill impacts of customer surcharges. Utilities that are rapidly ramping up energy efficiency investment often want to spread those costs over a longer time period during which customers continue to benefit from the investments, rather than recovering costs the year in which they costs are incurred. This alignment of spending and savings can be more equitable for customers, especially those who might leave the service territory before the end of the measures' benefits.

Approaches to the appropriate amortization period and rate of return vary by state. PSE&G amortizes costs over a 7-year period, with IT system costs amortized over 5 years; both Rocky Mountain Power and Con Edison use a 10 year amortization period, and ComEd and Ameren use the weighted average measure life of the portfolio, or 11.6 years and 12.6 years respectively, for 2019 in for the most recent filing.^{7,8}

PSE&G in New Jersey sets a return on investment for energy efficiency cost recovery at the utility's weighted average cost of capital, and Utah's mechanism also requires a similar return to its traditional infrastructure investments. Similarly, in New York, the efficiency measures were filed as part of a larger base rate increase for 2017-2019, and received the same ROE as the other assets in their rate case. In Illinois, the formula rate ROE varies based on energy efficiency program performance, but starts from a basis of the average of the prior year's monthly average yields of 30-year US Treasury bonds plus 580 basis points.

Performance-Based Options

Neither New Jersey nor Utah tie these cost recovery methods to performance. In contrast, New York and Illinois both receive performance-based incentives in addition to their amortized cost recovery mechanisms. New York's is embedded in a separate earnings adjustment mechanism, or EAM.

Illinois' performance-based incentive is built into its cost recovery mechanism, and therefore offers a promising model for Maryland to consider. ComEd and Ameren have an energy efficiency formula rate for cost recovery, which includes performance incentives for utilities that meet or exceed their targets

⁶ Relf, G. and S. Nowak. 2018. "Snapshot of Energy Efficiency Performance Incentives for Electric Utilities." <https://aceee.org/topic-brief/pims-121118>

⁷ NJ BPU. 2015. "EEE Extension II". Docket No. EO14080897; State of Utah. 2016. *SB 115 Sustainable Transportation and Energy Plan Act*; NY Public Service Commission. 2017. *Order Approving Electric and Gas Rate Plans*. Case 16-E-0060.; IL State Legislature. 2016. Act 099-0906: the Future Energy Jobs Act., 2018.

⁸ Commonwealth Edison. Docket No. 18-1101, June 21. www.icc.illinois.gov/downloads/public/edocket/475994.pdf; and IL Commerce Commission. 2018. Docket No. 18-1100, November 1. www.icc.illinois.gov/downloads/public/edocket/487019.pdf

and penalties for not meeting targets. The formula rate is set using projected energy efficiency costs for the following year, amortized over the weighted average measure life of the portfolio and reduced for accumulated deferred income taxes. The projected costs are reconciled with actual costs the following year. The operational costs of administering efficiency programs are reflected as a regulatory asset in the rate base.⁹

As a part of the formula rate, the utilities are eligible to adjust the ROE for evaluated achievement of their energy efficiency targets in the following year’s cost reconciliations. The table below describes these incentives, which are symmetrical, scaled, and which differ by utility.

Return on equity for achievement of energy efficiency goals

Utility	Percentage of goal achieved	ROE	Percentage of goal achieved	ROE
Years	2018-2025		2026-2030	
ComEd	≤75%	Minus 200 basis points	≤ 66%	Minus 200 basis points
	More than 75%, less than 100%	Minus 8 basis points per % below goal	More than 66%, less than 100%	Minus 8 basis points per % below goal
	100% or more, less than 125%	Plus 8 basis points per % above goal	100% or more, less than 134%	Plus 8 basis points per % above goal
	≥125%	Plus 200 basis points	≥ 134%	Plus 200 basis points
Ameren	≤ 84.4%	Minus 8 basis points per % below goal	<100%	Minus 6 basis points per % below goal
	More than 84.4%, but less than 100%	No change in basis points	100%	No change in basis points
	≥100%	Plus 8 basis points per % above goal	>100%	Plus 6 basis points per % above goals

Basis point reductions and increases are capped at 200 in all the cases presented above.

Recommendation

While we typically recommend a performance-based mechanism for shareholder incentives in order to encourage even better performance, given Maryland’s good progress to date and the potential short-term ratepayer impacts from a switch to a shorter amortization period¹⁰, we do not recommend an immediate change to the cost recovery structure. We recommend caution in reducing the rate of return or amortization period without reviewing potential impacts on utility attention to cost-effective energy efficiency relative to other investments.

In the medium term, we suggest that the Commission clarify policy direction for the cost recovery mechanism and encourage further Work Group progress. We would recommend that this should include a shift towards a performance basis through a mechanism similar to the structure in Illinois, which

⁹ Commonwealth Edison. 2018. *Direct Testimony of Chad A. Newhouse: Director, Rates and Revenue Policy*. icc.illinois.gov/downloads/public/edocket/476000.pdf; Relf, G. and S. Nowak. 2018. “Snapshot of Energy Efficiency Performance Incentives for Electric Utilities.” <https://aceee.org/topic-brief/pims-121118>

¹⁰ Maryland Commission Staff, EmPOWER Cost Recovery Work Group Report EmPOWER Maryland Plans (ML# 224774) at pg. 15 and Office of People’s Counsel, at pg 11.

embeds a performance basis in the cost recovery mechanism, or a more wholesale change to treat efficiency costs as an expense and simultaneously create a separate performance-based incentive, the structure in twenty-four states.¹¹ ACEEE would be pleased to provide technical assistance to the Work Group in any such discussions.

Maryland has been a leader in energy efficiency in the utility sector, and we look forward to seeing the state continue to build on this progress. Changing the cost recovery mechanism without a plan for maintaining utilities' incentives to deliver energy efficiency risks setting back that progress. ACEEE appreciates your consideration of these comments and is available as a resource to discuss any of the issues raised herein.

Sincerely,

A handwritten signature in cursive script that reads "Rachel Gold". The signature is written in black ink and is positioned below the word "Sincerely,".

Rachel Gold
Senior Manager, Utilities
ACEEE
rgold@aceee.org
202-507-4005

¹¹ Relf, G. and S. Nowak. 2018. "Snapshot of Energy Efficiency Performance Incentives for Electric Utilities."
<https://aceee.org/topic-brief/pims-121118>