

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: THE NARRAGANSETT ELECTRIC :
COMPANY, DEMAND-SIDE :
MANAGEMENT PROGRAMS FOR 2003 : DOCKET NO. 3463

REPORT AND ORDER

I. Overview

Since 1989, the Commission has annually reviewed the design and implementation for Narragansett Electric Company’s (“Narragansett” or “Company”) proposed DSM programs and authorized the assessment of a conservation and load management adjustment factor (“C&LM Factor”) to fund program costs. The Utility Restructuring Act of 1996 (“URA”), as amended and set forth in Title 39 of the Rhode Island General Laws, has effectively codified the Commission’s practice by enacting into law a provision for the funding of DSM programs. In effect, the URA establishes a charge of 2.0 mills per kilowatt-hour for the 2002 programs, unless the Commission approves a higher factor.¹ Although the law provides the funding for the programs and states that the Company shall administer the programs, the Commission continues to have the responsibility for reviewing the design and implementation of Narragansett’s DSM programs.

On September 6, 2002, in response to Commission directives in Order No. 17106, Narragansett, filed with the Public Utilities Commission (“Commission”) direct pre-filed testimony in support of its proposed Demand-Side Management (“DSM”) programs for 2003. On October 22, 2002, the Division of Public Utilities and Carriers (“Division”)

¹ R.I.G.L. § 39-2-1.2(b) provides this level of funding for DSM programs for a ten-year period beginning January 1, 2003.

submitted its pre-filed direct testimony. On October 28, 2002, the Commission conducted a technical record conference to address the filings. The Parties had the opportunity to file supplemental testimony and to complete discovery.

On December 4, 2002, a Settlement (“Settlement”)² executed by Narragansett, the Division, and The Energy Council of Rhode Island (“TEC-RI”) in connection with Narragansett’s DSM for calendar year 2003 (“2003 Programs”) was filed with the Commission. The Settlement represents an agreement among its signatories (the “Parties”)³ regarding the design and implementation of Narragansett’s 2003 Programs, as well as the allocation of dollars between the DSM and programs. On December 9, 2002, the Commission conducted a public hearing to review the merits of the proposed Settlement. In response to Commission concerns at the hearing, on December 17, 2002, the parties submitted an Amended Settlement.⁴ On December 20, 2002, after considering the evidence presented, the Commission ruled on the propriety of the Settlement.

II. Pre-Filed Testimony

A. Narragansett

Narragansett submitted the pre-filed testimony of Timothy F. Horan, Vice President of Business Services for Narragansett Electric Company, Michael L. McAteer, Manager of Business Energy Efficiency Services for National Grid USA, Laura G. McNaughton, Manager of Residential Services for National Grid USA, and Carol S. White, Director of Evaluation and Research for National Grid USA.

Mr. Horan provided an overview both of Narragansett’s experience delivering energy efficient programs and of the Company’s proposals for 2003. He indicated that

² The Settlement was admitted as Joint Exhibit 1.

³ The Parties are members of the Demand-Side Management Collaborative (“DSM Collaborative”).

the Company has five goals for its programs: (1) that they be as cost-effective as possible; (2) that they serve a large number and broad mix of Rhode Island customers; (3) that they maximize the long-term savings; (4) that they capture potential lost opportunities; and (5) that they actively change markets for energy efficient equipment and service.⁵ Mr. Horan explained that the Company conducts annual reviews of its programs to identify areas of improvement in order to advance these stated goals.

He indicated that since the inception of the DSM programs, the Company has made numerous changes in order to improve programs.⁶ Mr. Horan asserted that the programs have assisted the Company in working to overcome certain market barriers that consumers face, such as higher first cost, lack of information and high search and verification costs, uncertainty about performance of complex, unfamiliar technologies, product unavailability, and misplaced rebates/split incentives. He noted, however, that although the market barriers have been overcome to a certain extent, there is still room for improvement.⁷

Addressing the proposed 2003 programs and associated budgets, Mr. Horan indicated that the Company proposed a total DSM budget of \$22,692,700 targeted to Residential, Small Commercial and Industrial (“Small C&I”), and Large Commercial and Industrial (“Large C&I”) customers. The Residential Program budget of \$5,956,600 would cover the following programs: the Energy Star Homes, Energy Star Appliances, Energy Star Lighting, the Energy Wise Program, the Appliance Management Program, the Energy Efficiency Educational Programs, the Home Energy Management Program,

⁴ The Amended Settlement is attached as Appendix A and incorporated herein by reference.

⁵ Narr. Ex. 1A (Pre-filed testimony of Timothy F. Horan), p. 2.

⁶ Id. at 2-5.

⁷ Id. at 5-7.

the Energy Star Heating Program, and the Rhode Island High Efficiency Air Conditioning Program.⁸ The Large Commercial and Industrial Program Budget of \$13,305,300 would be put toward the following programs: Energy Initiative, the retrofit program, *Design2000plus*, a new construction program, services offering technical, financial and other services to assist customers in choosing the proper measures for their operations.⁹ The Company also planned to continue the Small Business Program with a proposed budget of \$2,349,200.¹⁰ Funding for these programs would be comprised of the non-bypassable distribution charge, program leasing revenues, co-payments from customers and a balance of unspent funds from 2002.¹¹ With regard to the apportionment of budgeted funds among programs, Mr. Horan indicated that the Company proposed to have the ability to transfer funds from one program to another within a sector with prior approval of the Division. The Company proposed that with Division approval and notice to the Commission, it would be allowed to transfer funds from one sector to another if the transfer would only reduce the sector by 20% or less. Transfers between sectors of more than 20% in the aggregate over the course of the year would require Commission approval.¹²

Mr. McAteer's testimony focused on the commercial and industrial (C&I) programs. He indicated that the Company planned to offer the same C&I programs as those offered in 2002. He testified that the programs are nationally recognized. He noted that *Design 2000plus* and the Energy Initiative programs are available to all non-residential customers. The Small Business program targets those non-residential

⁸ Id. at 7-8.

⁹ Id. at 8.

¹⁰ Id.

¹¹ Id. at TFH-2.

customers with a demand of less than 100kW or annual usage of less than 300,000 kWh.¹³ Mr. McAteer indicated that the Design 2000*plus* and Energy Initiative programs contain several initiatives to aid in market transformation, including, the DesignLights Consortium, the Schools Initiative, Building Operator Training and Certification, Cool Choice, MotorUp, the Compressed Air Challenge, and the Building Codes and Standards Initiative.¹⁴

Addressing adjustments to the C&I programs for 2003, Mr. McAteer indicated that several modifications would not occur until the completion of the Company's review of the 2002 programs. However, he did note that Narragansett was considering reducing certain rebates to reflect pricing changes. Reduction of those rebates would allow for greater rebates to other customers and allow for greater energy and demand savings.¹⁵ Mr. McAteer then turned to more concrete proposals, such as Company participation in the development of "Advanced Building Design Guidelines" by the New Buildings Institute and other utility sponsors. The purpose of the Guidelines is to define the best practice in design, construction and start-up of new and renovated non-residential buildings.¹⁶ The other proposal related to non-residential customers was a pilot program in 2003 to determine the feasibility of a Demand Response Initiative. The primary goal of the program is to enable customers to actively manage and document their electrical consumption and loads through a building management system. The second goal would be to determine strategies for encouraging other market participants to adopt and promote this energy management philosophy. The funding for the pilot in the amount of \$25,000

¹² Id. at 9.

¹³ Narr. Ex. 1B (Pre-filed testimony of Michael L. McAteer), pp. 2-3.

¹⁴ Id. at 4.

¹⁵ Id. at 5-6.

would allow Narragansett to conduct load shed audits that would identify electric measures that can reduce customer demand.¹⁷

Ms. McNaughton's testimony addressed the proposed Residential Programs, detailing any changes from prior years. Regarding the Energy Star Appliance program, the Narragansett proposed discontinuing continuous rebates for clothes washers in favor of working with retailers and manufacturers on short-term promotions. Additionally, Narragansett proposed the addition of a new short-term rebate of \$25 on Energy Star air conditioners.¹⁸

Ms. McNaughton stated that the Company was proposing "dramatic" changes to the design of the Residential Lighting Program, including renaming it Energy Star Lighting. She indicated that there had been significant changes in the residential lighting market since 1991, including the adoption of national standards for lighting which lead to higher production and a willingness by more suppliers to stock compact fluorescent lights ("CFLs"). Furthermore, rebates had dropped significantly, from a high of \$28 in 1993 to \$3 in 2002. Therefore, Narragansett proposed eliminating the standard rebates for CFLs, in favor of engaging in special promotions to promote innovative or specialized CFL screw-ins. However, the Company proposed to continue rebates for Energy Star fixtures and torchieres in the amount of \$10 for exterior fixtures, \$15 for interior fixtures and \$20 for torchieres and table lamps.¹⁹

Ms. McNaughton did not highlight any changes to the Energy Wise, Appliance Management, Home Energy Management or Energy Star Heating Programs. Addressing

¹⁶ Id. at 6.

¹⁷ Id. at 6-8.

¹⁸ Id. at 4-5.

¹⁹ Id. at 5-6.

the Energy Star Central Air Conditioning Program, Ms. McNaughton noted that in 2002, Narragansett focused on start-up activities relating to this new 2002 program. She indicated that the Company's focus would shift during 2003 to concentrate on increased outreach and participation in the program. Ms. McNaughton indicated that Narragansett's goal will be to serve 200 customers in 2003.²⁰

With regard to the Energy Efficiency Educational Programs, Ms. McNaughton noted no changes to the National Energy Education Development Project, but did indicate that Narragansett will initiate the Rhode Island EnergySmart Schools in 2003. This program is designed to build upon programs that have been offered in Rhode Island. Services include kits and curriculum for students from kindergarten through high school, student/teacher training programs, workshops and conferences, a summer camp program, scholarships to national energy educational conferences and youth awards.²¹

Ms. McNaughton noted that Narragansett proposed expansion of the Energy Star Homes Vocational Schools Initiative to four schools, to include, in addition to the Woonsocket Area Career and Technical Center and the Warwick Career and Technical School, the Davies Career and Technical School in Lincoln and the Cranston Career and Technical School.²²

At the conclusion of her pre-filed testimony, Ms. McNaughton explained that customers in homes heated by natural gas are served by energy efficiency programs offered by the New England Gas Company through funding to the Rhode Island State Energy Office to provide weatherization and rebates to qualifying customers.²³

²⁰ Id. at 6-10.

²¹ Id. at 10.

²² Id. at 10-11.

²³ Id. at 11.

Ms. White provided testimony regarding the cost-effectiveness of the Company's programs and on the proposed shareholder incentives related to 2003 programs. She indicated that rather than the Rhode Island test used in the past to measure cost effectiveness, the Company was proposing to use a modified total resource cost test ("TRC"). She explained that the difference is that under the Rhode Island test, only electricity savings were valued. Under the TRC, the Company would factor non-electric savings, including avoided generation costs, avoided transmission and distribution costs, participant spillover, customer benefits, quantifiable avoided natural resource costs, and transmission and distribution line loss factors.²⁴

Regarding the actual cost effectiveness of the 2003 DSM programs, Ms. White testified that the entire DSM effort is expected to have a benefit/cost ratio of 1.87. The Large C&I programs are expected to have a benefit/cost ratio of 2.16, the small C&I programs, a benefit/cost ratio of 2.29, and the residential programs, a benefit/cost ratio of 1.28.²⁵

Ms. White indicated that the Company proposed to make several modifications to the Shareholder Incentive Mechanism that was approved in prior DSM-related Commission dockets. At the outset, Ms. White indicated that it was Narragansett's view that there are five (5) purposes behind the shareholder incentive mechanism: (1) to reward Narragansett for effective program implementation; (2) to encourage Narragansett to prudently spend the entire DSM budget; (3) to encourage program innovation; (4) to encourage Narragansett to make services available to all customer constituencies; and (5)

²⁴ Id. at 3-7.

²⁵ Id. at 8-9. Ms. White noted that although the residential Energy Star Air Conditioning Program is not expected to be cost-effective under the TRC (having a benefit cost ratio of less than 1.0), the Company believes it should be implemented due to its importance to residential customers.

to eliminate adverse financial affects to Narragansett related to aggressive program implementation. Under the previously approved shareholder incentive mechanism, the Company earned an incentive based on annual electric savings targets within each of the customer classes. Narragansett had the opportunity to earn up to 4.25% of its DSM implementation budget, excluding evaluation expenses and expenses related to the Home Energy Management Program once it achieved 45% of the targeted annual kWh savings goal for the sector.²⁶

Under the new proposal, rather than using the three customer classes served in calculating the shareholder incentive, Narragansett would only use two - residential and non-residential. Narragansett would base the potential shareholder incentive on expenses rather than budget to motivate the Company to spend the entire budgeted amount. Also, rather than earning up to 4.25% of the DSM budget once the Company achieved 45% savings, Narragansett suggested a higher incentive if it exceeded goals. Therefore, the Company suggested setting the target incentive at 4.5% of total expenses, with a total incentive cap of 6% of expenses for the portfolio of programs once the Company reached 55% of a sector goal.²⁷

²⁶ Id. at 10-12, Schedule CSW-4, pp. 1-4.

²⁷ Id.

B. Division

On October 22, 2002, the Division submitted the Pre-filed Testimony of Dr. Jonathan Raab, President of Raab Associates, Ltd., an energy, environmental, and regulatory consulting and dispute resolution firm. Dr. Raab's testimony was designed to comment on Narragansett's proposed changes to the shareholder incentive plan, to the proposed DSM budgets by customer class, to the specific design of several programs, and to the benefit-cost test.²⁸

Dr. Raab indicated that, overall, the Division supported Narragansett's proposed DSM programs which represented a continuation of the existing, relatively successful portfolio of programs. However, the Division believed that the proposed changes to the incentive structure were unnecessary and counter-productive. Specifically, the Division believed that the incentive cap should not be increased from 4.25% to 6%, but rather held steady, or even decreased to represent the lower interest rates and the fact that there is less risk to the Company than when the incentives were first introduced. Additionally, Dr. Raab opined that a stretch incentive system may lead to gaming of the programs. Furthermore, the Division argued that Narragansett should not be allowed to earn incentives on planning and evaluation costs. Nor should the incentive be based on expenditures rather than on the budget because, according to the Division, "basing incentives on budget rather than expenditures actually provides a higher incentive to spend the entire budget than what the Company suggests."²⁹ Finally, Dr. Raab indicated that the Division is strongly against combining the Large and Small C&I customers into a single category for purposes of calculating the shareholder incentive. Such a move,

²⁸ Division Ex. 1 (Pre-filed Testimony of Jonathan Raab), p. 3.

²⁹ Id. at 6.

according to the Division would reduce the likelihood that the Company would focus adequate effort on serving the smaller commercial customers.³⁰

However, Dr. Raab indicated that the Division could support the Company's proposal that the calculation of the shareholder incentive should be designed to recognize the non-electric resource benefits, especially in light of the fact that the Commission has been encouraging the Company to pursue programs that have benefits to conservation of fuel oil, propane and water. Second, the Division supported increasing the threshold the Company needs to reach before earning an incentive in each of the sectors to 55% from 45%.

Furthermore, Dr. Raab expressed concern regarding Narragansett's proposal to reallocate money away from residential and small commercial customers in favor of large commercial and industrial customers. He indicated that it appeared that the Company's overall budget break-down appeared to shift resources away from residential and small commercial customers and toward large C&I customers. Dr. Raab provided a chart showing a 5% reduction in the 2003 residential and small commercial allocation and a 5% increase in the large C&I allocation of the overall budget as compared to the 2002 allocations.³¹

Additionally he indicated that the Division was concerned with program design changes in some areas and a lack of changes in other areas. Specifically, the Division targeted the Energy Star Appliance, residential lighting, small business and larger C&I programs. Dr. Raab indicated that it was not clear why the Company proposed eliminating the continuous rebates for clothes washers when the most recent data showed

³⁰ Id. at 4-6.

³¹ Id. at 4,6-7.

that Rhode Island was lagging behind other states in market share. Also, the Division questioned whether \$25 is a sufficiently high rebate for Energy Star air conditioners and whether the level of rebate should be associated with the air conditioner size or efficiency rating. With regard to the residential lighting program, the Division supported targeted promotional rebates, but supported them in addition to the continuous rebates for CFL screw-ins, not in place of the continuous rebates. According to Dr. Raab, there was no evidence that the market has been sufficiently transformed in this area.³²

Addressing the small business program, Dr. Raab reiterated the Division's concern that the Company has proposed to cut the budget by over 20%. It was not clear to the Division why Narragansett was convinced that it could not expect to hit its targets in the program in 2003. He indicated that Narragansett had not provided sufficient evidence that it has explored all avenues to boost participation in the program.³³ With regard to the Large C&I programs, Dr. Raab indicated that the Division did not yet have sufficient information upon which to base an opinion.³⁴

Finally, Dr. Raab indicated that the changes to the benefit-cost test create a different test that should supplement rather than supplant the existing benefit-cost test. While Dr. Raab noted that the Division could support adding non-resource savings, adding customer costs to the test would distort the results. Therefore, the Division recommended not including customer costs in the analysis. However, Dr. Raab opined that if the Commission wished to use a more societal test, it should require the Company

³² Id. at 6-9.

³³ Id. at 9.

³⁴ Id. at 9-10.

to calculate the benefit/cost test under both the original and new TRC benefit-cost test for each program.³⁵

III. Technical Session

On Monday, October 28, 2002, the Commission convened a Technical Record Conference to discuss the pre-filed testimony filed by the parties and to address issues raised prior to the parties working toward a settlement. A Technical Record Conference allows the parties and Commission to participate in a free exchange of ideas within the confines of a docketed matter. The Technical Record Conference does not normally take the place of the public hearing, but allows the parties and the Commission to work toward common resolution without raising the Commission to the level of a party to the docket.

The following people were present at the Conference: Doug Hartley, Commission Energy Policy Director, Arline Bolvin, Director of the Coalition for Consumer Justice, Matt Guglielmetti, State Energy Office, Bill Gilmore, The Energy Council of Rhode Island (“TEC-RI”), Bill Lueker, Special Assistant Attorney General representing the Division, Jonathan Raab, Raab Associates, consultant to the Division, Terry Schwennesen, counsel to Narragansett, Carlos Gavilondo, Vice President, Distribution and Regulatory Services for Narragansett, Amy Rabinowitz, counsel to Narragansett, Timothy Horan, Vice President of Business Services for Narragansett, Michael McAteer, Manager of Business Energy Efficiency Services for Narragansett, Carol White, Director of Evaluation for Narragansett, Laura McNaughton, Manager of Residential Energy Efficiency Service for Narragansett, Tim Roughan, Director of Distributed Resources for Narragansett, David Jacobson, Principal Analyst for National Grid, Kate Ringe-Welch, Principal Analyst for National Grid, Michael Hager, Director of

³⁵ Id. at 10.

Energy Supply for Narragansett, Thomas Gentile, Manager of Transmission Planning for Narragansett, Erich Stephens, Executive Director of People's Power and Light, Kevin Menard, Al Contente, Engineer with the Division and David Stearns, Division Fiscal Analyst.

The proceeding covered many issues of interest regarding DSM programs, but primarily focused on five: (1) the continuation of shareholder incentives and the appropriate mechanism for their calculation;³⁶ (2) the sufficiency of programs and budget allocations to Small C&I and Residential sectors;³⁷ (3) the necessity and levels of rebates;³⁸ (4) the creation of an advisory committee in lieu of the collaborative;³⁹ and (5) the concept of multi-year program and budget approval.⁴⁰

1. Shareholder Incentives

Narragansett defended the continuation of shareholder incentives tied to the administration of DSM programs. According to the Company, the kWh savings produced by DSM programs causes a reduction of revenues and therefore, in order to incent the entire company, including upper management, to support strong programs which cause a reduction in revenues, a monetary incentive is necessary. Additionally, Narragansett argued that the shareholder incentive encourages Narragansett to continue developing new programs. However, in response to Commission inquiry, Narragansett indicated that while the Company believed that the traditional method of calculating the shareholder incentive was the most straightforward, the Company was open to the idea of an incentive based on performance based metrics.

³⁶ Tr. 10/28/02, pp. 19-59, 86-91, 200-201, 205-210, 223.

³⁷ Id. at 92-118.

³⁸ Id. at 119-170, 202-204, 255-260.

³⁹ Id. at 182-196, 225.

Addressing performance based metrics specifically, Narragansett noted that its sister electric utilities have incentives based on performance based metrics. The Company suggested that any alternative incentive mechanism should be understandable to the people going out in the field so they understand how their actions affect the potential earnings attributed to the programs. Additionally, Narragansett asserted that an overly complex incentive mechanism may actually impede the effectiveness of the programs.⁴¹

2. Budget Allocations

Turning to the budget allocations for 2003, the Commission and Division expressed concern regarding a reduced budget for the Residential and Small C&I customers in comparison to an increase in the Large C&I budget. Narragansett indicated that many customers had already participated in the Small Business Programs and it is challenging to gain further participation from them. Mr. McAteer indicated that Narragansett was looking for ways to increase participation, such as allowing the Small C&I customers to extend the term on their co-pays from 24 to 26 months. Ms. White added that Narragansett had recently conducted an evaluation/survey of customers in Rhode Island, both participants and non-participants to determine how to better serve them.⁴²

3. Rebates

Addressing the concerns regarding the residential programs, specifically the rebates, the Commission and Division supported the addition of an air conditioner rebate, but expressed concern that the rebate level of \$25 may not be sufficient. Additionally,

⁴⁰ Id. at 211-223.

⁴¹ Id. at 19-59, 86-91, 200-201, 205-210, 223.

there was discussion regarding the level of the rebates relative to the Energy Star heating systems. There was concern that the \$500 rebate covered the incremental cost between non-Energy Star heating system and some, but not all, of those systems with the rating. However, Narragansett indicated, without objection from the SEO, that consultations with the SEO, who administers the program, one rebate is easier to implement and is less confusing to customers. There was also discussion regarding the Commission's concern that rebates were being phased out too quickly in the area of CFLs and that they were being restructured too dramatically in the area of the Energy Star clothes washers. Narragansett conceded that the Rhode Island market had not developed as robustly in these areas as its surrounding geographical area where the rebate changes were being implemented.⁴³

4. Advisory Committee

As part of Docket 3240, the previous DSM docket, Narragansett had filed a brief, at least implying that under 2002 amendments to the Utility Restructuring Act, the Commission could not require a continuation of the Collaborative in administering DSM programs. Additionally, Narragansett's pre-filed testimony was not entirely clear regarding the continuation of or the role of the Collaborative in 2003. Therefore, during the Technical Conference, the Commission queried as to whether it could create an advisory committee that would review Narragansett's programs and report back to the Commission. Mr. Horan indicated that an advisory committee may be a good idea as long as it did not take away from the administrative powers of the Company and he indicated Narragansett would like to be involved on the committee. Ms. Bolvin indicated

⁴² Id. at 92-118.

⁴³ Id. at 119-170, 202-204, 255-260.

that her constituency believed that the advisory group should have a more active role in the administration rather than simply providing oversight for the Commission. The Commission did raise a concern that the advisory committee be set up in such a way that it could become so independent from the Commission and the parties that it would somehow become an adversary in the annual DSM process.⁴⁴

5. Multi-Year Program Approval

Traditionally, Narragansett and/or the Collaborative have filed annually for approval of the proposed DSM budget and programs for the upcoming year. In response to a question of whether efficiency could be added to the DSM programs if multi-year approval was granted, Ms. White indicated that there are pros and cons to this approach. Approval of a program to be in place for more than one year provides certainty to the Company and to customers. However, she expressed a concern that the initial budget or program design may not be adequate to take full advantage of a multi-year approach. The parties agreed that a mechanism would have to be created to allow the Company to approach the Commission in the event of any significant changes or new ideas for programs that occur during the term of the approved programs. Finally, there was discussion questioning whether a multi-year approval would, in fact, reduce the need for an annual filing made by a certain date or whether the annual process would simply look different.⁴⁵

IV. Settlement

On December 4, 2002, Narragansett filed a Settlement entered into between the Division, TEC-RI, the State Energy Office, the Coalition for Consumer Justice and

⁴⁴ Id. at 182-196, 225.

⁴⁵ Id. at 211-223.

Narragansett. The Settlement initially reviewed the status of Narragansett's DSM Programs approved for 2002. The Company's overall DSM and renewable energy budget for 2002 was set at \$29,907,300 after the May 2002 true-up. The estimated year-end balance was estimated at \$10,149,724 with all but \$210,706 committed to DSM and Renewables programs in progress.⁴⁶

A. Residential Programs

The parties agreed to a continuation of the 2002 residential programs with similar rebates. The residential budget for 2003 was set at \$3,972,200, allocated among the Energy Star Products, Energy Star Lighting and EnergyWise programs. Narragansett agreed to review and monitor the performance of the Rhode Island rebate programs in comparison to the Massachusetts rebate programs to determine whether the rebate levels should continue in 2004 or should be modified.⁴⁷

B. Small Business Services Programs

The parties agreed to modify the Small Business Service programs by reducing the customer co-pay by 10% in an attempt to promote more customer participation. Additionally, four new measures were added to the Programs (Domestic Hot Water Pump Time Clock, Efficient Evaporator Fan Motors, Condensate Evaporators and Automatic Door Closers on Walk-in Equipment). The Small Business Services budget was set at \$2,699,200. Finally, Narragansett agreed to conduct a mid-year review of the Small Business Services Program to determine whether the changes have the desired effect of

⁴⁶ Jt. Ex. 03-1, Settlement., pp. 2-3, Attachment 1, p.2.

⁴⁷ Jt. Ex. 03-1, p. 3.

boosting customer participation. If the program changes appear ineffective, the parties agree that funds may be shifted back to Large Business Services Programs.⁴⁸

C. Large Business Service Program

The parties agreed that Narragansett should offer its proposed Large Business Programs with a few modifications. First, Narragansett agreed to increase the customer contribution on measures in the Energy Initiative (“EI”) program wherever feasible. Second, the budgets for EI and Design2000*plus* were reduced by \$500,000 to cover budget restorations in the Residential and Small Business Service Programs.⁴⁹

D. Budgets and Funding Sources

Funding of the 2003 budget for DSM programs will be provided from the mandatory 2003 DSM, carryover of the 2002 fund balance, fund interest earned and funds received from Small Business program co-payments in 2003.⁵⁰ True-up of the 2002 fund balance to be carried over to the 2003 budget will occur no later than May 2003. If the difference between the amount of the true-up and the filed budget is 20% or less of the total approved budget, only Division approval will be necessary for reallocation; otherwise, Commission approval will be required.⁵¹

E. Cost Effectiveness.

The Parties agreed not to change the cost-effectiveness analysis from previous years with the exception of allowing Narragansett to include non-electricity resource

⁴⁸ Id. at 3-4.

⁴⁹ Id. at 4.

⁵⁰ Id. at 5-7. According to the parties, “in accordance with R.I.G.L. § 39-2.1.2(b), \$3,789,018 has been excluded from the proposed DSM budget for 2003 reflecting a transfer of the Company’s renewable energy fund to the SEO effective January 1, 2003.” At the request of the SEO, this was approved separately by a 2-0 vote on December 11, 2002 (Commissioner Gaynor abstaining on the basis that she did not believe the Commission had sufficient information before it upon which to base a decision). Id. at 5.

⁵¹ Id. at 5-6.

savings in the current calculation of cost-effectiveness. The estimated overall benefit/cost ratio is 2.51 (for every \$1 spent, a benefit of \$2.51 is produced).

F. Shareholder Incentive

The Parties agreed that rather than basing its incentives on actual expenditures as originally proposed by the Company, Narragansett's incentives will be based on budgeted expenditures, will not exceed the capped percentage from 2002 of 4.25%, would not seek any type of bonus above that cap, nor increase the threshold level of annual energy savings. Additionally, the parties agreed that Planning and Evaluation costs will be included in the incentive calculation.⁵² According to the original Settlement, "any transfers between sector budgets will also result in adjustments to the calculation of thresholds under the cost effectiveness test as well as adjustments to incentive calculations."⁵³

G. Education and Public Interest

The parties agreed to continue the Collaborative, comprised of the Parties to the Settlement as well as any other interested third party as identified by the Commission. The Collaborative members agreed to meet at least six times in 2003, including during two public forums. The public forums will be noticed to the public and recorded by a stenographer. In addition, the Collaborative will submit a report to the Commission regarding the content of the forum, the proposed actions to address and the feedback received.⁵⁴

The Collaborative will review all proposed programs for 2004, including a proposal to implement performance based metrics for purposes of calculating the

⁵² Id. at 9-10.

⁵³ Id. at 6.

shareholder incentive. According to the Settlement, in the event the Collaborative is unable to agree to Narragansett's 2004 proposal, the Company will be free to file with the Commission on or before October 2004 for approval of its proposals.⁵⁵

V. Hearing

Following notice, a hearing was held on December 9, 2002, at the offices of the Commission, 89 Jefferson Boulevard, Warwick, RI, to consider the Settlement filed by the Parties and the proposals contained therein.

The following appearances were entered:

FOR NARRAGANSETT:	Terry Schwennesen, Esq.
FOR THE DIVISION:	William K. Lueker, Esq. Special Assistant Attorney General
FOR THE COMMISSON:	Cynthia G. Wilson, Esq. Senior Legal Counsel

The hearing focused on two areas: (1) how the Settlement differed from Narragansett's initial position; and (2) the appropriate calculation of the shareholder incentives.

Despite the fact that there were significant changes between Narragansett's initial position and the Settlement between the parties, the Commission expressed concern in three main areas: (1) shifting funds from the Small Business Services Programs back to Large Business Programs; (2) the effect of a transfer of funds from one sector to another on shareholder incentive calculations; and (3) the calculation of shareholder incentives. The latter two were intertwined at the hearing and will be addressed together.⁵⁶

⁵⁴ Id. at 8-9.

⁵⁵ Id. at 9.

⁵⁶ There were smaller issues that arose for purposes of clarification and which were addressed in a later filed Amended Settlement.

The Commission noted that with regard to the Small Business Services Programs, the co-pay would be decreased. Mr. McAteer also indicated that if the change still did not spark sufficient interest, the Company, in consultation with the Collaborative, would consider raising the eligibility criteria in order to introduce more customers to these programs. Finally, Mr. Horan testified that only if all of the changes did not produce the results desired and there is a demand in the Large Business Programs, the funds that were transferred under the Settlement from the Large Business Programs to the Small Business Services Programs would be returned.⁵⁷

In response to the fact that the Settlement maintained the status quo with regard to the calculation of the shareholder incentive mechanism, despite the Commission concerns in 2001 and during the Technical Record Conference in the instant docket, the Commission proposed an alternative calculation of the shareholder incentive.⁵⁸ The Commission started with the Company's total estimated incentive of \$665,400 and the Program Savings Goal for each sector. The Commission's proposal stated that incentives begin to accrue once the Company achieves 45 percent of the estimated savings, either in total or by class. Eighty percent of the total estimated incentive or \$532,320 will be available for the Company to earn for total MWh savings after reaching the 45 percent threshold of total MWh savings. Twenty percent of the total estimated incentive or \$133,080 will be available for the Company to earn if the Company achieves greater than 45 percent of the MWh savings goals established in Attachment 6 of the Settlement for Small C&I Programs. If Narragansett reallocates funds from Small C&I Programs to

⁵⁷ Tr. 12/9/02, pp. 131-133.

⁵⁸ Id. at 56, 64-67.

Large C&I Programs, such reallocation of funds will not alter the savings goal for Small C&I Programs for the calculation of this additional incentive.

For example with regard to Small C&I Programs, if Narragansett reaches 50 percent of the total anticipated savings established in Attachment 6, it will be entitled to an incentive in the amount of \$12,098, representing 5 percent of the remaining 55 percent possible MWh savings to earn the entire incentive attached to Small C&I Programs. As Narragansett achieves more savings, the incentive earned will increase proportionally to the savings achieved.⁵⁹

Essentially, the Commission's proposal split the incentive into two specific objectives. The first is the total energy savings and the second is the specific energy savings targeted to one of the customer classes. Eighty percent of the goal would be achieved by reaching the total company savings objective and the remaining 20 percent would be achieved by reaching the small C&I company objective.⁶⁰

The parties were not entirely comfortable with the Commission's proposal. Dr. Raab testified that the effect of the proposal would be to reduce some of the Company's incentive in the Residential Class in favor of the Small C&I class. He stated that the traditional shareholder incentive calculation already includes weighting between the classes. For example, the per kWh incentive for each kWh above the threshold savings level for the Residential Class was 3.81 cents versus 3.53 cents for Small C&I and 2.25 cents for Large C&I.⁶¹

Narragansett indicated that it would be willing to address the shareholder incentive mechanism in its filing for 2004, something the Commission believed the

⁵⁹ Commission Exhibit 4.

⁶⁰ Tr. 12/9/02, pp. 56-60.

Company had already agreed to do for the 2003 filing. However, after listening to the Commission's concerns regarding a perceived lack of responsiveness in this area, and after a recess, the Division returned with a counter-proposal. The parties proposed to change the incentive rate for each customer class from a set 4.25 percent to a class-specific percentage. Therefore, the Division proposal changed the incentive rate for Residential Customers from 4.25 percent to 5 percent; for Small C&I Customers from 4.25 percent to 6 percent; and for Large C&I Customers, from 4.25 percent to 4 percent. The Division also advocated for allowing the Company the flexibility to shift funds between customer sectors, but that such a shift would not lead to a change in the incentive thresholds or formulas.⁶² Dr. Raab explained that this proposal is similar in the direction the Commission was indicating through its proposal with the addition of a greater incentive for the Residential Class. Narragansett indicated that it could live with the proposal.⁶³

Finally, in response to the Commission's interest in performance based metrics, Narragansett proposed that the Company attend a technical conference to discuss metrics. Additionally, Narragansett discussed, for 2003, tracking some of the same metrics that were in the process of being developed in Massachusetts.⁶⁴

VI. Amended Settlement of the Parties

On December 17, 2002, in response to Commission concerns raised at the December 9, 2002 hearing, Narragansett filed an Amended Settlement of the Parties

⁶¹ Id. at 61.

⁶² Id. at 85-90.

⁶³ Id. at 202.

⁶⁴ Id. at 187-193.

(“Amended Settlement”). Although substantially the same as the Settlement, the Amended Settlement contained four substantive changes for the Commission to review.

The first change, under the Small Business Services Programs, rather than allowing the Company to shift funds from the Small Business Programs to the Large Business Programs in the event the Small Business Programs are not producing the desired results, the parties agreed that the Company may expand the eligibility requirements to allow customers with a maximum demand of up to 150 kW to be eligible to participate.⁶⁵

The second change addressed a concern regarding the effect on the shareholder incentives of a transfer of funds between sectors. The Settlement allowed the Company to recalculate the shareholder incentive in a sector at the time of a transfer from one sector to another. The Amended Settlement disallowed that recalculation, stating, “[t]he Company will not be permitted to adjust its incentive target calculations for any transfers between sector budgets.”⁶⁶ However, the Amended Settlement reiterated the parties’ intent to allow Narragansett to recalculate the projected spending budgets and savings goals in the shareholder incentive calculation in accordance with adjustments made in the budgets as a result of the annual true-up filing to occur in May 2003.⁶⁷

The most fundamental change, however, occurred in the section of the Settlement addressing the calculation of shareholder incentives. Whereas the Settlement continued the practice of a straight shareholder incentive, not weighted percentage-wise in favor of any programs, but based only on budgeted expenditures and kWh savings goals, the Amended Settlement provided a method of weighting certain sectors for purposes of

⁶⁵ Amended Settlement, p. 4.

⁶⁶ *Id.* at 6.

encouraging innovation in those areas. Although the incentives will be based on budgeted expenditures combined with a kWh savings goal, the incentive percentage cap for each sector is set at 5% for Residential Programs, 6% for Small Business Services Programs and 3.5% for the Large Business Services Programs. The threshold level of annual energy savings will continue to be set at 45% of the annual kWh savings goal for each sector.⁶⁸

The Amended Settlement set forth three circumstances that would necessitate the recalculation of the threshold, calculated cap, and incentive rate for a particular sector. First, the parties agreed that Narragansett could continue the past practice of adjusting its sector budgets as a consequence of Narragansett's true-up filing. Second, the parties agreed to a continuation of the past practice of allowing Narragansett to apply any uncommitted funds in the Large C&I budget to become part of its spending budget. Both of these practices allow the potential for the incentive amounts to rise, but also requires Narragansett to achieve additional kWh savings in order to reach the threshold. Third, the parties agreed to continue the past practice where Narragansett updates the assumptions used for calculation of energy savings goals when filing its reports regarding the calculation of the savings goals. The effect is that while the overall the incentive possible for a sector does not change, the threshold savings may be adjusted either up or down when determining whether Narragansett has earned an incentive.⁶⁹

VII. Commission Findings

At its open meeting on December 20, 2003, the Commission approved the Amended Settlement between Narragansett, the Division, the SEO, CCJ and TEC-RI. In

⁶⁷ Id. at 7.

⁶⁸ Id. at 10.

approving the Amended Settlement, the Commission noted that the process undertaken in 2002 and the resulting agreements reflect an infusion of new ideas and also efforts to target Small C&I customers, a difficult target class. The Commission is pleased with the efforts of the parties, all of whom took active roles in developing the 2003 budgets and programs.

The programs for 2003 include more education and outreach to encourage more participation by members of the public, both residential and commercial. It is important that all ratepayers, who are mandated by law to contribute to the demand side management programs, have the information and tools available so that they can make these programs work for them. Hopefully the public forums will provide more information to the Collaborative to further expand programs that are needed and to continue their hard work in developing new ones.

The process in the instant docket focused on two areas of concern to the Commission. The first was the seemingly lackluster level of participation by small business customers in the Small Business Services Programs and the second was the calculation of shareholder incentives. Hopefully the weighting of the incentive caps in favor of the Small Business Services Programs will provide Narragansett with some additional incentive to continue its efforts to serve this group of customers. In the event Narragansett creates a new program prior to its 2003 filing for 2004 programs, the Commission will entertain a motion to approve the program in the interim. However, if Small Business customers still do not take advantage of the programs within the Small Business Services Programs, the Commission will entertain a motion to review the performance and potentially re-assign the incentive caps for other sectors. However, the

⁶⁹ Id. at 10-11.

Commission cautions Narragansett that such a request will be reviewed strictly and should only be used as a last resort.

Additionally, the Commission has expressed interest in alternative methods of calculating shareholder incentives. One method is through the use of performance based metrics. Rather than simply calculating the kWhs saved, performance based metrics allow incentives to be based on certain goals for the DSM programs, such as achievement of a higher level of market share for Energy Star appliances or increasing customer education and participation. The Commission does not necessarily believe that the performance based metrics should supplant the kWh savings method of incentive calculations, but rather, should supplement it. Each year, the filings in the annual DSM docket show unique strengths and weaknesses in the performance of various programs or in various sectors. Therefore, the supplement of the performance based metrics will give the Commission the opportunity to direct Narragansett toward specific policy goals for the year ahead.⁷⁰

However, when altering any policy regarding the continuation or discontinuation of past practice such as approval of shareholder incentives, the Commission will take a measured approach. Therefore, the Commission has directed Narragansett, with the Collaborative, to propose, no later than March 31, 2003, a recommendation of five performance based metrics to be tracked during 2003. These metrics will not affect Narragansett's shareholder incentives for 2003, but will provide a basis to further address

⁷⁰ It is for this reason that the Commission does not follow another state's approach of basing the entire shareholder incentive on performance based metrics. If there are so many metrics that a relatively small amount of dollars is attached compared to the level of effort that is required to meet the metric, the Commission believes that the Company will naturally focus on a few higher dollar metrics in lieu of attempting to achieve all of them. By choosing a few metrics to supplement the traditional calculation, the Commission is able to send a stronger statement of policy.

the appropriate calculation method of the shareholder incentives for the 2004 DSM programs.

Finally, while the Amended Settlement allows Narragansett the flexibility to file its proposed 2004 DSM programs and budget on or before October 1, 2003, if the Company and the other parties are not in agreement, the Commission directs a filing to be made on or before October 1, 2003.⁷¹ The filing shall propose a single shareholder incentive calculation mechanism to combine the traditional per kWh savings method with the performance based metrics method. The parties may propose actual metrics or may wait until after the technical record conference is held in October.⁷²

VIII. Proposed Performance Based Metrics

On March 19, 2003, the Commission conducted a Technical Record Conference to review Narragansett's proposed performance based metrics. The Company proposed three C&I metrics and two Residential metrics. The C&I metrics were developed with some input from C&I customers. The first, "Building Operator Certification," has a goal of enrolling 20 Rhode Island facility building engineers, technicians or operators in the NEEP-Level 1-O&M training certification course. The course develops skills in evaluating building energy use and fosters the creation of a safer and healthier work place. In 2001, Narragansett trained seven people and in 2002, trained 15 people.

The second, "High Performance Schools," has a goal of contracting with two new school projects through Design 2000*plus*, offering full incremental cost for high

⁷¹ If the parties come to a Settlement prior to October 1, 2003, they may file a Settlement. If the parties are unable to come to an agreement, Narragansett shall file its pre-filed testimony and proposals no later than October 1, 2003. The Commission historically has a full schedule in the fall with the required annual reconciliation filings and DSM filings. Therefore, the process relative to the 2004 programs will be accelerated in order to be completed before the end of the year.

performance design and construction practices. Narragansett would provide technical and financial support to the schools from the outset of the project to emphasize thermal, acoustic and visual comfort with a focus on lighting design. The program's value is in assisting cities and towns in high quality, environmentally sensitive school construction that is less costly to operate than traditional buildings.

The third, "Comprehensiveness in Small Business Installations," has a goal of implementing comprehensive installations at 50 small business customer sites, which means non-lighting measures or HVAC tune-up services. The value of the metric is to enhance the appeal of the small business programs to the smaller commercial customers. The target is based on overall participation in 2002.

The two residential programs were developed with input from the Collaborative. The first, "Energy Star Clothes Washers," has a goal of achieving an 18% market share for Energy Star qualified clothes washers in the first two quarters of 2003. In 2002, the penetration was 14.8% penetration. The value of the metric is in increasing participation by consumers in this market. The second, "Energy Star Homes," has a goal of conducting plans analyses and home ratings, and sign Energy Star builders' agreements with 10% of the new homes built in Rhode Island. Achieving this goal would represent a 1.7% increase from 2002. The value of the metric is in supporting market transformation in the construction of new energy efficient homes.

The Commission is pleased with Narragansett's response to the Commission's direction. These metrics cover a wide range of program types and the indicators are sufficiently within the Company's control or influence. Additionally, the performance

⁷² Because the technical record conference provided the Commission with an opportunity to fully explore the programs and raise policy concerns early in the process and prior to the official hearing, it should

levels required to achieve the metrics exceed historical performance, rather than attempting to simply retain the status quo where there is not market saturation. Furthermore, the use of objective information to measure performance is also a sound design principle. The Commission looks forward to a report in late summer 2003 that will indicate how these metrics have worked.

Accordingly, it is

() ORDERED:

1. Narragansett's Filing made on September 6, 2002, is hereby denied.
2. The Settlement of the Parties filed December 4, 2002, is hereby rejected.
3. The Amended Settlement of the Parties filed December 17, 2003 regarding the Company's 2003 demand-side management programs is hereby approved for implementation on January 1, 2003.
4. A Conservation and Load Management Adjustment Factor of \$0.0023 per kilowatt-hour is hereby approved for usage on and after January 1, 2003 through December 31, 2003.
5. The proposed 2004 DSM budget, programs and shareholder incentives shall be filed no later than October 1, 2003.

become a regular practice.

6. The Parties shall act in accordance with all other findings and instructions contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND, PURSUANT TO AN OPEN MEETING DECISION ON DECEMBER 20, 2003. WRITTEN ORDER ISSUED JULY 21, 2003.

PUBLIC UTILITIES COMMISSION

Elia Germani, Chairman

Kate F. Racine, Commissioner

*Brenda K. Gaynor, Commissioner

*Commissioner Gaynor concurs but is unavailable for signature