February 1, 2018

VIA ELECTRONIC FILING

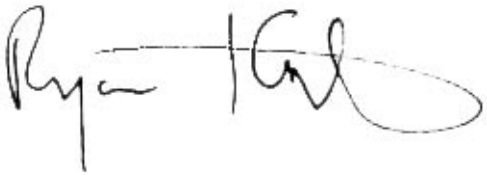
Hon. Kathleen H. Burgess
Secretary to the Commission
New York State Public Service Commission
Empire State Plaza, Agency Building 3
Albany, New York 12223-1350

Re: 17-E-0238 Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Niagara Mohawk Power Corporation d/b/a National Grid for Electric Service.

Dear Secretary Burgess:

The Advanced Energy Economy Institute (AEEI), on behalf of Advanced Energy Economy (AEE), the Alliance for Clean Energy New York (ACE NY), and their joint and respective member companies, submits for filing these comments on the Joint Proposal.

Respectfully Submitted,



Ryan Katofsky
Vice President, Industry Analysis

Comments on the *Joint Proposal* (Case 17-E-0238)

Advanced Energy Economy Institute
Alliance for Clean Energy New York

Preface

In order to respond to the Joint Proposal ("JP"), filed by the Niagara Mohawk Power Corporation d/b/a National Grid ("National Grid" or the "Company"), Advanced Energy Economy Institute ("AEE Institute") is working with Advanced Energy Economy[1] (AEE) and its state partner, the Alliance for Clean Energy New York ("ACE NY"), and their joint and respective member companies to craft the comments below. Both AEE Institute and ACE NY are intervenors in the above captioned proceeding, and AEE Institute has provided testimony and engaged in the settlement negotiations on Earnings Adjustment Mechanisms. These organizations are referred to collectively in these comments as the "advanced energy community," "advanced energy companies," "we," or "our."

Summary

We would like to clarify upfront that these comments are neither in support nor opposition of the JP. Our comments are focused exclusively on the Earnings Adjustment Mechanisms ("EAMs") contained within the JP. We realize that there are other, larger issues at play in which we did not participate, so therefore we offer no opinion here on those other issues. However, in regard to EAMs, we believe they fall short of what is necessary to support the goals of Reforming the Energy Vision, past policy positions of the New York Public Service Commission ("Commission"), and the clean energy goals of New York State.

Chief among our concerns is that the EAMs generally, and especially in the case of peak demand reduction metrics, fail to provide an incentive that is strong enough to overcome the preference to increase capital investment inherent in cost-of-service ratemaking. Absent an incentive that provides a sufficient counterbalance, a utility's most rewarding course of action is likely to be to maintain the status quo.

[1] AEE is a national business association representing leading companies in the advanced energy industry. AEE supports a broad portfolio of technologies, products, and services that enhance U.S. competitiveness and economic growth through an efficient, high-performing energy system that is clean, secure, and affordable. ACE NY's mission is to promote the use of clean, renewable electricity technologies and energy efficiency in New York State, in order to increase energy diversity and security, boost economic development, improve public health, and reduce air pollution.

Background on EAMs

On May 19, 2016, the Commission issued an *Order Adopting a Ratemaking and Utility Revenue Model Policy Framework* ("Track 2 Order") in the Reforming the Energy Vision proceeding, which required the utilities to begin implementing EAMs. These mechanisms provide financial rewards to utilities for meeting performance metrics for a number of public policy goals provided by the Commission.[2]

The Advanced Energy Community considers EAMs to be one of the most important elements of the REV proceeding and a necessary adjustment to the basic cost-of-service model that is critical for making REV work. As the Track 2 order[3] put it:

> "Some of these new expectations run counter to conventional methods of operation and, importantly, also run counter to the implicit financial incentives that are embedded in the cost-of-service ratemaking model. If cost-of-service calculations are to remain the basis of utility rates for the foreseeable future, then creating new earning adjustment opportunities are both a fair and a necessary means of promoting change."

We wholeheartedly agree with this assessment. Here the Commission states that one of the purposes of EAMs is to promote changes in utility behavior by adjusting for embedded incentives in cost-of-service ratemaking that run counter to state goals.

In enacting EAMs, the Commission indicated[4] that another goal was to overcome information asymmetries that exist between utilities and their regulators and incent utilities to use all of their knowledge about their system and capabilities to achieve the metrics:

> "Several parties commented that utilities should simply be ordered to implement specific tasks, with no need for incentives. Other parties argued that utilities should not be rewarded merely for performing what is expected of them. These arguments assume that regulators are in the best position to know precisely what actions are needed to achieve policy outcomes. In fact, the optimal role of regulators is not to dictate program terms but rather to set policy and ensure that results are just and reasonable. A construct in which regulators presume foreknowledge of how innovation must occur is antithetical to the premise of REV. Outcome-based incentives will allow utilities to determine the most effective strategy to achieve policy objectives, including cooperation with third parties and development of new business concepts that would not be considered under narrow, program-based incentives."

This passage identifies an inherent drawback of cost-of-service ratemaking. The regulatory model does not incent utilities to look for inefficiencies and cost savings because the utility is financially indifferent (for operating expenditures) or penalized (for capital expenditures) over the long-term when

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[2] System Efficiency, Energy Efficiency, Interconnection, and other optional EAMs for the Clean Energy Standard and Customer Engagement.
[3] Track 2 Order, Proceeding 14-M-0101, P. 59
[4] Track 2 Order, P. 62

efficiencies are created. Therefore, the current system relies on Staff and intervenors to identify inefficiencies and ensure that a utility's rate plan is the best way to serve customers. However, these parties' knowledge of utility systems is far more limited than the utility itself, and so their effectiveness at accomplishing this goal is limited. Another unfortunate result of these counterproductive incentives in cost-of-service is that they create distrust between regulators, intervenors, and utilities. Parties distrust that a utility may actually be serving the customers' best interest through needed capital investments and may oppose those investments out of the concern that they are merely financially-motivated rather than actually needed.

The greatest potential of EAMs is that they can align the financial success of a utility with the delivery of customer benefits and cost reductions. Utilities would become motivated to seek out inefficiencies in their systems not only because it is good for customers, but also because it is good for their bottom line and their shareholders. If over time these EAMs are successful, parties may become confident that a utility's interests are aligned with customers' interests, and instances where necessary investments are blocked could decrease.

This all assumes that the EAMs are effective at aligning utility interests with those of their customers. In order to do so, the metrics must be structured to ensure that the desired outcomes are actually occurring and that the incentives are rewarding enough to motivate utilities to work toward these desired outcomes.

Structuring an EAM to Achieve Commission Goals

The Commission has accurately identified that some utility actions, encouraging peak demand reductions for example, carry an opportunity cost for utilities. Continuing with this example, increases in peak demand often require new distribution investments to serve those higher peaks. Those distribution investments could serve to expand rate base and overall value to shareholders. Therefore, reducing peak demand carries the opportunity cost of not receiving earnings on investments that would have been made to serve higher peak demand. In order for the utility to be at least financially neutral toward achieving peak demand reductions, it must provide earnings that are equivalent to what it would have received had the demand reductions not been achieved. This creates a lower bound for an EAM to be effective at achieving the goals described in the Track 2 Order. The extreme upper bound of an EAM is the point at which the incentive outweighs the benefit of the action that it is meant to reward. At this point, customers would no longer benefit.

Ideally, the incentive should be just above the point at which it outweighs the utility's opportunity cost for pursuing the status quo. That ensures that the utility will pursue the action out of its own financial self-interest, but leaves the remainder of the benefits to customers. So long as the net benefits of an action are higher than the incentive provided to the utility, customers benefit. If the opportunity cost of a utility is

higher than the net benefits for pursuing a specific action, EAMs are not appropriate as they will be either ineffective at motivating utilities to action or customers will pay more than the incentive is worth and will receive no benefit. EAMs must both create net benefits for customers and exceed the utility's opportunity cost of alternative actions to truly be effective.

EAMs in the Joint Proposal

The parties of the JP took care to ensure that one of the requirements of an effective EAM (listed above) is met: the plan delivers significant net benefits to customers. Further, those benefits are not just societal. When looking at the rate and cost impacts to customers and excluding carbon and other societal benefits, these plans still provide large net benefits to customers. Where the JP falls short is that parties did not consider the second requirement: the plan, especially in regard to peak demand reduction targets, does not provide sufficient rewards to overcome National Grid's opportunity cost for meeting these EAMs. National Grid may choose to meet its EAM targets for other reasons, and the EAMs may help alleviate the opportunity costs to a degree, but meeting the EAMs would still require National Grid to act outside of its financial self-interest. In order to increase the likelihood that National Grid would work toward achieving the EAM targets, it would have been possible to increase the value of the EAM to National Grid while still providing net benefits to customers.

As seen in Table 1 below, we are also concerned that the basis point equivalent of the EAMs maxes out at 61 basis points, far short of the 100 basis point allowed for in the Trak 2 order. This is a small share of the total value that the EAM plan provides. This is especially concerning for the peak demand reduction EAMs, which have the highest potential to reduce the Company's opportunity to earn on future investments needed to serve peak demand.

In order to protect the confidentiality of the settlement talks talks, we have not used data from the BCAs that were used to establish these targets. Forbidding the use of analysis developed in the settlement negotiations places a high burden on other parties to develop such analysis independently. While we cannot cite those BCA numbers here, we can state the customers take the overwhelming majority of benefits in the EAM plan. This is only a concern in that the plan is not rewarding enough for the Company. The low value of the incentives may jeopardize the Company's ability to generate the significant value that the EAM plan holds for its customers.

Table 1: Incentive Levels in Basis Point

Metric	Level	2019 Targets	Incentive in Basis Points
Peak demand Reduction	min	1,500,000	4
	mid	2,200,000	6
	max	4,400,400	12
DER Utilization	min	500,000	1
	mid	1,100,000	3
	max	2,200,000	6
Incremental EE	min	900,000	2
	mid	1,800,000	5
	max	3,600,000	10
LED Street Lighting	min	0	0
	mid	900,000	2
	max	1,800,000	5
Residential Energy Intensity	min	400,000	1
	mid	1,100,000	3
	max	2,900,000	8
Commercial Energy Intensity	min	400,000	1
	mid	1,100,000	3
	max	2,900,000	8
Developer Satisfaction	min	400,000	1
	mid	900,000	2
	max	1,800,000	5
Beneficial Electrification	mid	500,000	1
	min	1,100,000	3
	max	2,500,000	7
Total	min	4,600,000	13
	mid	10,200,000	28
	max	22,200,000	61
Value of a pre-tax basis point in 2019			364,000

Conclusion

We appreciate the opportunity to comment on the Joint Proposal, and we urge the Commission to take note of our concerns on the EAM plan and the ramifications that the plan's deficiencies may have on the ability of the state to achieve its clean energy, REV, and cost-efficiency goals. We understand that EAMs are a new concept and that parties may want to go slow in providing incentives to utilities. Nevertheless, if the EAM incentives are insufficient to motivate meaningful changes in utility behavior, then they are less likely to be effective and the conclusion may be reached that EAMs do not work, causing parties who may already be skeptical to doubt the effectiveness of EAMs, even before this important

regulatory mechanism has been given a chance to prove itself out. We believe that New York's bold vision of reforming regulation to unlock markets and to align customers, third-parties, and utilities alike in the pursuit of the state's vital clean energy goals is at stake here, and we encourage the Commission to consider ways to uphold its vision.