

TARGETED DEMAND MANAGEMENT PROGRAM INCENTIVE MECHANISM

INTRODUCTION

On December 17, 2015, the New York Public Service Commission (“Commission”) issued its “*Order Implementing With Modification the Targeted Demand Management Program, Cost Recovery, and Incentives*” (“Order”).¹ The Order approved Consolidated Edison Company of New York, Inc.’s (“Con Edison” or the “Company”) request to invest up to \$60 million over two years to implement customer side solutions (“CSS”) to manage load growth and investment requirements. In the Order, the Commission directed Con Edison, in consultation with Department of Public Service Staff (“Staff”), to “develop a proposal for an incentive mechanism whereby the incentive achieved by the Company is not directly related to the costs incurred to achieve the required load reduction.”² Accordingly, the Company has developed, after consultation with Staff, an incentive mechanism designed to be used for the Targeted Demand Management (“TDM”) program that is “reasonable for customers and meaningful for the Company.”³ The incentive mechanism is separate from the recovery of program costs approved in the Order.⁴

The TDM incentive mechanism proposed in this filing separates potential projects into two categories – “Large” and “Small” – to reflect the wide range of load relief projects that may be required and the associated quantities and cost of traditional infrastructure build that the Company may seek to delay or avoid through the TDM program. For purposes of the incentive mechanism described here, the Company proposes that Large projects be defined as those that seek to defer infrastructure at the area station level or further upstream, i.e., projects that seek to defer or avoid traditional infrastructure usually rated at 69 kV and above. These projects, compared to Small projects, typically, (i) require larger quantities of load relief (ii) provide for longer lead times for execution (usually 3 years or longer), and (iii) defer higher total costs of

¹ Case 15-E-0229, *Petition of Consolidated Edison Company of New York, Inc. for Implementation of Projects that Support Reforming the Energy Vision*, Order Implementing With Modification the Targeted Demand Management Program, Cost Recovery, And Incentives (issued December 17, 2015).

² *Id.*, p. 14.

³ *Id.*

⁴ *Id.*, pp. 11-12.

traditional infrastructure. The Company proposes that Small projects be defined as those that seek to defer infrastructure at the primary level or further downstream, i.e., projects that seek to defer or avoid traditional infrastructure usually rated at below 69 kV. These Small projects, compared to Large projects, typically, (i) require smaller quantities of load relief, (ii) require shorter lead times for execution (usually under 3 years), and (iii) defer lower total costs of traditional infrastructure.

I. Large Projects

A. Calculation of Incentive

For Large projects, a TDM Benefit Cost Analysis (“BCA”) will be developed in consultation with Staff until such time as the Company’s formal BCA procedures are approved by the Commission in the REV proceeding (“BCA Order”).⁵ The TDM BCA will include a comparison of the present value of the costs and benefits associated with implementing the traditional project with the present value of the costs and benefits associated with implementing an alternative “CSS Portfolio” (defined as the targeted number of CSS MWs necessary to defer or avoid the traditional solution). The TDM BCA calculation will include as benefits the costs associated with the deferred construction of the traditional project plus customer wholesale energy and environmental externality savings, similar to the BCA that was developed for the Brooklyn Queens Demand Management (“BQDM”) program. The difference between the two present values represents the “Net Benefits” resulting from implementing the alternative portfolio of solutions to defer building traditional infrastructure.

The Company proposes that the incentive for Large projects be calculated using a “Base Incentive” that is a 50-50 sharing of Net Benefits, with adjustments based on a process flow timeline as described below.⁶ The percent share of net benefits that is calculated as the Company’s share and that forms the basis for Company’s collection of the incentive, from the inception of the NWA through implementation and true-up as explained in this document, will be on a pre-tax basis. This results in a reduction in the Company’s real share of net benefits from

⁵ *Id.*, p. 10; see Case 14-M-0101 - *Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision*, Order Establishing The Benefit Cost Analysis Framework (issued January 21, 2016).

⁶ Please refer to Exhibit 1 (spreadsheet) for the detailed process for calculating the incentive and Exhibit 2 (process flow chart) for a visual illustration of the process.

50 percent to the 25 -30 percent range. The Company believes it represents a reasonable distribution of benefits for the currently authorized TDM program, as it is beneficial to customers who receive a majority of the benefits. The Company also believes that the two-year TDM program provides an opportunity to study the application and impact of the incentive mechanism even as the Commission looks to develop meaningful incentive mechanisms that will result in utilities choosing CSS over traditional infrastructure investments. Additionally, the incentive fairly compensates providers of capital for their investment in regulatory assets with less certain cash flows than those from traditional infrastructure, thereby mitigating the risk of increased financing costs and the corresponding increase in customer bills.

As illustrated in Exhibit 2, the “Initial Incentive” for Large projects will be based on the “Initial Net Benefits” when the Company has either entered into contracts with CSS providers for the entire CSS Portfolio, or when Company and Staff agree there is reasonable certainty regarding the likely price of the portfolio of solutions that will enable deferral of the traditional infrastructure. The latter alternative, relying upon reasonable certainty regarding the likely price of the portfolio, may be used in situations such as the following: 1) projects with longer lead times or that require incremental CSS procurements over multiple years and would benefit from a contractual structure that allows for staged procurement, or 2) projects that involve direct contractual relationships with private customers or public entities whose budgetary cycles and consequent ability to enter into contractual agreements may occur at some point later in time after an agreement on price is reached. A project-specific BCA will be developed to determine the Initial Net Benefits, and the Initial Incentive will be set at 50 percent of these Initial Net Benefits. Staff will have the opportunity for observation and oversight of the procurement process.

The Company proposes a reasonable incentive for it to manage and reduce the utility’s cost to procure CSS during the period after the Initial Net Benefits have been determined through the end of the NWA Deferral Period. The NWA Deferral Period refers to the period that begins when the Initial Net Benefits are set and extends through the time that the CSS portfolio delays the traditional infrastructure build, as determined at the time of setting the Initial Net Benefits. To provide this incentive, following the implementation of the alternative portfolio of solutions, the Initial Net Benefits will be trued-up based on the Difference in Utility CSS Cost. Difference

in Utility CSS Cost is defined as the difference between the total utility cost of CSS assumed for the Initial Net Benefits calculation and the actual total utility cost of CSS determined after implementation of the CSS portfolio. The sum of Initial Net Benefits and the Difference in Utility CSS Cost will result in the “Final Net Benefits.” The Initial Incentive will then be adjusted up or down to equal 50 percent of the Final Net Benefits, resulting in the “Final Incentive.” For example, if the Initial Incentive were \$100, and the Difference in Utility CSS Cost were negative \$50 (i.e., a \$50 overrun in the CSS cost), then the Company’s Initial Incentive would be reduced by \$25 (50 percent of \$50 overrun) to provide a Final Incentive of \$75.

This Company sharing in CSS portfolio cost reductions or overruns would be subject to the conditions that the final incentive will a) have a “floor” so as not be negative and b) have a “cap” so as not be greater than 75 percent of the Initial Net Benefits. For example, if the Initial Incentive were \$100 and the Difference in Utility CSS Cost were negative \$300 (i.e., the CSS portfolio had a \$300 cost overrun), the Company’s Final Incentive would be set at \$0 (the floor) and not be negative \$50 (\$100 Initial Incentive less 50 percent of the \$300 Difference in Utility CSS Cost). Similarly, if the CSS solution had Initial Net Benefits of \$200 and thus an Initial Incentive of \$100 (50 percent of Initial Net Benefits), and the Difference in Utility CSS Cost was \$200 (i.e., the Utility cost of the CSS portfolio was \$200 under budget), the Initial Incentive would be set at the cap of \$150 (i.e., 75 percent of \$200 Initial Net Benefits), not increase by \$100 (50 percent of Difference in Utility CSS Cost) to \$200.

The Company will begin collecting the incentive once 70 percent of the CSS portfolio has become operational, where operational refers to CSS being installed and verified through Measurement and Verification (“M&V”). The Company will collect the incentive, set as a percent share of net benefits as described above, based on the present value of net benefits at the time of collection, present value being calculated using the same utility weighted average cost of capital (“WACC”) used for the BCA. The incentive will be amortized over the remaining NWA Deferral Period (e.g., if the 70 percent of CSS portfolio is operational three years into a five-year Deferral Period, the incentive will be recovered over the remaining two years of the Deferral Period). The Company will earn on the unamortized incentive balance at its effective weighted average cost of capital (“WACC”). The Company will collect all incentive payments through

the MAC and NYPA surcharges, using the same cost recovery mechanism approved in the Order for other program costs.

B. Change in CSS Portfolio Amounts

The Company performs periodic reliability needs assessments as part of its responsibility to maintain the overall reliability of the distribution system. Reliability needs assessments are conducted at least annually as part of the forecasting and planning process. If such an assessment, over a sustained period of three years, results in a consistent determination that a material decrease in the amount of CSS would suffice in achieving the intended deferral of the traditional infrastructure build and maintain reliability, the Company will reassess the amount of CSS that it will seek to procure as part of its implementation process, and notify Staff of the outcome of the reassessment. If such an assessment results in a determination that an increase in the amount of CSS procured is necessary to achieve the intended deferral of traditional infrastructure and maintenance of reliability, the Company will notify Staff of such determination.

The Company anticipates these occurrences to be relatively infrequent. In many cases, changes may extend or curtail the length of the deferral period, but will typically not materially change the amount of CSS needed to achieve deferral.

1. Reduction in CSS

If the reassessment results in a determination that a material reduction in the amount of CSS will suffice to achieve the intended deferral of traditional infrastructure and maintain reliability, then the Company will plan to reduce CSS procurements accordingly, to the extent contractually feasible. A “material reduction” is defined as being based on 1) a consistent, downward trend over a period of three years and 2) in excess of 30 percent of the amount of CSS that was determined as necessary at the time of determining Initial Net Benefits. However, if the Commission directs the Company otherwise, for example to animate markets in the early stages of DER market development, then the Company will not reduce CSS procurements in accordance with the Commission directive. Similarly, if the Company, following consultation with Staff, determines that it should not reduce CSS procurements to reflect all or part of the

material reduction, it may continue CSS procurements at such higher level, upon notice to the Commission of its intent to do so, unless and until the Commission directs otherwise.

If the Company moves forward with a material reduction in the amount of CSS being procured, as explained above, the Company proposes a true up of the incentive following the implementation of the CSS portfolio. This true up will reduce both the Company incentive and the required level of DER operational to earn the Company incentive so as to reflect the reduced amount of CSS needed to achieve the intended deferral. The Company proposes the following process. First, the Initial Incentive will be converted to an “Initial Unit Incentive” by dividing the Initial Incentive by the amount of CSS (MW) determined as needed at the time of setting the Initial Net Benefits. Second, the Difference in Utility CSS cost described above will be calculated on a unit basis. The Final Incentive will then be calculated as the sum of the Initial Unit Incentive plus or minus the Unit Difference in Utility CSS cost, then multiplied by the reduced amount of CSS (MW) now needed, subject to the same “Cap” and “Floor” described above. While this represents a reduced incentive for the Company even as it provides the benefit of 1) achieving the intended deferral at a lower cost and 2) providing additional time and flexibility to determine if the traditional infrastructure being targeted for deferral is ultimately needed, the Company believes that it is appropriate for the limited purpose of providing a learning opportunity through the TDM program of the impact and application of different incentive mechanisms in practice.

2. Increase in CSS

If the reliability needs assessment results in the determination that an increased amount of CSS is necessary to achieve the intended deferral of traditional infrastructure and maintain reliability, then the Company will plan to increase CSS procurements accordingly, or if technically or operationally infeasible, plan to implement a traditional, reliability backstop solution instead. If additional CSS acquisitions are feasible, the Company will plan to procure additional CSS and will only earn its effective WACC on expenditures related to the additional amount of CSS acquired, and therefore forego any additional incentives. These additional MWs will not be included in the calculation of the Difference in Utility CSS cost described above.

If the reliability needs assessment results in the determination that an increased amount of CSS within the same targeted area could result in additional opportunities for deferral of traditional infrastructure build, separate from the traditional infrastructure originally targeted for deferral, then the Company will develop a new CSS portfolio to address the new opportunity and will receive an incentive as if it were a new project being pursued under the TDM program to address the newly determined reliability need.

II. Small Project Incentive

To streamline the administrative process, the Company proposes to use the same general methodology for Small projects that it has proposed for Large projects with the following exceptions –

1. A Simplified TDM Benefit Cost Analysis (“SBCA”) instead of a full BCA will be developed in consultation with Staff until such time as the Company’s formal BCA procedures are approved by the Commission in the REV proceeding. The SBCA will include a comparison of the present value of the costs associated with the traditional project with the present value of costs and main benefit categories associated with implementing an alternative CSS Portfolio. The SBCA for the CSS portfolio will include the benefits of avoided costs at the wholesale and distribution levels, and will include an environmental externality based on the social cost of carbon as provided for in the BCA Order. Unlike the full BCA, the SBCA does not include: 1) the non-energy benefits other than carbon such as economic growth, health impacts for the CSS portfolio; and 2) any benefits associated with the traditional project that is being deferred.
2. The Company will begin collecting on an amount equal to the Initial Unit Incentive as each megawatt of the CSS portfolio for the small project becomes operational and will true up to a Final Incentive using the same methodology as for Large projects, once implementation has been completed. If the CSS portfolio for a Small project is for a need

that is under 1 MW, the Company will collect the Final Incentive once the entire CSS portfolio is implemented.

3. Reliability needs assessments at the Primary and Secondary levels are conducted at least annually as part of the planning process. Considering each single annual assessment for Small projects differs from the approach to be used for Large projects; for Large projects the Company will evaluate the need for downward revisions to the amount of CSS by taking into consideration whether there are three years of consistent, downward decline in the amount of CSS that will suffice. If the annual assessment results in a determination that a material decrease in the amount of CSS, that is a decrease in excess of 30 percent of the amount of CSS that was determined as necessary at the time of determining Initial Net Benefits, would suffice in achieving the intended deferral of the traditional infrastructure build while maintaining reliability, the Company will accordingly reduce the amount of CSS that it will seek to procure as part of its implementation process, notify Staff, and use the same incentive mechanism as developed for reductions in the amount of CSS needed for Large Projects in item 1, Section I, Sub-section B.