# Discussion and Recommendations on MT Policy Issues Raised by Comments on the IL TRM MT Savings Framework

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# Purpose

An attachment to the IL TRM was developed in 2019 to delineate a framework for counting Market Transformation (MT) savings. During public comment on the draft, a few policy issues surfaced that need resolution to inform utility energy efficiency portfolio planning and to count savings from individual MT initiatives. The recommendation was that the IL MT SAG Savings working group discuss and decide on how these policy issues could be treated in order to create more certainty for counting savings from MT.

This paper discusses the policy issues raised during public comment and provides recommendations/options.

# Key Considerations: Nature of MT, and its Size in the IL EE Portfolio

It’s important to note that MT initiatives typically require a long term horizon (often 10-20 years) to be fully successful and usually require the majority of the expenditures in the early years while significant savings accrue predominantly in the later years – after the market has changed or code/standards are adopted. This situation has implications for how to weave MT into a regulatory system that was set up to count annual costs and savings that mostly occur simultaneously during the four-year portfolio plan.

Implementation of MT programs has the potential to pose regulatory challenges within Illinois’ existing EE planning review framework because as stated above, MT requires long-term investment over multiple plan cycles before savings are achieved. Accordingly, some of the options presented below will have to be evaluated in relationship to the need for possible regulatory change to implement them.

Another factor in considering the options below is that the proportion of MT investments in the context of the overall EE portfolio for utilities in IL will be small in the near-term, so the force or size of the impact – at least for the first 4-7 years of MT initiatives – is minimal. However, the best framework going forward is one that accommodates the presently small and potentially larger MT activities in the future.

Recommendations included in this paper try to provide a simple path forward, especially considering that the financial impact is fairly small in the near-term. Identifying and agreeing to a single path as a guide will allow IL to get some experience with MT and its effects on portfolio cost-effectiveness, goals and incentives while MT stakeholders, utilities and regulators develop a better understanding and trust in MT efforts. Learnings during this period can then be applied to future iterations as MT initiatives evolve over time.

# Question 1:

How will MT savings and costs be treated in calculating portfolio cost-effectiveness (C/E)?

Each MT initiative’s Business Plan (BP) will estimate the cost-effectiveness[[1]](#footnote-1) of that initiative over its expected duration, which is likely to stretch over multiple 4-year planning cycles. However, since costs usually occur up front and savings occur later, there may be a problem incorporating the “life cycle” metric of initiative C/E into a given four-year planning cycle since costs could happen in one planning cycle and energy savings in subsequent one(s). Whether or not portfolio cost-effectiveness is a determinative factor in a utility’s decision to pursue a given MT initiative, recognition of a single year’s or single 4-year cycle’s reportable MT initiative investment and attributable/verified savings will likely impact willingness to pursue an initiative and when. Still, how should MT costs and energy savings be incorporated into portfolio cost-effectiveness? In considering options, it might be good to ask: what will encourage MT investments but not create too large a risk to any one party? Put another way, which method should we use to manage MT’s inherent uncertainty while still motivating action to implement MT?

Option 1: **MT initiative expenditures are categorized as an EE program expense in the portfolio** (whether as part of a programmatic or administrative expense category)**,** subject to the TRC and **required to demonstrate energy savings**.

* This option means utilities bear the full costs/risk of an MT initiative before the transformation occurs. And depending on the size of the MT costs and the level of overall portfolio cost-effectiveness, it could cause ripples in the overall portfolio C/E, especially if the portfolio C/E is already on the margin.
* Additionally, if meeting savings goals is a struggle, MT options could lose out to other programs such as resource acquisition offerings that may carry more certainty for more immediate savings.
* On the other hand, this option will also enhance the portfolio cost-effectiveness and goals achievement in out-years when significant savings are accruing, and little to no cost is needed.
* Given that in early years MT initiative expenses are unlikely to produce energy savings, the utility might decide to include the MT initiative costs in its R&D/ET/BED budget category, which is subject to the TRC, **but not required** **to demonstrate energy savings** (unless or until energy savings occur and the utility decides to verify them). Once savings become large, they can be verified and the total program costs and benefits would be moved to a category of the portfolio outside of R&D/ET/BED.[[2]](#footnote-2)

Option 2: Design a way that **the first few years of an MT initiative’s costs can be deferred to being included in portfolio C/E calculations at a time when savings are larger**. This would probably be calculated by adding up the early costs and dividing the total over a 3-4 year period to develop an “adder”. This adder would then be added to portfolio costs in future years. The intended timing of when the “deferred” costs are applied to the initiative would need to be described in the MT Business Plan.

* If savings never materialize, then the initiative is a failure, but the deferral mechanism would ensure it does not count against the portfolio C/E requirements, and it removes the near-term disincentive discussed in Option 1.
* This method will likely require detailed “bookkeeping” to ensure that all costs and benefits are eventually included. Most of these options will require the same, but this option in particular will need to be clearly tracked.
* Note: Placing the MT initiative costs in its R&D/ET/BED budget category could provide utilities with flexibility in terms of energy savings, but as described in Option 1, such expenditures will still be subject to the TRC under current statute. Once savings become large, they can be verified and the total program costs and benefits would be moved to a category of the portfolio outside of R&D/ET/BED.

Option 3: **Exclude MT from the portfolio C/E calculation**. The modified IL TRC already has exclusions and MT could be similar. There are policies that could be adopted to support this idea (eg: Low-income programs need not pass the TRC). For informational purposes, the C/E calculation could also show results if the MT were included.

* One caution on this option is that legislative change would be required, otherwise, it might be hard to claim savings without counting the costs.
* Stakeholders should also consider any unintended impacts this option could have on low-income programming, given that MT and LI/IQ programming could be in competition for limited funding for low-TRC scoring measures within overall portfolio analysis.

Option 4: **Exclude MT from the portfolio C/E calculation for the first 4-year planning cycle** in which the initiative operates (or if the last year of a cycle, for that year and the subsequent cycle). In subsequent 4-yr portfolios, MT costs and savings would add to the C/E calculations. This method provides a natural “break” where these calculations can be applied across the entire portfolio.

* This grace period provides an avenue for utilities to safely take risks to get initiatives off the ground that will produce long-lasting benefits to Illinois customers.
* Note: Placing the MT initiative costs in its R&D/ET/BED budget category could provide utilities with flexibility in terms of energy savings, but as described in Option 1, such expenditures will still be subject to the TRC under current statute. Once savings become large, they can be verified and the total program costs and benefits would be moved to a category of the portfolio outside of R&D/ET/BED.

Option 5: **Apply an initiative-specific estimated cost-effectiveness score to each year of the initiative's time horizon across EE planning cycles**. To develop the applied score, this option requires spreading the expected/projected investments and energy savings equally across the entire initiative time horizon by determining the proportional investment and savings values, rather than actual individual year investment activities or resulting savings which can vary over the course of the initiative.

* This option might require periodic evaluation with some period of prorated savings up front and a schedule of discounted/depreciated savings as the initiative matures to its completion.
* To weight the initiative appropriately in the context of the overall portfolio, you would estimate the total investment required (per MT Business Plan) and divide it by the number of years proposed for the initiative. This way the investment is spread out evenly even though it will be spent in early years. In addition to the costs, some agreed upon authorized savings value (static across the initiatives or inclining/declining if desired) would also be applied, consistent with the identified cost-effectiveness score applied on an annual basis.
* This option could require a post-initiative costs and energy savings calculation with potential savings true up (with some agreed-upon guardrail/bookend limits – similar to a decoupling mechanism true up procedure) applied to the utility’s CPAS (rather than a specific planning cycle).
* This option would potentially negate one of MT’s biggest benefits – large savings in the long term. Utilities might be relying on these large long-term savings to fill anticipated holes resulting from diminishing RA opportunities.
* In the case of MT initiative failure, this option could present a number of concerns. Accordingly, a specific course of action should be developed to better understand how to further mitigate the potential impacts to the customer base and utility portfolio in the case of MT initiative failure.

**Note**: It may be appropriate to use one of the options as the default but allow utilities to make a case to the SAG for using other options during review of the initiative’s business plan parameters.



# Question 2

How will MT savings be incorporated into gas & electric utility EE goals?

In IL, utilities lay out an energy efficiency plan that describes how they will reach their legislatively-defined goals for the next four-year planning cycle and at what cost.

Recommendation: As noted above, savings from MT are expected to be a small proportion of EE portfolios in the next 5-6 years (2020 to 2025-2026). While CPAS goals and incentives are currently required and available through 2030, Illinois energy policy observers anticipate the current electric CPAS will be extended beyond 2030. As a result, the recommendation is to incorporate any MT savings into goal achievement using the same method as used for current resource acquisition programs. MT savings will be a very small piece of the near-term, but possibly a significant contributor in the next and future portfolios. Utility goal planning will rely heavily on whatever option(s) is selected for cost-effectiveness treatment of MT initiatives to arrive at when savings will be/become claimable.

# Question 3

How will MT savings be incorporated into electric utility financial incentives?

Recommendation: Similar to the answer for Question 2, the recommendation is to fold MT savings into the calculations currently used for traditional Resource Acquisition (RA) programs when calculating any incentive payment. Savings are anticipated to be small in the near-term and this seems like a straightforward approach for the near-term.

Note that since savings are small overall in the near term, this will not likely be a motivating factor to cause utilities to conduct MT initiatives, especially if achievement of annual goals is difficult. While CPAS goals and incentives are currently required and available through 2030, Illinois energy policy observers anticipate the current electric CPAS will be extended beyond 2030. Given this, there is ample motivation to invest in MT since the energy savings potential could guarantee incentives for several cycles to come. If an even stronger motivator were desired, the financial incentive would need to be re-designed around MT characteristics or a longer-term frame, rather than the current emphasis on near-term savings achievement.

# Question 4

If adjustments to the Natural Market Baseline (NMB) are needed during initiative implementation will the adjustment be applied retrospectively or prospectively to estimates of savings for that initiative?

A best estimate of NMB will be developed and documented in the initiative’s MT Business Plan. This NMB will be reviewed by any pertinent evaluation teams at the time of development and will be based on the best information available for the resources committed. It will also be presented to SAG MT Working Group.

As the initiative progresses, new information/data could become available that would cause a shift in the NMB. If this shift is large enough to be consequential, it is recommended that a new NMB be documented and developed, and savings estimates adjusted. Ideally, initial estimates of NMB are sufficiently accurate that revisiting is infrequent.

For example, imagine new information/data becomes available in year 4 of the initiative, and it’s consequential enough to change the savings estimated. Should the new data be incorporated into a new NMB (and therefore savings estimates) going forward -- so starting in year 5? This is applying the change “prospectively”. Or should any adjustments also be made to change savings estimated in years 1-4? This is applying the change “retrospectively”. Savings in years 1-4 may have already been part of goals or incentives calculations, especially if those years cross plan cycles.

Recommendation: The recommendation is that adjustments only be applied prospectively. Best data was used and reviewed to develop the initial estimates and as new information becomes available it should not benefit or penalize actions taken when the new data was unavailable. This is similar to the practice codified in the IL Energy Efficiency Policy Manual, section 7.2 where new net-to-gross ratios are applied prospectively to subsequent program years.

# Question 5:

How will savings and costs be dealt with across filing periods?

At the November 2019 meeting of the SAG MT Savings working group, there was consensus that savings and costs needed to be counted across filing periods. The issue is more about *how* they will be counted, especially as they appear in utilities’ EE plans, portfolio cost-effectiveness or apply toward goals and incentives. These are the subject of other questions already addressed above.

During the same SAG MT Savings working group meeting, there was a request to draft and circulate proposed resolution on whether savings from market transformation initiatives in one EE Plan cycle may be counted in a future EE Plan cycle.

The SAG Facilitator circulated proposed policy resolution for review on December 13, 2019: *Savings from market transformation measure(s) counted in one Energy Efficiency Plan cycle that last beyond the end of that approved cycle may be counted by Program Administrators in a future Energy Efficiency Plan cycle.*

The SAG Facilitator received one suggested edit, indicated in red: *Savings from market transformation initiatives with approved savings protocols counted in one Energy Efficiency Plan cycle that last beyond the end of that approved cycle may be counted by Program Administrators in a future Energy Efficiency Plan cycle.*

Question for discussion: Do any Working Group participants have additional suggestions on the proposed resolution?

1. The MT Business Plans include the estimate of annual savings and cost over the life of the initiative, and also the savings-weighted average lifetime of the measures included in the initiative. This is not an IL TRC calculation, but rather a simple cost/benefit analysis. [↑](#footnote-ref-1)
2. There are limits to R&D/ET/BED investments, so any inclusion of MT into R&D would limit MT spending within R&D, especially since the R&D budgets are already, generally, fully allocated. 3% of total portfolio cost can be used for BED/ETP by gas companies and 6% for “R&D” (also ET) by electric companies. [↑](#footnote-ref-2)