

MEMORANDUM

To: SAG

From: Philip Mosenthal, OEI
Susan Hedman, OAG

Date: January 13, 2012

Subject: **Proposed Framework for Counting Net Savings in Illinois**

This memo proposes a framework for the use of net-to-gross (NTG) ratios in claiming future DSM savings from the efficiency portfolio's of Ameren, ComEd, and DCEO (collectively the program administrators or PAs). We believe this framework effectively balances the desire for greater certainty and lower performance risk by the program administrators, while still providing effective incentives to pursue all cost-effective net efficiency savings within budget constraints.

The Illinois legislation establishes net savings goals, and places performance risk on the PAs through various potential penalties. However, the determination of how that risk should be balanced, and how net savings measured, is not fully established. We acknowledge that different evaluation methodologies, contractors, and simple random statistical variation can influence the measurement of NTG, resulting in a higher than desired level of uncertainty for PAs if used solely on a retroactive basis.¹ In addition, evaluation funds are limited, and we believe it may not be a good use of ratepayer resources to perform evaluations on all programs every year to estimate NTG. Further, while the ICC Order clearly rejects use of default NTG ratios and requires at least an *initial* retroactive application of evaluated NTG ratios, it is not clear that all savings claims must use

¹ We do not believe this uncertainty results in inappropriate risks, and that if standardized methods are used, this risk will be diminished over time. However, we do acknowledge that in the very early stage of PA efforts risk and uncertainty are higher than desired.

retroactive evaluated results in the future. At the same time, we also note that deeming NTG ratios can result in perverse incentives that might discourage a PA from making appropriate program changes to ensure against high freeridership, at least in the short term, by guaranteeing savings claims regardless of the program's true effectiveness.

We propose that:

1. Where a program design and its delivery methods are relatively stable over time, *and* an Illinois evaluation of that program has estimated a NTG ratio, that ratio can be used *prospectively* until a new evaluation estimates a new NTG ratio.
2. In cases that fall under #1 above, once new evaluation results exist, these would be used going forward, to be applied in program years going forward until the next evaluation, and so on.
3. For new programs *or* programs undergoing significant changes — either in the program design or delivery, or changes in the market itself² — NTG ratios established through evaluations would be used *retroactively*, but could also then be used prospectively if the program does not undergo continued significant changes, similar to #1 above.
4. For programs falling under #3, deeming a NTG ratio *prospectively*, may be appropriate if: the program design and market are understood well enough to reasonably accurately estimate an initial NTG (*e.g.*, based on evaluated programs elsewhere); or it is determined that the savings and benefits of the program are not sufficient to devote the evaluation resources necessary to better estimate a NTG ratio.
- 4.5. With input from the evaluation contractors, the SAG will recommend, in advance of the evaluation study start date, whether the NTG values resulting from the evaluation study should be applied in the year they are determined (due to significant program or market changes) or only in the following program year.

The above framework achieves four things. **First**, it provides some certainty of savings claims for PAs for the *majority* of their portfolio savings, thus dramatically reducing short term performance risk. For example, the Residential lighting and C&I Prescriptive lighting programs at this point provide the

² An example of a market change might be where baselines have improved significantly and the likely free riders are growing substantially because of it.

vast majority of portfolio savings, have not undergone significant changes since PY1, and have been evaluated.³

Second, it continues to provide a strong — albeit diminished — incentive for PAs to work to maximize NTG ratios and net savings by continually doing the necessary research to understand markets and make program changes as appropriate in a timely fashion. This is because, while current savings may be counted on a “NTG deemed” basis, future evaluations that find a significantly diminished NTG ratio will increase PA challenges to meet future goals. Thus, longer term the PAs are still served best by minimizing free riders.

Third, it ensures that decisions about new initiatives or significant program changes are made recognizing and balancing performance risk as part of the overall portfolio. This provides PAs with an incentive to design and deliver these programs to minimize free riders initially, and be held accountable for results. Thus, PAs can experiment with innovative strategies (since these will represent a minority of portfolio savings, significant flexibility and hedging ability will exist) while not encouraging program designs or delivery strategies that are likely to have very high freeridership or questionable cost-effectiveness.

Finally, it provides a mechanism to manage evaluation resources to ensure they are spent most effectively, and on those areas with the greatest impact and/or uncertainty.

Evaluation Inconsistencies

The PY1 evaluated NTG ratios for Residential lighting are significantly different for Ameren and ComEd. While there are real differences in the demographics of their service territories that may have contributed to this difference, it is important to note that the utilities used different evaluation

³ It is important to note that the current lighting market is undergoing significant change, and pending federal standards going into effect in 2012 will further this transition, so we believe these savings will need to undergo additional evaluations and program changes will be warranted in the near future, especially if they continue to account for such a large share of net savings.

contractors and significantly different evaluation methodologies. As a result, there is little certainty about the attribution of these differences. We propose that wherever possible, joint and consistent statewide evaluations be performed. This will eliminate these uncertainties, allow for more direct comparison between PA's performance, as well as provide economies of scale and greater consistency and certainty to PAs about likely future evaluation results. We propose that standardized approaches to measuring freeridership and spillover be adopted in Illinois that ensure consistent measurement both across territories and over time.⁴

⁴ An example of this exists in Massachusetts where all PAs have for roughly a decade used a standardized methodology and set of survey questions that were collaboratively developed to measure freeridership and spillover every year. This approach has proven to provide relatively stable results over time, and better elucidates differences between PAs that may result from different program approaches.