

ARKANSAS PUBLIC SERVICE COMMISSION

FILED

IN THE MATTER OF THE CONSIDERATION OF)
INNOVATIVE APPROACHES TO RATEBASE)
RATE OF RETURN RATEMAKING INCLUDING,)
BUT NOT LIMITED TO, ANNUAL EARNINGS)
REVIEWS, FORMULA RATES, AND INCENTIVE)
RATES FOR JURISDICTIONAL ELECTRIC AND)
NATURAL GAS UTILITIES)

DOCKET NO. 08-137-U
ORDER NO. 15

ORDER REGARDING UTILITY ENERGY EFFICIENCY INCENTIVES

This Order approves a general policy under which the Commission will approve incentives to reward achievement in the delivery of essential energy conservation services by investor owned public utilities (IOUs) in Arkansas. This Order also establishes energy savings goals. The goals provide guidance regarding the scope of essential energy conservation services during the next three program years.¹ Separately, the goals provide a basis to award, or not award, energy efficiency ("EE") program incentives.

Positions of the Parties and Discussion
Regarding the Statutory Basis for Awarding Utility Incentives for Energy
Efficiency Program Achievement.

Some parties have argued that the Commission is not authorized to approve incentives to utilities above the direct cost of EE programs. *See*, Brief of Arkansas Electric Energy Consumers, Inc., and Arkansas Gas Consumers, Inc.'s On Legal Issues [*sic*], November 9, 2010, at 3, citing Ark. Code Ann. § 23-3-405(a)(3) and Ark. Code Ann. § 23-3-404 (arguing that statutory authority is adverse); *see also* Post-Hearing

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¹ Docket No. 08-144-U, Order No. 17 (December 10, 2010) establishes the goals for that purpose.

Reply Brief of Wal-Mart Stores Arkansas, LLC and Sam's West, Inc., November 12, 2010
at 5 (arguing that statutory authority is questionable).

On the other hand, the IOUs argue that statute requires Commission approval of utility incentives. The Arkansas Energy Conservation Endorsement Act of 1977 ("ECEA"), Ark. Code. Ann. §23-3-401 *et seq.*, requires that, prior to approving any EE program, the Commission must determine that the program is "beneficial to the ratepayers of such public utilities and to the utilities themselves." (Ark. Code Ann. § 23-3-405(a)(2)). The IOUs argue that the concept of "benefit to the utility" is empty without shareholder earnings: shareholders invest in order to earn. Since shareholder benefit cannot be assured without an earnings opportunity, the IOUs contend that some form of incentives (in addition to direct cost recovery and collection of lost contributions to fixed costs("LCFC")) must be approved.

The Commission hereby references and incorporates the reasoning of Order No. 14 in this Docket to respond to these arguments, in addition to the following comments: As noted in that Order, the statute expressly authorizing Commission approval of EE programs, the ECEA, requires recovery of direct program costs upon Commission approval of EE programs, and expressly reserves all other Commission authorities that might be used to promote energy conservation. (Ark. Code Ann. §§ 23-3-405(a)(3), 23-4-405(b)).

As the Attorney General has pointed out, the ECEA does not dictate the method used to define "costs." (AG's Legal Brief Regarding Shareholder Incentives and Lost Contributions to Fixed Costs at 3-4 (November 9, 2010)). The Commission views incentives as one component of program cost that may be approved for the purpose of

enhancing the prospect of annual achievement, and for generating company and shareholder interest in excellent program performance over the long term. This component promotes improved achievement of the “overriding public interest” in energy conservation. (Ark. Code Ann. § 23-3-402). The fact that this component must be included in the cost benefit analysis reasonably guarantees that program portfolios deliver aggregate benefits to the majority of ratepayers, to utilities, and to the utility system as a whole.

Position of the Parties Regarding Policy Considerations in Awarding Utility Incentives for Energy Efficiency Program Achievement.

The IOUs argue that ratemaking tradition and sound policy require the Commission to approve some form of incentives, thereby creating an earnings opportunity, in order to place the implementation of EE programs “on a par with” utility investment in supply-side resources such as power plants.² (Entergy Arkansas, Inc.’s (“EAI”) Initial Comments in Response to Order No. 7 at 16 (March 26, 2010) (Tr. 118)). Supply-side investment, under this view, creates an opportunity under traditional utility ratemaking for utility company shareholders to earn profits commensurate with the amount of capital put at risk by the investment. EE program activity, by contrast, reduces revenues that otherwise would provide cost recovery (the fixed component of which is addressed in concurrent Order No. 14, approving the collection of an LCFC mechanism) and shareholder earnings. CenterPoint Energy Arkansas Gas (“CenterPoint”) has characterized the earnings opportunity that could be provided by incentives as the third leg of a “three legged milk stool” (the other two legs being direct

² The Electric Cooperatives state that, as non-profit organizations serving member-owners, they do not need incentives to support implementation of EE programs.

program cost recovery and LCFC) necessary to support aggressive utility pursuit of energy efficiency. (CenterPoint's Post-Hearing Brief at 2 (November 9, 2010)).

Some utilities argue that this earnings opportunity should be granted for each increment of program achievement (i.e., an incentive for each kilowatt hour or therm saved), in order for EE implementation to reward the utility on a par with investment in supply infrastructure. (*Id.* at 17; Tr. 119). However, some gas utilities assert that, while rewarding each increment of achievement would be ideal, it is not essential. (Comments of CenterPoint in Response to Order No. 12, October 5, 2010, at 2; Tr. at 440-441). Arkansas Western Gas ("AWG"), noting that its proposal to reward achievement above a threshold, rather than for each energy savings increment, is a "compromise to the Attorney General." (Prepared Testimony of Paul D. Smith at 13:19-20 (March 26, 2010)).

Electric utilities generally favor an incentive based on the concept of "shared savings." Under this approach, the projected benefits of the EE program to ratepayers and utility resource planning, in terms of fixed and variable costs avoided over the lives of the measures that will be implemented, are totaled and given a net present value. Also, expected program costs are totaled. The benefits minus the costs give "net benefits" of the program. (Tr. at 89). A share of those net benefits (for instance, 20%) is then granted to the utility, with ratepayers retaining the remaining value. The amount of annual incentive allowed is often capped at a percentage (for instance, 20%, of program budgets). (Tr. at 95). Electric and gas utilities cite examples of other jurisdictions that have adopted and implemented a shared savings incentive. (Tr. at 291). (OG&E noting approval of shared savings in Oklahoma); (Tr. at 419). (CenterPoint

discussing its experience with shared savings in Minnesota); and (Tr. at 80). (EAI witness Eric Woychik suggesting that at least 13 of 20 states that have approved utility incentives rely on sharing costs avoided).

While most electric utilities (and those other parties that support shared savings) indicate that, for purposes of calculating shareholder incentives, net benefits should be calculated based on a cost-benefit test called the Total Resource Cost (“TRC”) test, SWEPCO argues that the utility cost test (“UCT,” or “PACT,” for program administrator cost test) is more appropriate. (Tr. at 237 & 247). SWEPCO argues that the UCT provides the proper incentive for the utility to keep customer rebates or other incentives to the minimum needed to change customer behavior, because under UCT analysis customer rebates are accounted as a program cost to the utility. (Tr. at 247). By contrast, under the TRC, customer rebates are considered a wash, since ratepayers both fund and receive the rebates. Other parties support TRC because it is the broadest measure of cost-effectiveness on behalf of ratepayers and utilities. (Tr. at 303).

Also, SWEPCO and OG&E note that certain important programs, such as education and training, either cannot be assessed under or usually do not pass standard cost-benefit tests. For those programs, SWEPCO (Tr. at 247 & 267) and OG&E (Tr. at 271) propose that utilities should receive an incentive based on a percentage of program budgets.

Gas utilities do not oppose the shared savings approach, but rather argue that a simpler calculation is more appropriate for an industry with fewer capital costs to avoid and fewer energy savings opportunities in terms of different types of equipment. (Tr. at 379). (CenterPoint, noting that a shared savings approach “could be appropriate”); (Tr.

at 358, lines 4 to 21). (CenterPoint, noting that gas utilities can avoid fewer capital costs than electric utilities); (Tr. at 323, lines 1-16). (CenterPoint, describing the more limited nature of opportunities to reduce gas usage); (Tr. at 350-351). (CenterPoint, describing simpler approach); and (Tr. at 440). (AWG's similar incentive approach). Gas utilities' proposed incentive would grant the utility 0.5% of EE program costs for each 1% of energy savings above 80% of a Commission-approved savings goal. CenterPoint further argues that, because this approach involves simpler calculations than the shared savings/net benefits approach, it will lead to fewer disputes. (Tr. at 350).

The Attorney General ("the AG"), the National Audubon Society ("Audubon"), and to some degree the Federal Executive Agencies ("FEA"), contest the view that the basis for awarding incentives for EE program achievement should be to create a reward for investors that is equivalent to (and numerically similar to the rate of return for) utility investment in supply side infrastructure. The AG (Tr. at 532) and Audubon (Tr. at 514) argue that EE programs to date in Arkansas (and generally) involve pass-through expenses, not investments. Since direct program costs are recovered, by statute, no shareholder investment is put at risk. (Tr. at 518). Once the Commission approves program direct cost recovery, plus recovery of the fixed component of lost revenues, the utility is made whole, according to these parties. Further, they argue, the utility is relieved of the duty to raise capital and invest in avoided supply side infrastructure: any freed up earnings may be invested elsewhere, used to buy back stock, or distributed as dividends. (Tr. at 536). The AG and Audubon thus assert that incentives should be justified by the need to reorient utilities towards the new and complex task of energy efficiency program management. (AG's Initial at 8-9; Chernick's Direct at 21-23).

Therefore, Audubon and the AG and Audubon favor tying incentives to a level of achievement that exceeds a Commission-defined threshold of excellence (although the two parties would use different metrics in the short term to measure excellence). Audubon asserts that, on a financial basis, incentives (which it supports) create shareholder opportunity “much richer” than supply-side investment. (Supplemental Direct Testimony of Paul Chernick, at 11:1-2 (October 6, 2010)). Because the investment of time and managerial expertise in EE program development and implementation would not involve as much financial risk as supply-side investment, the AG and Audubon favor capping utility incentives at a modest level of program budgets. (Tr. at 686, 654, 673).

FEA agrees with this line of argument to this degree: the utility need not be rewarded at the same rate for EE achievement as for supply side investment, because shareholders are not placing capital at risk. Rather, FEA suggests establishing a Treasury-bill-based “risk free” investment reward for EE program spending. (Tr. at 778: 9-17 & 779:4-9). Because FEA agrees that EE program earnings should grow in proportion to the size of the resource like the supply-side investment program earnings, FEA agrees with utilities that incentives should be earned for each increment of EE program achievement. FEA also explicitly adopts a cap on annual utility incentive earnings similar to that proposed by the AG and Audubon. (Tr. at 792, 805).

FEA also asserts that the award of shared savings in addition to LCFC, if not correctly calculated, may result in double counting of capacity costs. FEA witness Larry Blank explains that the LCFC mechanism will recover the full amount of existing capacity related costs. The shared savings mechanism then generates an award based in

part on avoided capital costs. While energy cost savings due to EE programs are immediately realized, capital cost savings are not. Blank asserts that the present value of capacity costs should not reflect avoided capital costs during those years for which LCFC is claimed, so that the “present value of avoided costs for a particular energy efficiency program” should be zero for several years. (Tr. at 777-778).

The AG points to disputes in California over the calculation of incentive amounts that are rooted in the difficulty of determining program effects. (Tr. at 523). Also, the AG raises the concern that the variability of key inputs to the net benefits equation (i.e., the price of natural gas) will result in arbitrary variations in the amount of shared savings, since natural gas price swings affect avoided costs. (Tr. at 524). Also, the AG asserts that a net benefits incentive tends to promote “cream skimming” and short term energy savings measures that strand the potential investment by customers in deeper and more difficult energy savings projects. (Tr. at 524, 554). Therefore, the AG proposes that the Commission design an incentive structure based on energy savings, but strongly modified by factors that boost programs judged to achieve comprehensive energy savings that otherwise would not be achieved because of the difficulty of the project or the market being reached. (Tr. at 526).

Audubon argues that, while the AG’s incentive structure would be valuable in later stages of EE program development, at the current stage in Arkansas, a shared savings/net benefits approach offers key benefits: It incorporates an incentive for the utility to minimize program administration costs. Also, because the benefit calculation includes a net present value of future energy savings, utilities would be rewarded for creating long-term energy savings. (Tr. at 749, 765).

FEA suggest that the Commission may wish to consider penalties for failure to substantially achieve each utility's goal. (Tr. at 818-819). Audubon and the AG support the provision of penalties for substandard performance. Utilities uniformly oppose the imposition of penalties for substandard performance on EE program implementation. (See, e.g., Tr. at 389). Small IOUs in particular argue that events beyond their control could unfairly result in penalties. General Staff argue that penalties may be appropriate at a later stage of program development, but not now. (Tr. at 904).

**Position of the Parties Regarding
the Establishment of Energy Savings Goals.**

Order No. 12 of this Docket directed parties to comment on the questions of whether energy savings goals should be established, and if so, whether utility performance incentives should be tied to achievement of those goals.

Parties disagree, primarily not over whether energy savings goals should be set, but rather over who should set goals.³ The IOUs hold that each utility should propose its own goal, for approval by the Commission. See, for example, (T at 283). Electric utilities in particular argue that utility-by-utility goal setting is inherent in the development of Integrated Resource Plans ("IRPs"), and that the IRP process is most appropriate for considering the many factors that determine what level of energy efficiency program delivery will be cost effective for a particular utility. (Tr. at 76, 78). IRPs must be filed with the Commission every three years. EAI points out that the EE program approval process and timetable under current rules is coordinated with the IRP process and timetable. (Tr. at 138). In addition, utilities argue that the National Action

³ While SWEPCO and Empire District Electric Co. argue that no goals should be set, each supports annual approval of company-proposed EE programs, which include a budget and estimated energy savings impact. Arkansas Western Gas states that "energy efficiency goals or targets for performance should not be set at this time. It is too early to set such goals or targets." (Tr. at 455).

Plan for Energy Efficiency (“NAPEE”) outlines a widely-accepted process to study and develop the energy efficiency potential estimates commonly incorporated into resource planning documents. EAI and SWEPCO have completed such studies.⁴ The Commission should build upon these existing, widely-accepted processes, and continue to tailor energy savings goals to the cost and resource structure of each utility, according to the IOUs. (Tr. at 141). Further, the IOUs note that their ability to achieve goals depends partly on Commission decisions on issues such as whether large industrial and commercial customers will participate fully in energy efficiency programs, and whether programs that promote switching from electric to natural gas end-uses could strongly affect the applicability of any savings goals. (Tr. at 221).

The IOUs generally oppose the imposition of any statewide, one-size-fits-all energy savings goals (sometimes called an Energy Efficiency Resource Standard, or “EERS”) by the Commission.⁵ The IOUs argue that each utility and territory has unique characteristics, such as different supply portfolios, different growth rates, and different relative proportions of residential, commercial, and industrial customers. (Tr. at 132).

The IOUs particularly oppose Commission adoption of an EERS based on a study published in June 2010 and conducted by the American Council for an Energy Efficient Economy (“ACEEE”), entitled *Advancing Energy Efficiency in Arkansas: Opportunities for a Clean Energy Economy*. As part of the Sustainable Energy Resources Docket investigation into the potential to develop energy efficiency resources

⁴ However, EAI has testified in Docket No. 08-144-U that its EE potential study, filed in late 2009, is incomplete because it does not include the effects of EE Quick Start programs begun in 2007, and that greater cost-effective energy savings are available than are reflected in the study.

⁵ However, while OG&E believes that each utility should propose its own energy savings goal, it recommends that the State of Arkansas should consider the aggregate of all utility company energy savings goals, plus “[s]tatewide potential studies and other input” in developing a “comprehensive state goal” to promote excellence.

in Arkansas, the Commission encouraged all jurisdictional utilities to cooperate in providing data and guidance to ACEEE in the development of its study, which was coordinated by a state agency, the Arkansas Energy Office. (Order No. 14, Docket No. 08-144-U). EAI argues that, because ACEEE incorporates statewide average program participant energy costs (and other statewide data), it is inappropriate for estimating energy savings potential in EAI territory. (Tr. at 147). EAI also claims that ACEEE inappropriately bases available potential on a participant cost test rather than the TRC test. (Tr. at 148). According to EAI, arbitrary reliance on such inapplicable statewide goals may endanger grid reliability. (Tr. at 143). EAI emphasizes the need to provide opportunities for discovery and cross-examination of the results of ACEEE's study. (Tr. at 148).

Gas utilities agree that imposition of ACEEE's statewide goals would be an example of arbitrary statewide goal-setting. (Tr. at 376). CenterPoint incorporates by reference its critique of the ACEEE Report filed in Docket No. 08-144-U, which argued that ACEEE inappropriately relies on U. S. Energy Information Administration projections that natural gas sales will increase in Arkansas, when historically CenterPoint sales have declined. AWG and AOG state that there is not enough program experience or data yet in Arkansas to assess whether ACEEE's goals (or other goals) are achievable. (*See, e.g.*, Tr. at 456). However, AWG comments that "North Carolina, a state that is comparable to Arkansas, has an EERS goal for gas utilities of 0.25% per year." (Tr. at 456).

In response to the Commission's request that utilities estimate near-term achievable EE potential, EAI reports that a prior internal program planning estimate,

subject to further adjustment, suggested that EAI could achieve savings of 0.3%, 0.4% and 0.6% of kWh sales in 2010, 2011 and 2012, respectively. (Tr. at 705). (Audubon calculations based on EAI numbers are provided at Tr. 154-155). SWEPCO estimates that it could save 0.4% in 2011, 0.45% in 2012 and 0.5% in 2013, depending on other Commission decisions regarding industrial customers, and many other factors. (Tr. at 249-250). OG&E estimates that it could ramp up to savings of “slightly less than 1% per year,” based on a 2008 EE potential study and its experience in Oklahoma. (Tr. at 286-287). SWEPCO and OG&E specify demand savings as well.

Audubon is perhaps the chief proponent of statewide goal-setting in this docket. Audubon argues that, after a multi-year period of time in which to study, design, implement and ramp-up EE programs, more ambitious goal-setting is the next logical step. (Tr. at 748-749). Goals will create benchmarks to measure and reward progress, assist in determining whether current programs should be continued or abandoned, assist in resource planning, and create greater certainty for the broader EE contractor market. (Tr. at 749). Audubon testifies that, if goals are moderate, the differences between utilities are not important barriers to implementation (except that gas utilities in general merit a lower energy savings goal as a percentage of sales than electric utilities). (Tr. at 681). Audubon suggests that if differences between service territories are a great concern, then uniform goals could be set for each of the residential, commercial and industrial classes. (*Id.*).

Audubon recommends specific goals for energy savings performance over the next three years. Audubon recommends that electric utilities aim to save 0.5% of the utilities' 2010 energy sales in 2011. The goals would rise to 0.75% of 2009 sales in 2012

and 1% of sales in 2013, unless the Commission later changes the goals. Audubon recommends that gas utilities save 0.3% of [2010] deliveries in 2011, 0.4% in 2012, and 0.5% in 2013, unless the Commission later changes the goals. Audubon holds that goal-setting beyond three years is of limited use since many factors may reduce or increase achievable potential. (Tr. at 682). Audubon bases these proposed goals on similar goals applicable in the territories of other utilities with limited prior experience implementing comprehensive EE programs; similar goals stipulated by Duke Power Carolinas; the July 2007 of expert witness Jeff Loiter on behalf of General Staff recommending similar “moderate” levels of achievement in SWEPCO territory; and on the ACEEE Report. (Tr. at 683). The Audubon recommended goals roughly comport with the “medium” scenario in the ACEEE Report, which outlines low, medium, and high energy savings scenarios. Audubon attaches the 200+ page ACEEE Report as an exhibit to the testimony responding to Order 12. The Report notes that the recommended medium scenario is not tailored to individual utilities, but rather is expressed as a statewide figure because “the targets . . . are modest targets and can be met by all Arkansas utilities.” (Tr. at Exh. 114).

FEA argues that goals would “complement the implementation of” EE programs. (Tr. at 804). FEA suggests that targets should be based on expected net program cost savings. (*Id.*).

The AG prefers that the state establish statewide goals encompassing both utility and non-utility actions (such as the setting of building energy efficiency goals), and that utilities then make their case for what portion of the goal they can deliver. (Tr. at 552-553). The AG states that the ACEEE Report “provides a reasonable estimate of cost-

effective EE and achievable EE potential in Arkansas via” the wide range of public and private entities that could help deliver energy savings. (Tr. at 553). The AG recommends that the Commission evaluate the next round of annual EE program applications “[w]ith the ACEEE Report as the basis for statewide goals or targets...” (*Id.*).

General Staff comments that it is reasonable for the Commission to set energy savings goals, and that such goals initially should be simple energy usage savings goals (and thus not demand reduction goals).⁶ (Tr. at 901). Staff also urges that the Commission not approve utility incentives for EE program performance unless and until it establishes clear goals. (Tr. at 885). However, Staff recommends that any goals be set on a utility-by-utility basis as part of the annual EE tariff and program review. (Tr. at 903).

With the exception of those parties who oppose goal-setting outright, and those parties who express no position regarding goal setting, remaining parties generally advocate that incentives should be tied to goal achievement, or acknowledge that it is reasonable to do so. For instance, Staff states that “[t]here should be no shareholder incentives awarded unless a utility is able to show that its programs have performed at a level that meets or exceeds the Commission's established goals.” (*Id.*) The Attorney General agrees with Staff on this point. (Tr. at 573). CenterPoint’s proposed incentive structure rewards achievement, starting above 80% of goal. (Tr. at 377). Audubon advocates creating a clear connection between incentives awarded and goal achievement at a level of exemplary performance (often starting somewhere between 70% and 100%

⁶ Earlier this year, in the related proceeding in Docket No. 08-144-U, Staff stated that it may be reasonable “to establish the levels of savings in the ACEEE Report with incentives for meeting or exceeding those targets.” (Docket No. 08-144-U, Staff Comments at 6 (August 20, 2010)).

of goal, depending on whether the goal is a moderate goal or a high, aspirational goal). (Tr. at 672). While not advocating a linkage between goals and incentives, OG&E admits that “[c]ertainly, there is an argument to be made for incentives for over achievement.” (Tr. at 284).

Discussion.

As noted above, the Commission finds that it has the statutory authority to grant incentives to public utilities in exchange for performance of essential (and exemplary) EE services.⁷ The Commission hereby determines that it will approve incentives reasonably calculated to promote and reward EE program achievement by utilities as part of the annual EE tariff process, subject to the required statutory findings and to guidelines outlined below. However, incentives will not be awarded contemporaneously during the program year, but rather, only after the fact, based on the robust EM&V program developed pursuant to the relevant companion order issued today in this docket.

The Commission adopts the shared savings of net benefits approach recommended by electric IOUs and by Audubon, and deemed acceptable by CenterPoint. This approach has the benefit of promoting economy of program administration, of rewarding achievement progressively, and of rewarding long-term energy savings in a proportional and reasonable manner. Also, because it has been adopted in a number of jurisdictions, some Arkansas-based utilities or their affiliate companies have experience with shared savings, and there is a broader body of experience with its terminology, effects, and regulation. While the IOUs note in their

⁷ Ark. Code Ann. §§ 23-3-405(a)(3), 23-4-405(b).

Joint Motion for Commission approval of an LCFC mechanism that development of consensus on a joint incentive proposal needs more time, the Commission intends by this Order to reach resolution of an issue that each utility has argued is necessary to place EE program implementation on a par with supply side investment. This order approves each component of the “three legged milk stool” that utilities have argued is necessary to remove all utility disincentives to EE program implementation, and should allow a directed focus on program development, implementation, and achievement. Indeed, because recovery of direct program costs and LCFC will be contemporaneous, and because shared savings incentives will predictably follow, this system of reward should and is intended to favor the implementation of cost-effective EE over meeting demand through supply-side investment, in recognition of (1) the historic underrepresentation of EE in the portfolios of Arkansas IOUs and (2) the overriding interest of ratepayers and society in energy conservation.

In reaching this decision, the Commission acknowledges the IOUs argument that the lack of some type of earnings opportunity connected with energy efficiency program implementation has been a disincentive to the development and implementation of robust energy efficiency programs in Arkansas. However, the Commission does not accept the view that the return on investment applicable to supply-side infrastructure can be mechanically applied to EE program expenses. Both ratepayers and the industry deserve thoughtful development of an incentive structure tailored to the particular financial and administrative requirements of this service. Further, adoption of a single incentive model will enable comparison of program costs across utilities and promote

administrative economy in the development of program and regulatory practices for the next several years.

The Commission will review and approve shared savings of net benefit incentive proposals which award 10% of net benefits to a utility for achievement above 80% of the savings goals established in this order. Total incentive awards within any year are capped at 5% of proposed program budgets for achievement between 80% and 100% of goal; for achievement between 100 and 110% of goal, incentives are capped at 7% of proposed program budgets. The determination, establishment, and approval of shared savings of net benefits will be based upon independent and Commission approved EM&V which is addressed in the companion order on EM&V.

Net benefits for the purpose of calculating shared savings shall be based on the TRC test, to provide a broad basis for evaluating value to both ratepayers and the utilities (the danger of overlarge customer rebates does not yet appear to be a concern in the record of EE tariff proceedings in Arkansas, although the question of incentives that may be too small to clearly generate net savings, as opposed to gross savings, may be). Projected incentive awards shall be included in the cost benefit analysis used to seek program approval. During this three-year period for shared savings purposes, net benefits will be calculated for program portfolios as a whole, including education programs and other joint programs coordinated through the AEO. In order to guard against potential weaknesses in the shared savings of net benefits approach, the IOUs shall propose, and the Commission will review in the tariff filings, a method of limiting arbitrary fluctuations in the value of net benefits stemming from fluctuations in the price of natural gas (such as using a running average gas prices, or a jointly-agreed

average price, or some other mechanism), and a method of ensuring that the award of shared savings does not duplicate fixed-cost recovery under LCFC in the manner outlined by Professor Blank.

The Commission adopts the following default goals for individual utility EE program portfolio energy savings as a percentage of 2010 energy sales, during the following years:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Electric IOUs	0.25%	0.50%	0.75%
Natural Gas IOUs	0.20%	0.30%	0.40%

The IOUs are directed to submit EE program tariff applications calculated to meet at least these levels of program achievement. Having submitted such an application, a utility also has the opportunity to demonstrate that the particular circumstances of the utility make achievement of such goal infeasible or unreasonable, such that an alternative program portfolio is indicated. In this manner, the Commission can ensure that program planning adequately explores a level of achievement commensurate with expanded development of energy efficiency programs, while still tailoring goals to the circumstances of each utility.

While the companion order issued today helps define “essential” energy efficiency program service levels and providing guidance on the factors that will be considered in the review of “comprehensive” program applications establishes the greatest achievable level of cost effective energy efficiency as the general standard for energy efficiency program services, during the next three-year period, when programs are transitioning from the current, initial level, to a level more in accord with

performance in jurisdictions with greater EE program experience, these target program performance levels will presumptively satisfy the essential standard.

The record indicates that these goals are achievable by every Arkansas IOU. These goals roughly accord with OG&E's estimate that it can achieve savings of slightly less than 1% per year, with the award of LCFC and incentives. In the first year, the Commission-established goal of 0.25% energy savings is actually below EAI's estimate that it can achieve 0.30%, and below SWEPCO's estimate that it can achieve 0.40%. In the second year, the Commission-established goal is almost exactly what these electric utilities project that they can achieve. In the third year, the goal is a modest stretch. Throughout these three years, utilities would experience no detriment if they do not meet goals, because of the award of LCFC. Further, even falling short of the goal, the utility could still earn significant incentives. The Commission establishes no penalty during this three year period, although it reserves the right to revisit this question if needed.

Relying on indications in the record that gas utilities have fewer opportunities to generate savings, the Commission establishes lower goals that also do not rise as quickly. As AWG points out, "North Carolina, a state that is comparable to Arkansas, has [a goal] for gas utilities of 0.25% per year." Our goal in the first year is lower than this requirement, and is only slightly higher in years two and three. The goals also roughly accord in 2011 with the midpoint of AOG's planned 2010 through 2012 filings.⁸

⁸ Also, the goals track the "medium" case for achievable, cost-effective energy efficiency potential recommended by Audubon for utility EE programs in Arkansas, although they are one year behind the schedule proposed by Audubon, and thus lower.

In accordance with the recommendation of Staff, these goals do not include demand reduction goals, for simplicity, although utilities will continue to track data on demand reduction and the Commission may later establish demand reduction goals. Also, target percentages are based on sales levels during a single year (2010), meeting Empire District's concern that fluctuations in load caused by the recruitment of industry might hamper achievement, and promoting stability and certainty in expectations. This single-year baseline also supports the simplicity and clarity recommended by Staff, Audubon, and others. Target percentages may be adjusted based on large industrial and commercial customer participation, in accordance with the companion order on that subject.

By looking forward only three years, the Commission heeds testimony by the IOUs and by Audubon that conditions can significantly change. This Commission would expect based on today's conditions and technology that targets might continue to rise past year three, but does not prejudge that issue for 2013. Also, the Commission reserves for future consideration the possibility of adding "dimensions of value," as the AG has suggested, to the incentive mechanism to promote program comprehensiveness and the delivery of service to hard-to-reach markets, if those aims appear not to be served by annual comprehensive program review. Likewise, the Commission finds merit with the position taken by Staff and others and will defer, for now, the issue of penalties for lack of performance in energy efficiency programs. The Commission is hopeful that the issue of penalties need never be addressed; however, the Commission reserves the right to revisit this issue if programs are not proceeding as envisioned.

The verification and measurement of achievement, for the purpose of calculating LCFC and incentives, are addressed in separate orders today. It is the intention of this Commission to establish fair, but rising goals, which move utility service in this state towards a high level of excellence and customer service, with fair rewards for that service. To make sure that ratepayers garner the benefits of those programs, and that utilities themselves can rely on calculations of LCFC collected and resource needs avoided, achievement must be accurately assessed. If, as the AG has predicted, such measurement proves to be unworkable, then the Commission will more seriously consider decoupling in the electric industry and other means of promoting conservation in the electric and gas industries, as a means of ensuring that cost effective energy efficiency becomes an appropriate part of the utility portfolio in Arkansas, in accordance with statutory intent, the duties of the Commission, and the public interest.

BY ORDER OF THE COMMISSION.

This 10th day of December 2010.

I hereby certify that this order, issued by the Arkansas Public Service Commission, has been served on all parties of record on this date by the following method:

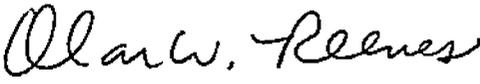
U.S. mail with postage prepaid using the mailing address of each party as indicated in the official docket file, or
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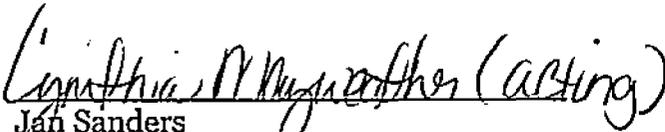
Paul Suskie, Chairman



Colette D. Honorable, Commissioner



Olan W. Reeves, Commissioner



Jan Sanders
Secretary of the Commission