Budget and Savings Recommendations

Compensation Structure

Summary

VEIC proposes a new compensation rate for above-cost earnings in each of the three budget scenarios under consideration for the 2015-2017 Efficiency Vermont program budget. The proposed compensation rate varies according to the size of the overall budget for each scenario.

For Budget Scenario 1, VEIC recommends 6% of program budget for operations; 6% for Budget Scenario 2; and 5% for Budget Scenario 3. VEIC proposes them as fair market value rates, and further proposes that they be split equally between the operations fee and the performance award.

These rates are collectively higher than what has been historical practice. However, they are aligned better with the median New England regional compensation rates for similar program providers, and reflect the increasing demands on VEIC's performance, and the corresponding increased risk to VEIC of under-performance.

Each rate is derived from an application of the following factors:

1. The 2010 Order of Appointment determination of compensation and budget, and the components of the compensation structure
2. An analysis of compensation structures for both utility efficiency program and other types of efficiency program providers
3. Fair market compensation
4. Comparable compensation nationwide and regionally
5. Risks to VEIC
6. Balancing the roles of risk and value in setting the compensation rate

This document discusses each of the factors, and rationales for the recommendations.

Components of Compensation Structure

From the Order of Appointment (December 20, 2010), Section IV. Compensation and Payment 1. General; A.:

An EEU shall be afforded the opportunity to recover just and reasonable costs and expenses accrued in the provision of services and initiatives under an Appointment, and to earn a fair return.

VEIC's Order of Appointment establishes a compensation structure with three components: (1) reimbursement of actual incurred costs; (2) performance compensation; and (3) an operations fee. The operations fee is a fixed percentage of the total approved budget and is applied to all Efficiency Vermont expenditures. The performance award is a fixed amount that is also calculated as a percentage of the total approved budget. Together with reimbursement of actual costs, they comprise VEIC's total allowable performance period earnings. The operations fee and the performance award are the primary subjects of this compensation structure recommendation, and are discussed in more detail, below.

Overview of Entity Structures for Energy Efficiency Programs

Throughout the United States in the past 15 years, compensation for the administration and implementation of efficiency programs has evolved into many different forms. Further, each performs a different function. A review of the many different types of energy efficiency delivery entities indicates that few, if any, have structures that align with that in Vermont. Nevertheless, a broad analysis is possible if the entities are categorized into three functional areas:

- *Administration only*
- *Implementation only*
- *Administration and implementation ,* a combination of unspecified weights toward one function or the other—essentially, an "everything in between" functional area

Table 1 demonstrates the scope of the types of businesses and the types of functions performed in energy efficiency program delivery. The colors indicate the frequency with which various models occur throughout the United States.

Table 1. The variety of entities delivering energy efficiency programs in the United States, relative to function in program delivery

Legend

Yellow	Frequent
Green	Less Frequent
Blue	Rare

	Administration Only		Administration and Implementation		Implementation Only	
Entity	Admin	Implementation	Admin	Implementation	Admin	Implementation
Regulated investor–owned utilities	• (Frequent)	Subcontractor(s) (Frequent)	• (Less Frequent)	• (Less Frequent)	NA	NA
For-profit businesses	• (Frequent)	Subcontractor(s) (Frequent)	• (Less Frequent)	• (Less Frequent)	NA	• (Frequent)
Nonprofit businesses	• (Frequent)	Subcontractor(s) (Frequent)	• (Rare)	• (Rare)	NA	• (Frequent)
Municipal / cooperative utility	• (Frequent)	Subcontractor(s) (Frequent)	• (Less Frequent)	• (Less Frequent)	NA	NA
Government or quasi-governmental agency	• (Frequent)	Subcontractor(s) (Frequent)	• (Less Frequent)	• (Less Frequent)	NA	NA

The predominant model is one in which the entity that administers the energy efficiency program neither implements nor directly provides services to customers.[1] In this model, the administrative entity hires subcontractors to deliver program services. Both for-profit and nonprofit entities provide implementation services in this model. Less frequently, entities carry out ***Administration and Implementation***, delivering all services and being held accountable to regulators. VEIC, as the administrator and implementer for Efficiency Vermont, falls into this category.

In the category of ***Implementation Only,*** there are very few utilities (investor-owned, municipal, or cooperative) that offer these stand-alone services. VEIC therefore will not address this function area in the following comparison.

Comparing functions

[1] Within the ***Administration Only*** model, distribution utilities represent the majority of the programs throughout the country. This is due to several factors, the most dominant of which is regulatory encouragement of these utilities to subcontract their energy efficiency implementation services.

To compare compensation among these different entities and the functions they carry out, it is important to gain a deeper understanding of each type of entity and the functions it performs.

There is a significant difference between ***Administration Only*** models and ***Administration and Implementation*** models.

In the ***Administration Only*** models, the Administrator might receive compensation above costs, but the highest proportion of compensation is typically provided to subcontractors.[2] *This compensation above cost is never reported in program filings, although it exists in program expenditures. The net impact is that compensation above direct costs is much higher than what is reported.*

For ***Administration and Implementation*** models, there are few examples of cost-plus contracts similar to that of Efficiency Vermont. A very small percentage of costs have built-in margins in the Efficiency Vermont contract, and almost all compensation above cost is accounted for by the performance award and the operations fee. Unlike the predominant ***Administration Only*** model, the Efficiency Vermont model assigns 60% of total above-cost compensation to meeting performance goals, putting a greater amount at risk on that component, compared to 40% of compensation on operations. For more discussion on this point, see the section, **The Role of Risk and Value in Setting Compensation Rates,** below.

Comparing regulatory engagement

Another relevant characteristic for how an entity is compensated is the extent to which the entity is subject to regulation. There is a wide range of compensation strategies for utilities administering energy efficiency programs.[3] It is becoming increasingly common for public utility commissions to establish a performance period with clearly defined performance goals and financial bonuses (sometimes referred to as *incentives*). A common strategy for determining the performance bonus set-aside (the dollar compensation for each performance indicator) is to establish a percentage of total allowable expenditures in the program budget, as is the case in Vermont. Another strategy is a shared savings approach, in which payment is determined as a percentage of the verified net total resource benefits.

Some might suggest that comparing VEIC to regulated utilities is not appropriate because regulatory conditions differ by jurisdiction, and cannot be easily compared to conditions in Vermont. Some might also suggest that regulation accounts for variations in the allowable compensation rates. However, it is VEIC's experience that other utility efficiency programs'

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[2] Examples of companies providing subcontracting services in the ***Administration Only*** model are KEMA, GDS Associates, Honeywell, ICF, Leidos (formerly SAIC), Nexant, Conservation Services Group, CleaResult, APT, and Lockheed Martin.

[3] In addition to compensation strategies, regulators can reduce the negative impacts of energy efficiency on utilities' revenue through decoupling.

compensation allowances are generally not at greater risk than are those in Vermont. In some cases, the risks can be lower than those experienced in Vermont.

In most states that have aggressive efficiency programs, utility regulatory practice has evolved to a model much like that in place in Vermont. Cost disallowance is not a regulatory technique frequently employed in the oversight of other energy efficiency programs. Program costs are treated as annual expenses (often paid for through a separate utility charge). Actual program disallowances are very rare, since most jurisdictions recognize the chilling effect such disallowances can have on an efficiency program.[4] Instead, regulators seek to guide performance through a combination of removing disincentives (various forms of "decoupling") and imposing performance-related incentive structures.

In this context, we observe that Vermont's level of review of savings and the complexity of its performance metrics are at least on a par with, if not greater than, most of the state's surrounding jurisdictions. For instance, savings verification changes in many jurisdictions apply only to future reported savings claims, just as savings targets might be modified in the next performance period because of changed savings calculations in the verification phase of a current performance period. *This is not the case in Vermont, where savings verification changes apply retroactively to savings claims.*

Regulated supply side utilities often are required to administer efficiency programs at cost. Therefore the concept of an operations fee is not common in the industry. Where there are for-profit and nonprofit administrators, the existence of operating margins not at risk is hard to quantify because it is rarely disclosed. Other than VEIC's programs in Vermont, Ohio, and the District of Columbia, VEIC knows of no other entity whose operations fees are part of an above-cost compensation structure.[5] This observation is reinforced by the fact that VEIC's average labor rates are significantly lower than national averages for energy efficiency delivery. This indicates that operations fees are built into labor rates for most other for-profit and nonprofit organizations.

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[4] Significant and sustained investment in energy efficiency by utilities very clearly requires a broad and firm consensus on investment goals, strategy, investment levels, measurement, and cost recovery. It is this consensus that provides the necessary support for consistent application of cost recovery and incentives mechanisms. "Aligning Utility Incentives with Investment in Energy Efficiency" (EPA Study, 2007). http://www.epa.gov/cleanenergy/documents/suca/incentives.pdf.

[5] VEIC obtained data on two other methods for setting operations fees. One method reflects mutual agreement of fixed, non-incentive budgets that the implementer can draw upon throughout the course of the performance period. The invoices do not contain direct costs, but they draw down the budget at set intervals. The second method allows implementers to negotiate set fees for services. Those fees involve actual costs and a negotiated mark-up. In neither case is the operations fee transparent, and thus VEIC does not recommend either of them for adoption.

For comparison, VEIC has found it useful to compare the total percentage of compensation above cost (sum of the performance award and the operations fee) to the performance award percentage of budget for other entities that operate energy efficiency programs.

The Role of Margin in a Nonprofit

It is sometimes thought that a nonprofit organization does not need, does not require, or is not allowed a margin above expenses. There are several substantive reasons that none of these arguments pertains. With regard to the legal issue, the only restriction on the use of margin for a nonprofit is that it cannot be distributed to individuals, as they can be in a for-profit organization.

Nonprofits require margins above expenses for the following reasons:

- Cash reserves provide financial stability and healthy balance sheets
- Margins allow the accessibility to credit and borrowing capability
- Margins allow the mission to grow
- Margins mitigate risk of failure during economic downturns
- They enable the organization to remain competitive with other organizations

It is also said that because a nonprofit organization is mission-driven, it should not need financial awards to drive performance. This argument fails to note that it is a key organizational goal to maintain strong fiscal health in order to expand the mission. As VEIC takes on more risk to expand its mission of reducing the economic and environmental costs of energy use, the need for organizational financial stability grows, as well.

VEIC operates Efficiency Vermont as a part of its fulfillment of a public-benefit mission, and to keep its tax organization status as a nonprofit corporation serving low-income populations. The company treats above-cost earnings from delivering Efficiency Vermont services in a manner that is consistent with both VEIC's nonprofit status and its mission to reduce the economic and environmental costs of energy use.

A substantial portion of those above-cost earnings is in turn re-invested in activities that go to advance VEIC's broader mission. This re-investment is largely consistent with the State's overarching policy objectives on energy, economic development, and the environment.

VEIC has a 28-year history of building a project portfolio that spans the United States; clearly, it is dedicated to staying in Vermont, growing in Vermont, and creating good jobs and meaningful career opportunities in Vermont. This fundamental business structure benefits Vermonters and provides special benefits to Vermont—particularly in its ability to attract and keep local and external talent.

Comparable Compensation as a Percentage of Budget

To better understand compensation in the marketplace for the administration and implementation of energy efficiency programs, VEIC surveyed national data and commission orders to determine how compensation is structured. VEIC began by separating energy efficiency implementers into the five classes of entities shown in Table 1. To determine comparable compensation rates, VEIC examined only the entities that fell into categories 1, 2, or 3 from the following list:

1. Regulated investor-owned utilities (IOUs)
2. For-profit entities
3. Nonprofit entities
4. Municipals and cooperatives
5. Government or quasi-governmental agencies

Companies in categories 4 and 5 were excluded from comparison because of their inherently different business and economic models. Entities in categories 4 and 5 are all designed or chartered not to earn a margin; instead, they are incorporated by their members or by the general public to serve a social good. As shown in Table 1, these entities participate primarily in *Administration Only* models. Margins above cost occur in these models, but those margins do not accrue to the Administrators. Therefore, how those margins are calculated is likely to differ, and in any case, those calculations are not transparent to the public.

Vermont chose to create a different business model for Efficiency Vermont. It is a private model, rather than a public model, and thus different from categories 4 and 5. The state chose a private, nonprofit organization to administer and implement the energy efficiency program when it appointed the Efficiency Vermont franchise to VEIC. Thus, it would be unreasonable to compare VEIC's compensation rate to a public-purpose business model in categories 4 and 5. Further, that kind of comparison is even less applicable because Efficiency Vermont is an *Administration and Implementation* model, as opposed to an *Administration Only* model.

For the selected dataset, VEIC chose 36 energy efficiency program administrators meeting the criteria for categories 1, 2, and 3 in 15 states. VEIC compared compensation as a percentage of annual budget. These programs were further segmented into the relevant functions described above. Table 2 shows the results.

Table 2. Three types of energy efficiency program service entity for which margins are allowed, by type of business model

Entity	Administration Only	Administration and Implementation
Regulated investor-owned utilities	32 programs AZ, CA, CO, CT, MA, MI, MN, NC, NH, RI, TX,	
For-profit businesses		1 program HI
Nonprofit businesses		3 programs VT, DC, OH

Legend

(yellow)	Frequently
(green)	Less Frequent
(blue)	Rare

Across the sample, the compensation rate as a percentage of annual budget ranged from 2.6% to 29%, with a median of 7.6% for the sample. **Figure 1** shows these respective values.

Vermont Energy Investment Corporation

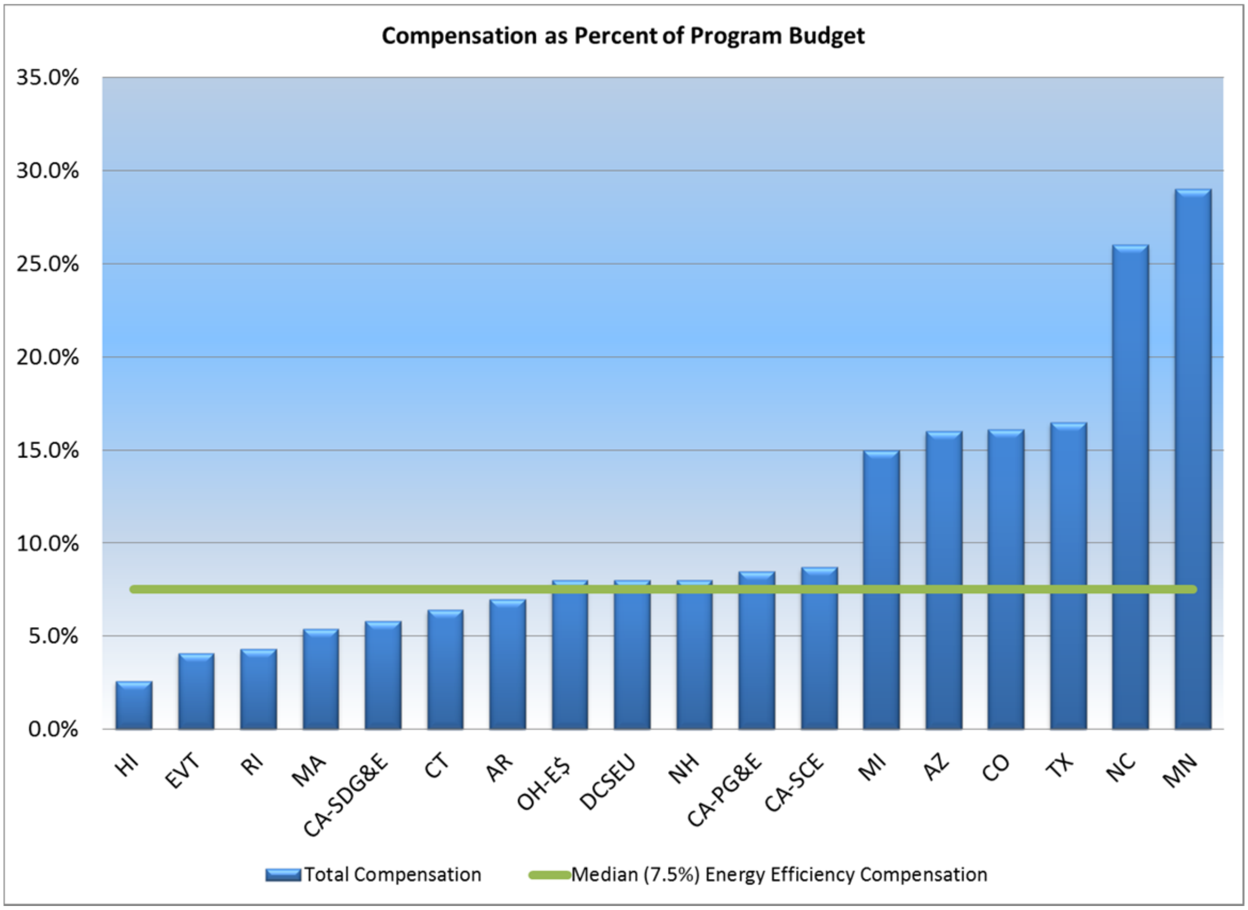

Figure 1. Comparison of energy efficiency service delivery jurisdictions and the compensation rates paid as a percentage of total program budget.

Program administrators in New England represented approximately 41% of the administrators in the selected group. For this group, the median percentage of budget for performance compensation is 5.4%.

Fair Market Compensation

For perspective, other regulated markets impose economic regulation to approximate the results obtainable in a competitive marketplace. VEIC's recommendation is that the compensation rate for Efficiency Vermont services be guided by the principle of equivalent compensation for equivalent work.

Thus, VEIC proposes that the Board use a "marketplace" standard, determined by the earnings of other companies that deliver services similar to those of Efficiency Vermont.

This “comparable earning” method is similar to economists’ concept of “opportunity costs,” and bases the compensation rate on what one might receive if one were under contract to deliver efficiency services elsewhere.

With the survey data of similar state program administrators providing similar services, it is possible to compare VEIC’s compensation for the administration and implementation services that it provides. The comparison helps to inform whether the VEIC compensation is in the “zone of reasonableness” of the sample companies’ earnings, adjusted for quality of service.

Clearly VEIC’s current, above-cost compensation rate of 4.1% is below the median of the group meeting the inclusion criteria for this comparison. It is also the lowest rate for all of New England, and 24% below the average compensation rate for New England program administrators.

Because the compensation rate for VEIC represents essentially all compensation above costs, a true comparison of compensation above costs with regional administrators would increase the gap between VEIC and those neighboring programs. Indeed, when compensation above cost is considered, compensation for VEIC is one of the lowest in the country for similar services.

VEIC Recommendation for 2015-2017 Compensation Rate

There are several unknowns that VEIC considered in the recommendation for compensation rate as a percentage of budget.

The first unknown is the budget scenario that will be selected for the 2015-2017 period. The three budget scenarios vary in magnitude from $153 million to $210 million. VEIC proposes a specific compensation rate recommendation for each budget scenario to account for the variance in budget, by scenario.

A second unknown is the final adjustment to the Quantitative Performance Indicators (QPIs) that the performance portion of the compensation addresses. In the coming Performance Period, there will be two new QPIs, Winter Peak kW and Monthly Peak kW. VEIC expects the financial weighting of the QPIs will be modified for the 2015-2017 Performance Period, but the magnitude and extent of adjustment are not yet known. This has made it difficult to recommend one compensation calculation over another. The VEIC recommendation for compensation is contingent on the assumption that the structure for QPIs will not vary substantially from the following:

- The process of setting *100% Targets* is based on 110% of the outputs or *Expected Savings* from the Portfolio Screening Tool

- The scaling (up to *100% Targets* and over *100% Targets*) of the current QPIs will not change from the current design; this involves:
    - the percentage threshold at which VEIC begins to earn a performance award
    - the scaling rates of the earned award
- The *Super-Stretch Targets* are based on 105% of the *100% Targets*
- The amount of the *Super-Stretch* set-aside is no more than 17% of the total performance award
- There will be no financial caps assigned to MWh, Total Resource Benefits, Summer Peak kW, or Winter Peak kW
- The individual thresholds and financial penalty percentages for each Minimum Performance Requirement (MPR) will be unchanged from current practice

The growing number of QPIs and the difficulty in achieving the minimum threshold for each QPI pose new risks for VEIC. VEIC finds it challenging to fully assess the risk it will face without fully knowing what the new QPI structure will look like. This uncertainty makes the process of requesting a fair compensation rate difficult for VEIC. VEIC will need to re-examine any risks associated with changes to the compensation structure, after the Board orders compensation rates.

VEIC therefore respectfully requests that it be allowed the opportunity to discuss with the Board any changes to those risks, and that VEIC be permitted to request that the Board reconsider the compensation rates, once the QPIs are set.

In addition to these primary unknowns, VEIC also has assessed the growing risks (see the section, **The Role of Risk and Value in Setting Compensation Rates,** below) associated with program performance. Currently, the compensation rate requires VEIC to place 60% of the compensation at risk. As discussed above, virtually no other private entity that provides services, with margin above cost, encounters this high a level of risk in the energy efficiency service delivery industry.

Therefore, VEIC recommends that compensation be distributed 50% - 50% between the performance award component and the operations fee component.

With these understandings, *VEIC proposes the following compensation rates for the 2015-2017 period:*

Scenario 1 Budget: Compensation rate = 6% of program budget
Scenario 2 Budget: Compensation rate = 6% of program budget
Scenario 3 Budget: Compensation rate = 5% of program budget

The rates recommended by VEIC still fall below the median of the 36 programs nationwide that were surveyed by VEIC. The rates are, however, very similar to the median rate for compensation in New England. It is also important to note that the proposed rates are conservative: they represent essentially all margin above cost, and thus do not contain any hidden margins in other expenditures.

The Role of Risk and Value in Setting Compensation Rates

In addition to setting compensation rates based on fair market value, it is also important to understand changing market conditions that impose risk. That risk too must be considered in the context of the cumulative value, *beyond economic value only,* that VEIC delivers for the EEU.

VEIC encounters risk in carrying out program administration and implementation. Compensation is used to recognize the level of risk that is not being compensated as part of expenses. It provides a business case for VEIC to take risk for the overall benefit, even when it might jeopardize the specific performance goals. VEIC is faced with three types of risk in operating Efficiency Vermont:

- General business risk
- Risk associated with efficiency programs
- Regulatory risks

General Business Risk

General business risk refers to business risks that are normally beyond the organization's control, but which can be mitigated through compensation and certain business decisions to hedge against these risks. These general business risks are:

a. *Ability to process payment*
    i. Description: VEIC is responsible for processing millions of dollars of payments for expenditures associated with operating Efficiency Vermont, including the costs of participating in the ISO New England Forward Capacity Market. Often, VEIC must borrow funds, prior to receiving its reimbursements from the State, to cover Efficiency Vermont expenditures. VEIC's ability to borrow is predicated on its cash position. If the cash position is not sufficient, the business model for processing payments will begin to fail.
    ii. Risk mitigation: VEIC maintains a sufficient cash balance to maintain a line of credit up to $6.9 million. For today's cash flow requirements, this cash balance and line of credit are sufficient to service Efficiency Vermont's fiscal obligations. It is the compensation to VEIC that provides the cash that enables healthy cash flow and good lines of credit.

iii. **Trends:** In the future, the potential for larger budgets and greater cash flow will require VEIC to maintain larger cash balances and larger lines of credit than have been needed historically. The only source of cash on hand to support the Efficiency Vermont line of credit is VEIC's compensation above expenditures. Without additional compensation, VEIC's ability to maintain adequate lines of credit will be put at risk.

b. Unanticipated fluctuations in the economy and energy prices

i. **Description:** Exaggerated downturns or upswings in the market that stretch the organization's ability to perform as desired. Downturns can stifle market activity, such as slowdowns in residential new construction or business investment in efficiency. Downturns can also suppress compensation, because fewer expenses are processed. Cash reserves are needed to manage through downturns. Alternatively, upswings in market activity can increase consumer spending and deplete cash reserves by requiring greater payouts.

ii. **Risk mitigation:** VEIC's ability to flex between market swings so that it can maintain good performance is mitigated by (1) the ability to use cash reserves during downturns and (2) access to capital to cover upswings in expenditures.

iii. **Recent trend:** Continued volatility in markets, driven by an increasingly interconnected global economy and continued weakness in the post-2008 crash economy in the United States.

c. Loss of staff to competition for higher pay

i. **Description:** Growth in the energy efficiency industry nationally creates competition for experienced staff. The salary differentials between Vermont and other states mean that VEIC must maintain competitive labor rates to recruit and keep high performers. So it must pay at a level commensurate with industry, but adjusted for the Vermont market.

ii. **Risk mitigation:** VEIC mitigates the risk of loss of staff by using a portion of its compensation to offer a performance bonus for staff. This bonus structure is designed to improve retention rates and to maintain a corporate culture of high performance. It is noteworthy that strategies for keeping employees have contributed to VEIC's achieving *Vermont Business Magazine's* "Best Places to Work in Vermont" awards on multiple occasions.

iii. **Recent trends:** The potential for scaling up program impacts in a manner consistent with meeting the State's energy goals and adhering to its policies will increase the need for more qualified staff and greater staff retention in the future.

Efficiency Program Risks

a. ***Initiatives and market innovations*** *(these reflect both risks that VEIC experiences, and value that VEIC provides).*
   i. **Description:** Throughout its history in the administration of Efficiency Vermont, VEIC has expanded its breadth and depth, sometimes on its own initiative and sometimes at the request of the State. Some efforts that fit this expansion are Geographic Targeting, supporting Recovery Act-funded projects, bidding demand resources into the Forward Capacity Market, supporting all-fuels initiatives, and collaborating with State agencies for Irene Relief. Each time there has been an opportunity for expansion of scope, existing performance goals are put at risk as the organization adapts to undertaking new responsibilities and meeting all project and performance objectives. VEIC has been successful in these expansion efforts, but these successes have been achieved only because VEIC has been willing to take on significant risk and managing to it. The ability and flexibility of VEIC to take on this risk has brought tremendous value to Vermont.
   ii. **Risk mitigation:** VEIC management has intentionally decided to put compensation at risk so that it can direct staff to innovate and expand the scope of Efficiency Vermont activity to benefit ratepayers. This strategy is relatively new, and avoids a more conservative approach to focus solely on achieving performance targets.
   iii. **Trends:** The recent and evolving nature of energy efficiency and Vermont's policies toward energy for the future will continue to require continuing innovation of the EEU. Meeting the State's policy goal of obtaining 90% of its energy from renewable sources by 2050 will require significant innovation on the part of VEIC to ensure that the "denominator"—energy used—in that equation is as small as possible. VEIC will continue to embrace the need for innovation and the associated risk.

b. ***Accommodating evolving complexity***
   i. **Description:** As VEIC better understands how to serve a larger portion of all markets, the complexity required to serve customers increases. Simple rebate processing has been or will be replaced by custom market approaches; a sole focus on electrical efficiency is expanded to all fuels efficiency; technical assistance and account management enables more customers to obtain deeper efficiency savings. The complexity adds to cost, and sometimes greater investment is needed before efficiency savings can be realized.

ii. **Risk mitigation:** Similar to innovation, VEIC management intentionally promotes complex and comprehensive treatment when it is needed, even at the risk of losing compensation. It is VEIC's position that embracing the complexity helps to build market transformation and realize positive, long-term impacts.

iii. **Trends:** Better use of data and business intelligence will help create specialized targeted marketing that can reduce some complexity and reduce costs, particularly in residential and small business markets. However, other trends indicate that deeper, more strategic involvement with large customers will continue to pave the way for deeper, ongoing efficiency savings. An example of this involvement is Efficiency Vermont's Continuous Energy Improvement (CEI) efforts.

Regulatory Risks

a. *Annual savings verification*

i. **Description:** Each year, the State EM&V contractor conducts saving verification against claimed savings submitted by VEIC. Realization rates that typically reduce the savings claim—and thus put the achievement of QPIs and other indicators at risk—are adopted for the entire portfolio of initiatives. Although the rigor and accuracy are needed for reliable savings, there is always a risk that custom baselines or measure characterizations might be challenged unexpectedly through saving verification, resulting in disallowed costs and penalties to VEIC for having followed classical reporting methods. Consequently, this can lower VEIC's ability to meet various performance targets.

ii. **Risk mitigation:** Keeping up the practice of over-achieving on targets, so that VEIC can manage disallowed savings.

iii. **Trend:** Continuing intensity of regulatory review and increased effort to comply with demands such as FCM requirements.

b. *Regulatory requirements can place certain barriers for customer engagement*

i. **Description:** Although VEIC supports the transparency of the energy efficiency charge on ratepayer utility bills, it also creates a negative effect for Efficiency Vermont staff who work directly with customers. This must be overcome if customer engagement is to be improved. Similarly, helping customers overcome barriers related to increasing EM&V metering required for Forward Capacity Market compliance can also add risk to customer engagement.

ii. **Risk mitigation:** VEIC must take extra time and make an effort to overcome unexpected barriers that might be present among customers who perceive that regulatory intervention has created a disadvantage in obtaining efficiency services.

iii. **Trends:** VEIC expects that regulators' requests for customer information will increase with the evolution of energy efficiency and new technologies. Although some information such as AMI might be easier to obtain in the future, VEIC will need to mitigate customer perceptions of unnecessary intrusion in order to keep customers engaged in efficiency.

c. Changes with key customers

i. **Description:** Treatment of large customers continues to change as a result of regulation and legislation. Today, Customer Credit and Energy Savings Accounts provide greater flexibility for customer participation, but they might require more administration and overhead for VEIC. The Legislature periodically considers new, large-customer opt-out programs that, if enacted into law, would add a new risk to overall budget levels.

ii. **Risk mitigation:** Although VEIC can provide input to proposed regulation and legislative changes, risks induced by these changes are beyond VEIC's control.

iii. **Trends:** The trends suggest that customers will want more self-directed and customized approaches to energy efficiency, to which VEIC will need to be responsive. To the extent that these approaches will reduce the ability to claim savings for performance, they will increase risk for compensation.

d. Launching innovations while regulatory approval is unknown

i. **Description:** There are many facets of initiative and measure development that require regulatory review. The review cycle can increase the time it takes to launch. In some cases, the review cycle can increase the costs to implement the measure. Both of these factors can put performance at risk. This in turn increases the risk of not meeting performance goals and obtaining the performance award. In other cases, it is simply not feasible to complete all of the review elements prior to launching an initiative. Further, regulators always reserve the right to re-introduce reviews and change findings, after initiatives have been launched and savings have been claimed.

ii. **Risk mitigation:** VEIC and regulators have undertaken a continuous improvement process to improve efficiencies of reviewing initiatives and measures so that development time can be optimized. Ongoing efforts through the Technical Advisory Group (TAG) and annual savings verification process continue to reduce the impact of reactive regulatory decisions, and of VEIC's taking action on behalf of Efficiency Vermont, with unknown regulatory approval.

iii. **Trends:** Innovation in efficiency services will require certain levels of future regulatory uncertainty, and where there is regulatory uncertainty, compensation will be put at risk.

e. Risks associated with bidding into the Forward Capacity Market

i. **Description:** VEIC is a NEPOOL Market Participant that bids demand resources from Efficiency Vermont activity into ISO New England's (ISO-NE's) Forward Capacity Market (FCM). Bidding these resources brings great benefits to Vermont. However, it also requires a savings verification standard that is reviewed and approved by ISO-NE. This standard differs from the standard required for Efficiency Vermont's performance targets. Similar to other types of innovations, requirements for FCM participation can introduce risk to overall Efficiency Vermont performance by adding complexity in customer engagement and EM&V requirements. FCM participation also involves financial risk in the form of potential penalties (see VEIC's Order of Appointment, Section 2. 11 D.)

ii. **Risk mitigation:** VEIC management has supported FCM participation even in light of the potential financial risks and performance risks. Accurate bidding forecasts continue to mitigate financial risks.

iii. **Trends:** EM&V requirements continue to become more stringent. These add to the costs of participation, and add complexity and potential barriers for customer engagement. As the FCM evolves and rules change, the ability of VEIC to manage the portfolio that has been bid into the market and to predict revenues and / or penalties will become less certain.

f. Evolution of electric technologies and roles of the EEU and distribution utilities

i. **Description:** New technologies such as AMI and efficient electric heat pump and transportation technologies create challenges and risks for coordination between the state's electricity utilities and the EEUs. With the emergence of new technologies that cross between efficiency and electric utility service, there is a need for guidance by regulators as to how electric utilities and the EEU will coordinate and define areas of responsibility. This must be done without confusing the customers and the marketplace. The emergence of these technologies will create tension between the EEU and distribution utilities, if coordination is not present.

ii. **Risk mitigation:** Active participation in legislative and judicial proceedings to facilitate the defining of appropriate roles and responsibilities for EEUs and distribution utilities takes time. It also introduces business risks as new, cost-effective technologies emerge.

iii. **Trends:** It is likely that the introduction of new electric technologies and opportunities for utility coordination will increase in the future. If so, they will accentuate the need for coordination between EEU and distribution utilities for adequate (if not enhanced) customer service and proper marketplace signals.

g. Changes in regulatory and / or legislative priorities

i. **Description:** There is always a risk that Efficiency Vermont budgets and performance goals can be adjusted or re-focused by changing regulatory and /or legislative priorities. Like new initiatives, these changes create a need to re-focus and transition to new priorities. These could mean a loss in performance, and perhaps in compensation.

ii. **Risk mitigation:** To the extent possible, VEIC is engaged with regulators and the Legislature to monitor and provide input into energy efficiency planning. Through participation, VEIC can mitigate potential adverse effects.

iii. **Trends:** Major shifts in direction can periodically occur during the term of appointment.

Value Provided by VEIC

Generally, service value is an implicit component that regulators consider when ruling on compensation. However, value is a powerful consideration in the private marketplace, particularly when long-term value is consistently strived for and delivered. In a sense, value is what separates a business entity from the competition in the mind of the consumer. In making the decision for the Order of Appointment, the Board considered the extent to which VEIC had demonstrated customer and regulatory value over a long sequence of performance periods prior to the appointment. Today that value proposition still exists and continues to grow.

VEIC has consistently built and enhanced the Efficiency Vermont brand throughout the state. Markets have been successfully transformed to higher levels of efficiency, and consumers have been engaged in higher levels of savings activity. Each has come to rely on Efficiency Vermont as a valued partner in the transformation to a more efficient economy. VEIC has been a resource in Vermont's business development efforts to attract new business. In fact, VEIC has responded to many state initiatives with innovation and leadership—sometimes while putting performance compensation at risk.

Just as VEIC has continued to bring new value to its operation of Efficiency Vermont in the past, it is committed to doing so in the future. It is difficult to predict all of the ways in which new value might be added in the next Performance Period. However, some of the new challenges and complexities that VEIC expects to tackle have already been described elsewhere in this document:

- Higher level of collaboration with distribution utilities and regulators to address cross-cutting and overlapping areas of development, such as electro-technologies
- Increasing emphasis on the conservation aspect of Efficiency Vermont's mandate to address both conservation and efficiency
- Managing the complexity of rapidly changing codes, standards, and baselines in a fashion that does not disrupt customer perception of benefits being received
- Continuing to innovate within a program that has reached maturity and increasingly needs to find deeper savings opportunities that might be more challenging to acquire
- Actively supporting overall State energy policy goals that simultaneously drive toward high levels of energy savings and substantially increased electricity use
- Providing financing expertise in response to the reality that meeting state energy goals (and Efficiency Vermont goals) will increasingly require effective mobilization of increasing amounts of private capital

VEIC has helped to position Efficiency Vermont as a national leader in efficiency. Other states, regulators, and utilities look to Vermont to help set industry standards and learn about new directions for their own jurisdictions. In the majority of cases, we share information at no cost to those parties.

VEIC has continued to improve administrative efficiency by keeping costs low through reasonable wages, high spans of control, and the use of shared services throughout VEIC's enterprises. VEIC has continued to grow and diversify from 2010, when Efficiency Vermont represented 85% of VEIC revenues. Today, Efficiency Vermont represents 65% of VEIC revenues. This diversification helps to keep costs lower, while leveraging knowledge and skills that benefit the delivery of Efficiency Vermont services.

Conclusion

The appointment of VEIC to the franchise for the EEU came with the proviso that VEIC must be able to recover reasonable costs and to earn a fair return. *VEIC recommends that the Board reset the compensation rate for the 2015-2017 period to reflect fair market value for similar services.*

VEIC recognizes the difficulty in comparing all of the different types of entities that administer and implement energy efficiency programs. In the end, the State and the Board chose a model in which a private entity, entitled to a fair return, administers and implements services for the EEU.

In light of the higher compensation rates that occur nationally and within New England, as well as the increasing risks and the cumulative value provided by VEIC for the Efficiency Vermont brand, VEIC recommends an increase in the compensation rate for the 2015-2017 period, as described in the Summary. *VEIC also recommends that the compensation be distributed equally between the operations fee and the performance award.*