The Public Utility Commission of Texas (commission) adopts new §25.181 relating to Energy Efficiency Goal with changes to the proposed text as published in the November 12, 1999 *Texas Register* (24 TexReg 9919). The rule is adopted to implement Senate Bill 7 (SB 7), Act of May 21, 1999, 76th Legislature, Regular Session, chapter 405, 1999, Texas Session Law Service 2543 (Vernon) which amends several sections of the Public Utility Regulatory Act (PURA). PURA §39.905 requires each electric utility to reduce Texas customers' energy consumption by a minimum of 10% of the utility's annual growth in demand in Texas by January 1, 2004. To achieve this goal, utilities must provide incentives through standard offer programs or limited targeted market transformation programs. The incentives are to be paid to energy services companies or retail electric providers for the implementation of the energy efficiency programs.

In adopting this rule, the commission seeks to achieve the installation of long-lasting energy efficiency measures that will result in reduced energy consumption and lower energy bills of Texas customers across all customer classes. To ensure that the energy savings goals are reached, the commission will implement interim goals at levels below the 10% goal that are to be reached by January 1, 2004. Each utility shall include in its April 1, 2000 rate-filing package for transmission and distribution (T&D) rates, funds for achieving the energy efficiency goal in this rule. On January 1, 2002, when the commission-approved T&D rates go into effect, the standard offer and market transformation programs shall be implemented. During the transition period from

January 1, 2000 to December 31, 2001, electric utilities will implement energy efficiency programs that spend all of the demand side management (DSM) funds previously approved in rates.

Utilities shall carry out the energy efficiency programs by providing incentive payments to participating energy efficiency service providers (EESPs), who will market such services to customers. To promote a competitive market, all programs shall offer the same, or standard, incentive payment for each Kilowatt (kW) and Kilowatt-hour (kWh) saved; however, the amount of incentive payment may vary according to customer class in order to effectively reach all customer classes. Inspections, measurement and verification (M&V) procedures, and an initial independent measurement and verification expert (independent M&V expert) review shall be conducted to ensure that the electric utilities' projected savings are achieved, and that the funding expended on achieving such savings is cost-effective. Only energy savings that result from these programs shall be counted toward the 10% goal prescribed by the rule. The commission is also adopting customer protection standards for the energy efficiency programs conducted under the rule.

The commission initiated the rulemaking proceeding on August 19, 1999 under Project Number 21074, *Energy Efficiency Programs.* The commission hosted nine workshops to elicit input from stakeholders on various aspects of the rulemaking. In addition, parties held informal meetings to resolve the issues. In September, the parties chose the Office of Public Utility Counsel, Texas Ratepayers Organization to Save Energy, Frontier

Associates, and the commission staff for the rule writing team. The proposed rule was therefore the result of a collaborative effort by all interested parties. At the Open Meeting on October 21, 1999, the commission voted to publish a proposed rule for comments in the *Texas Register*.

On January 10, 2000, commission staff held a public hearing pursuant to §2000.029 of the Administrative Procedures Act (APA). Thirty-four parties attended the public hearing, of which ten provided comments that either addressed provisions set forth in the proposed sections, replied to written comments, or both. Parties represented at the public hearing were the American Council for an Energy Efficient Economy (ACEEE), Austin Energy, Cities within the TXU Electric and Central Power and Light Company service areas (Cities), Clark, Thomas, & Winters APC, Community Action Council of South Texas (CACST), East Texas Cooperatives, El Paso Electric, Greater East Texas Community Action Program (GETCAP), Johnson Controls, Inc., Oak Ridge National Laboratory (ORNL), Public Citizen Texas Office (Public Citizen), Quantum Consulting, New Braunfels Utilities, Office of the Attorney General of Texas (OAG), Office of Public Utility Counsel (OPC), Public Citizen, Public Utilities Board of Brownsville (PUB), RFI Consulting, Shell Energy Services Company, L.L.C. (Shell), Texas Air Conditioner Contractors Association, Texas Industrial Energy Customers (TIEC), Department of Housing and Community Affairs (TDHCA), Texas Ratepayers Organization to Save Energy (Texas ROSE), Vera Consulting, Worsham, Forsythe & Wooldridge, and a coalition of parties consisting of Central and Southwest Corporation (CSW), Entergy Gulf States, Inc. (EGSI), Environmental Defense Fund (EDF), Frontier

Associates, National Association of Energy Service Companies (NAESCO), Reliant Energy (Reliant), Schiller and Associates (Schiller), Southwestern Public Service Company (SPS), Texas Energy Service Companies (TESCO), and Texas Utilities Electric (TXU). To the extent that these comments differ from the submitted written comments, such comments are summarized herein.

Written comments were filed on December 2 and December 13, 1999, and January 13 and January 18, 2000. ACEEE, Cardinal IG (Cardinal), Cities, Customers Union Southwest Regional Office (Customers Union), CSW, EDF, EGSI, Enron, El Paso Electric Company (EPE), Enron, Frontier Associates L.L.C. (Frontier), NAESCO, Nucor Steel (Nucor), OAG, OPC, Planergy, PUB, Reliant, Schiller, Shell, SPS, Texas A&M University System Energy Systems Laboratory (ESL), TDHCA, TESCO, TIEC, Texas Legal Services Center (TLSC), Texas ROSE, Texas-New Mexico Power Company (TNMP), TXU, UCONS-Texas and L.L.C. (UCONS) filed written comments and reply comments. Unless indicated otherwise in the summary, OPC and Cities filed joint comments and are referred to as OPC/Cities. ACEEE, Customers Union, Public Citizen, TLSC and Texas ROSE also filed joint comments and are referred to as Joint Public Interest Groups (Joint Public Interest Groups).

In addition to regularly filed comments, OPC also filed a report prepared by J. Kennedy & Associates, Inc. entitled *DSM Programs in a Competitive Market.* Parties were given the opportunity to provide comments on this report outside the regularly scheduled comment period.

At the public hearing on January 10, 2000, a coalition of parties consisting of CSW, EGSI, EDF, Frontier, NAESCO, Reliant, Schiller, SPS, TESCO and TXU (Coalition) presented a coalition agreement regarding the energy efficiency rule. All parties within the coalition had already filed comments of a similar nature during the comment period. Due to the nature and extent of the Coalition agreement, the commission allowed parties outside the Coalition to respond. The majority of the respondents expressed dismay over the fact that the Coalition operated outside the process, did not include representatives of customers and non-affiliate, competitive retail electric providers in the discussions, and that the agreement violated many of the compromises reached during the consensus building process.

Comments on specific questions in the preamble of the proposed rule

In the preamble, the commission requested that interested parties address ten issues related to the implementation and final development of the proposed rule. The parties' responses to the issues are summarized below.

Issue Number 1: What should be the cap on the utility's administrative and measurement and verification costs?

Most utility respondents advocated no cap or a flexible cap. EGSI, Reliant, SPS, TNMP, and TXU stated that the rule should not impose a cap on a utility's administrative and

M&V costs. These parties reasoned that these costs would depend on the utility's level of involvement, would vary significantly by program type, and would change with the maturity of the program. EGSI stated that any cap that is set on a general basis at this time would simply be arbitrary and could adversely impact both the utility and the customer. SPS and TXU recommended that the rule not include a firm cap on administrative and M&V costs, because at this early planning stage of a new, innovative program, it is difficult, if not impossible, to identify with any certainty the level of expenditures that will be necessary to meet the goal and comply with the rule. SPS and TXU further stated that rather than arbitrarily determining a firm cap before utilities have been able to evaluate the provisions adopted by the commission relating to administration and M&V, they proposed these costs should be required to be "reasonable". SPS and TXU proposed that those costs be justified in the utilities' April 2000 rate filing. According to SPS and TXU such flexibility is necessary and prudent to allow utilities to attain the energy efficiency goal in the most cost-effective manner. Reliant stated that the application of the cost-effectiveness test using utility-estimated administration and M&V costs would result in the appropriate overall program cost.

CSW, Shell, PUB, TESCO, NAESCO, Cardinal, ESL, OPC, and Joint Public Interest Groups indicated that there should be a cap. Shell, PUB, ESL, and Cardinal were unable to specify a level for the cap. Both Cardinal and Shell, however, were concerned that without a cap, the regulated utility would not have any incentive to hold down the cost, and escalating administrative and M&V costs will impede the competitive market. PUB stated that the cap should be flexible enough to allow the utility to recoup its costs plus a reasonable rate of return. ESL stated that the cost should be equivalent to what the utilities currently spend on metering the energy they sell to the customer. CSW proposed that the cap on the utility's administrative and M&V costs (exclusive of the costs of the statewide M&V auditor (independent M&V expert)) be 20% of total program costs initially. CSW further proposed that as the utility gains experience with the new programs, the cap might be adjusted as appropriate. TESCO proposed a 10% cap for mature programs but acknowledged that a higher percentage may be necessary during the years leading up to January 1, 2004 when the utilities are building their programs. NAESCO proposed that these costs should not exceed 5.0% of total program costs. OPC/Cities proposed a cap of 10-15%. Joint Public Interest Groups, based on the expenditure levels in New York, California, and the Northeast, and the reduction in utility's historical role in administering energy efficiency programs, stated that the cap should be 10%, with only 1.0% to 2.0% of that amount to be spent on the independent auditor (independent M&V expert). In reply comments, NAESCO raised its recommendation for the cap from 5.0% in its original response to 10%.

The Coalition stated that the rule should not include a cap on administrative costs. The Coalition believed that appropriate administrative budgets might differ among utilities due to the mix of programs offered by utilities, the maturity of their programs, the scale of their programs, and the characteristics of their service areas. The Coalition proposed that the administrative cost budgets should be included in the utility's energy efficiency plans and should be reviewed by the commission in connection with the review of the plans. The Coalition also proposed that the utilities be allowed to submit revisions to their administrative and M&V budgets. OPC, Cities, TIEC, Shell, and Enron filed joint reply comments (Joint Reply). Both Joint Public Interest Groups and the Joint Reply opposed the Coalition proposal. The Joint Reply stated that the proposal is completely at odds with the consensus agreement reached by the original parties, including members of the Coalition, during the energy efficiency workshops to support the caps. The Joint Reply also stated that OPC, Cities, and TIEC would not have accepted the cost-effectiveness methodology in the proposed rule if it were not for the inclusion of incentive caps.

The commission believes that there should be a cap on administration and M&V costs. Without a cap, utilities will have little incentive to control the costs of administration and M&V. Although the program as a whole, including the costs of administration and M&V, must be cost-effective, more funds spent on administration and M&V means less funds available for actual energy efficiency measures. This will discourage long-term, comprehensive projects. Without a cap, if the costs of administration, inspections and M&V fluctuate among utilities and over time it will raise the cost of the program. These energy efficiency costs are included in the T&D rates. Therefore, the commission concludes that higher energy efficiency costs will result in higher T&D rates and impair competition.

The caps proposed by some of the parties range from 10% to 20%. The commission finds that the utility's role under this rule is narrower than its historical role in administering DSM programs. The utility's role in M&V is limited to on-site inspections.

M&V will be conducted by the EESP, and shall be funded through the incentive payment. The EESP will therefore have an incentive to keep down the cost of M&V. The cost of the independent M&V expert is included in the utility's administrative cost. The commission finds that there are a number of both publicly and privately funded programs with similar administrative and M&V requirements on which to base a reasonable allowable cost level for administrative and M&V activities. The commission acknowledges, however, that there is a need for flexibility, as the costs for administration may vary by program type, and may be higher during the early years of program implementation. Therefore, the commission will set the administrative costs as a percentage of total program cost. The cap applies to all contracts in the aggregate, not to individual contracts. The commission seeks to reduce the need for regulatory oversight in reviewing individual program budgets and expenditures, and will, therefore, not request utilities to justify administrative budgets and expenditures at or below the applicable cap. The commission concludes that a cap of 10% until December 31, 2003 and 5.0% thereafter, minimizes administrative costs, while allowing some utility flexibility. The commission has revised §25.181(k) and (l) accordingly.

Issue Number 2: Energy efficiency programs will be funded through a charge in the T&D rates that will be adopted following the utilities' April, 2000 rate filing. Should the commission adopt a mechanism for timely cost recovery if the utility can demonstrate that it needs to spend more than what is approved in the rate order to meet the goal? Should utilities be allowed to rollover unspent funds from one year into the following program year? If so, under what circumstances?

EGSI, Reliant, TXU, SPS, PUB, and NAESCO favored a mechanism such as a timely cost recovery factor (TCRF) once a utility has demonstrated that, to meet the goal, it will need to spend more than what is approved in the rate order. CSW did not favor a TCRF, and instead proposed limited rate cases to true up energy efficiency program costs. Shell opposed a TCRF and any costs that may reduce the differential between the price-to-beat and the T&D rates, referred to as the headroom, and therefore stifle competition. OPC/Cities and TIEC opposed a TCRF because it would amount to piecemeal ratemaking, and it would take away any incentive to control costs. OPC/Cities and TIEC argued that utilities will have the opportunity to include energy efficiency expenditures in their rates at the time of the rate filing. Joint Public Interest Groups saw no justification for cost recovery beyond the standard rate-filing package. TNMP stated that a TCRF would not be needed if utilities were allowed to set energy efficiency funding at 100% of avoided costs for budgetary purposes. If 100% of avoided costs either failed to achieve or exceeded the energy efficiency goal, TNMP proposed to reexamine the standards. EDF did not favor automatic cost adjustment but instead proposed a system of rewards and penalties for performance.

In reply comments, EGSI rejected EDF's performance-based compensation proposal, arguing that utilities cannot be made responsible for the performance of the EESPs they hire to install the measures. EGSI also rejected TIEC and OPC/Cities' argument that the utilities will have an opportunity to include their costs in their T&D rates at the time of the rate filing, arguing that the rate filing will occur early on and the utilities won't be able to accurately project the energy efficiency program costs. EGSI suggested that a power cost recovery factor (PCRF) is the only way for EGSI to fund energy efficiency programs during the transition period since they do not have DSM expenditures included in their current rates. Shell agreed with OPC/Cities and TIEC and rejected the argument that the utilities won't know their cost at the time of the T&D rate filing, arguing that utilities have experience administering DSM programs that resulted from the integrated resource planning (IRP) process. OPC/Cities and TIEC added that allowing a flow-through of costs would serve to enrich the utilities in the absence of a complete review of utility costs and revenues, because the regulatory lag has historically allowed the utilities to retain excess earnings. OPC reiterated its objections and added that utilities have historically been able to utilize mechanisms to deal with the over- or under-recovery of funds from year to year.

The Coalition proposed to create a second set of books for DSM programs for the purpose of a periodic cost reconciliation and rate adjustment. The Coalition pointed out that PURA §36.204(1) allows for timely cost recovery, and that a number of other utility costs, like energy efficiency costs, will change on an annual basis and require rate adjustment. With a rate adjustment mechanism, the Coalition asserts, utility budgets could start out low as long as there is flexibility for adjustment if the energy efficiency goal is not met. This would avoid having to set rates too high initially, or having to undertake major rate cases later. The Coalition suggested an expedited approval process for such rate adjustment, and suggested using the Colorado Commission's procedure as a model, but did not explain what that procedure involves. In their joint response to the

Coalition, OPC/Cities, TIEC, Shell, and Enron stated that there is nothing in the legislative history of SB 7 that supports the premise that energy efficiency qualifies for such extraordinary treatment. They reiterated that the proposal results in further stifling competition – exactly the antithesis of SB 7's goal of robust competitive opportunities for all customer classes. They stated that the Colorado method, whatever it is, has no support in the record of this proceeding. Joint Public Interest Groups also disagreed with the Coalition, saying that the funds necessary to meet the energy efficiency goal will be included in the rate-filing package and reviewed on a case-by-case basis. As far as the transition period, they added that most utilities already have an allowance in their rates for demand-side programs that may be sufficient for meeting the energy efficiency goal. If additional funding is required, they contended it is the responsibility of the utility to make the funds available within its current rates.

EGSI, TXU, SPS, CSW, TEESP, and NAESCO favored the rollover of unspent funds collected in one year into the following program years if needed to implement and administer contracts. Joint Public Interest Groups agreed but argued that the rollover would require full justification. CSW and Shell stated that if a utility's spending exceeds its budget in any one year, unspent funds from another year should be used to compensate. Reliant and TNMP noted that there are a number of possible reasons for funds not having been spent and suggested that the issue should be reviewed on a utility by utility basis. OPC/Cities opposed the rollover of unspent funds that can be credited back to customers.

The commission finds that neither a timely cost recovery mechanism nor recurring limited rate cases to reconcile the costs of energy efficiency programs are warranted at this time. The commission is concerned that such mechanisms would let T&D rates creep up, thereby reducing the differential between the price-to-beat and the T&D rates. Reducing this differential would impair competition to serve residential and small commercial customers and provide less certainty to the market during the initial years of competition. A mechanism that guarantees the utility cost recovery for increases in energy-efficiency costs would also eliminate any incentive for utilities to control their costs. The commission is also cognizant of the "piecemeal rate-making" arguments advanced by the commenters that opposed these mechanisms. If energy efficiency program costs increase, these mechanisms could lead to inflated rates for T&D service.

The rule that the commission is adopting will give T&D utilities considerable certainty with respect to the budget for energy efficiency programs. The rule includes caps on the incentive payments for various groups of customers and caps on administrative and independent M&V expert costs. These caps should permit the utility to develop its energy efficiency budgets with considerable certainty, using the projected growth in demand and the caps for incentive payments, administrative costs, and independent M&V expert costs. During the workshops, the utilities demonstrated that they have adequate access to the expertise necessary to develop savings projections and energy-efficiency programs that are suitable for Texas. The utilities will be in a position to develop their budgets using such savings projections.

Under normal ratemaking procedures, a utility is not under an obligation to refund revenue that, for a specific item or in the aggregate, exceeds the approved revenue requirements. The commission has concluded, for reasons that are described above, not to adopt a special cost-recovery mechanism for energy efficiency costs. If no such mechanism is adopted, there will not be a mechanism for returning unspent funds to customers. The commission believes that expenses and revenues identified in a rate order for energy efficiency programs should be separately tracked. The commission also concludes that it is reasonable to allow a utility to roll over unspent funds from one year to the next under certain conditions. If a utility has proposed a change to its energy efficiency plan that requires an increase in costs, and the commission has approved the change, the utility can use unspent funds from a prior year to cover the additional approved costs. Additionally, the commission agrees that there may be legitimate reasons for a utility to spend less in a year than the commission has authorized for energy efficiency programs, such as the lag time in initiating new programs. Where the utility's expenditure for energy efficiency purposes exceeds 110% of the authorized funding level or is less than 90% of the authorized funding level in a year, the utility must include an explanation for this in its next energy efficiency report. Funds not spent within a given year should be spent on energy efficiency the following year, and the commission can consider utilities' requests to roll over unspent funds on a case by case basis in connection with the utilities' annual energy efficiency report filing. The commission adds new §25.181(h)(5) accordingly.

Issue Number 3: The energy efficiency programs will be subject to review by an independent auditor to verify the accuracy of the savings. What should be the consequences, if any, for the utility if verified savings prove to be less than the projected savings?

PUB, Cardinal, CSW, EGSI, EGSI, OPC-Cities, Reliant, Shell, SPS, TESCO, TNMP, Joint Public Interest Groups, and TXU commented that penalties should not be assessed unless the utility fails to properly implement and administer the contract. Several parties commented that remedial measures were appropriate to correct future discrepancies. CSW commented that if the utility properly performed its contract administration role and other functions, the only consequence for the utility should be to take any appropriate remedial steps in the selection and implementation of future contracts to ensure future projected savings are achieved. OPC/Cities added that if the commission determines the shortfall is a result of fraudulent behavior by the energy service provider or the utility, measures should be taken to punish the responsible parties to the extent permitted by current law. OPC/Cities further commented that if the inaccuracy of the savings results from misrepresentations made by the EESP, then the utility should have the option – with commission approval – to discontinue accepting contracts from the provider.

TNMP supported a cooperative investigation into program failings by the commission and the utility, but TNMP and SPS commented that it would be unfair to penalize utilities for market events that are outside their control. OPC/Cities also requested that the projection methodology be adjusted to correct any discrepancy between projected and verified savings and that the consequence of any shortfall should only affect future goals, and that the utility should not be forced to compensate for past savings that may have been over-estimated.

TESCO commented that it may be enough to simply require that starting January 1, 2004, the utility's goal for energy efficiency shall be cumulative; for example, if the utility achieves only 10 MW of savings and its goal is 12 MW, then its goal for the next year grows by 2 MW. CSW contended that if negative consequences were imposed against utilities that do not achieve the projected savings, then utilities would not undertake market transformation programs that pose benefits as well as risks related to M&V. Reliant commented that the utilities' risk should be commensurate with the opportunity for reward. Reliant commented that rewards should be available commensurate with the risk undertaken by the utilities if the utility exceeds its projected savings. Shell disagreed with Reliant, commenting that utilities should not be rewarded for exceeding the goal because it would encourage disproportionate spending by utilities on energy efficiency programs, further increasing the price to beat (the commission assumes Shell means reducing the headroom).

EGSI contended that the results from M&V should be used by the commission to fine-tune forecasted estimates of program savings. TNMP commented that if a discrepancy between projected and actual savings occurs because either the deemed savings amounts approved by the commission are erroneous, or the commission-approved standard offer contract is flawed, then the process by which the commission approved the deemed savings and M&V protocol should be corrected. EGSI suggested that adjustments be made in response to the annual reports required in the proposed rule.

NAESCO commented that the public has the right to expect that its rate dollars dedicated to energy efficiency will buy measurable, verifiable energy savings. However, NAESCO suggested that if a contract administrator delivers half of the expected savings, the commission should reduce the payments to the utility gradually during the transition period, rather than penalize the utility. Reliant disagreed with NAESCO's concept of pay-for-savings. TNMP commented that if an EESP fails to properly administer its M&V obligations under the contract, then provisions to prevent or correct the failure should be built into the standard offer contract, requiring EESPs to maintain a performance bond to compensate utilities for savings that are not realized. EDF commented that if savings are not achieved, the EESP should not receive incentive payments and the money can be diverted to other contracts. TESCO disagreed and stated that the utility must be required to spend all the money it collects for energy efficiency on energy efficiency programs.

EGSI, TXU, Reliant, and CSW commented that it is the EESP's responsibility to assure that the savings are achieved as promised. CSW commented that to rule otherwise would be unnecessarily punitive and would place the utility in the impossible role of being a 100% guarantor of the contracts. EGSI contended that under the terms of the proposed rule, a utility's role is limited in such a manner that it cannot be held accountable for projected savings.

EDF commented that the contract between the utility and the EESP should require the EESP to guarantee savings before being paid and that if contracts do not guarantee savings, then the utility should be liable for those programs and the expenditures should not be allowed in rates. TESCO also commented that the EESP is responsible for providing savings under whatever contractual and programmatic requirements are laid out by the utility administrator. However, TESCO clarified that if the utility's contractual requirements or enforcement is insufficient to assure such savings reliably, then the utility should make changes to correct such problems. TESCO contended that if the utility's programs are not leading to a level of savings commensurate with the utility's projected savings from their contracts, and funds are not being spent, the auditor (independent M&V expert) or the utility, with the input of the Working Group (energy efficiency implementation docket), should recommend and undertake other needed changes.

TNMP commented that because of the large potential for variance between projected and actual savings, the trigger for an investigation should be a substantial variance, at least 15%, for the entire sampled population of standard offer participants. SPS recommended that if verified savings are more than 10% below the savings claimed by the utility, then the utility should provide a written explanation for the discrepancy and the measures it will take to correct this problem.

NAESCO contended that the transition period will allow utilities to make adjustments in their management procedures to effectively deal with performance risk, or to petition the commission for relief from program administration responsibilities.

Several commenters noted that if projected savings were based on deemed savings previously determined and approved by the commission, no penalty should be assessed. Rather, they suggested that the deemed savings values be reviewed and possibly adjusted. Regarding deemed savings, CSW commented that those savings are determined in advance and need no further measurement and that due diligence on deemed savings should be conducted before utilities implement contracts using the values, not after.

Joint Public Interest Groups commented that it would support additional rulemaking concerning performance-based adjustments. EGSI disagreed with Joint Public Interest Groups that additional rulemaking should be done for performance based adjustments, claiming performance-based measures are inappropriate in this rulemaking.

Shell, Joint Public Interest Groups, and PUB commented that each case should be handled on a case-by-case basis under PURA Chapter 15, taking into consideration all circumstances and factual information. Shell also stressed that penalties were necessary only for failure to administer the contract properly, particularly since the utilities actively sought control of these contracts and should be held accountable. Reliant disagreed with Shell that incentives are needed through penalties to ensure goals are met, because the utility will not be able to actively manage the EESPs to see that savings are actually achieved. Joint Public Interest Groups added that the rule should specifically address enforcement provisions for energy efficiency performance.

Overall, the comments reflected a general consensus that the EESP is responsible for achieving the promised savings under the contract, and that the utility is responsible for proper administration of the contract. One of the critical functions of this rule is to provide the necessary framework to assure that the expectations of Texas customers to reduce energy costs and system demand are met. The commission finds that the revised rule sufficiently addresses the responsibility of both the EESP and the utility, and that since the commission will have reviewed and approved the utility's energy efficiency plan and the funds necessary to implement that plan, no consequences are necessary in the event the utility's projected savings are not achieved. The commission therefore deletes §25.181(m) relating to enforcement.

The commission however agrees with PUB, Cardinal, CSW, EGSI, EGSI, OPC/Cities, Reliant, Shell, SPS, TESCO, TNMP, Joint Public Interest Groups, and TXU that penalties should be assessed if the utility fails to properly implement and administer the program. However, the commission also acknowledges, as TNMP and SPS pointed out, that it would be unfair to penalize utilities for market events that are outside their control. In the event a utility consistently fails to properly administer its program, the commission may designate a different administrator.

The commission agrees with TESCO that if a utility's programs are not meeting the utility's projected savings, the independent M&V expert or the utility should recommend and undertake changes. The commission disagrees with CSW that utilities should not be held accountable for deemed savings once they are approved by the commission. Deemed savings should be verified, reviewed, and adjusted as needed to provide the savings intended to be achieved.

The commission also finds merit in the comments of TNMP that if deemed savings approved by the commission are erroneous, or the commission-approved standard offer contract is flawed, then the process by which the deemed savings and M&V protocol were developed should be modified.

With respect to administrative penalties, the commission agrees with OPC/Cities that the utilities may face penalties at any time for violating a commission rule or order in administering its contracts with the EESPs. The commission agrees with Shell, Joint Public Interest Groups, and PUB that enforcement provisions under PURA Chapter 15 are the appropriate manner in which to evaluate and assess, if necessary, administrative penalties.

The commission concludes that if a pattern of poor performance emerges on the part of an EESP, such as failure to achieve projected savings under a standard offer contract, then the utility should address the problem, including disqualifying the EESP from further contracts under the energy efficiency program. The utility is ultimately responsible to customers, and thus, should develop mechanisms for ensuring performance from the EESP.

In the event the discrepancy between projected and actual savings is the result of protocols or methodology used in the M&V requirement or in the development of deemed savings, the independent M&V expert shall make recommendations in its initial report to address this matter. The independent M&V expert should identify problems early, thus addressing the concerns expressed about the utilities' responsibility for implementing a potentially imperfect commission-approved methodology.

The commission concludes that because the independent M&V expert will study utility and EESP programs and performance, and report to the commission, that it is not in the public interest to set a threshold for initiating an investigation of a utility's program. The level and depth of a review should be determined by the utility's performance as reflected in its energy efficiency annual report. This flexibility gives the utilities assurance that each program will be evaluated on its own merits.

The commission anticipates that the programs and methodologies may need adjustment as the market evolves and thus the rule provides for the utilities to request adjustments to their programs on their own initiative. As currently proposed, the rule does not require the utility to be a 100% guarantor for energy savings. Rather, utilities are responsible for developing a program that is consistent with this rule and for administering the standard offer and market transformation contracts. In administering these contracts, the utilities necessarily must evaluate the performance of the EESPs, to ensure that the programs achieve energy savings in a cost-effective manner.

The commission disagrees with EDF and NAESCO's recommendation that utilities should be paid only for the savings that are achieved and that unspent funds should be diverted to other programs. The commission finds this suggestion inconsistent with the utility's role under this rule and with general ratemaking procedures. The commission finds that pursuing performance-based adjustments should be made in a separate rulemaking and is not appropriate at this time. Similarly, rewards for exceeding projected savings are not anticipated in PURA. The commission agrees with TNMP that if an EESP fails to properly administer its M&V obligations under a contract, then provisions to prevent or correct the failure should be built into the standard offer contract. However, the commission disagrees that this should be prescribed in the rule. The energy efficiency implementation docket prescribed under subsection (m) may address this issue.

Issue Number 4: Contracts under the standard offer program will not be awarded through a competitive solicitation, but will be awarded in the order the project proposals are received. This mechanism potentially limits the ability for the utility to control the quality of participating contractors. Should the rule provide for minimum criteria for contractor participation?

CSW, EGSI, Reliant, TXU, PUB, Shell, TESCO, NAESCO, OPC/Cities, and the Joint Public Interest Groups agreed that there should be minimum criteria for contractor participation. Most parties recommended the following minimum criteria: 1) evidence of financial strength and capability (e.g., 10-K's for public companies and audited financial statements for private companies); 2) demonstration of professional experience; 3) demonstration of a solid work plan that covers the design, implementation, operation, and management of the project; 4) proof of all necessary insurance; and 5) a performance bond. EGSI noted that the "first come, first served" concept conflicts with the ability to control the quality of participating contractors. EGSI and SPS stated that the criteria should be spelled out in the program guidelines rather than the rule.

SPS did not specifically recommend criteria for contractor participation, but proposed the establishment of a statewide registration system for EESPs. NAESCO proposed that objective criteria might include use of the Department of Energy and Department of Defense qualification lists or the NAESCO accreditation list.

Enron and OPC noted that the criteria could be used to manipulate the process and set up barriers to participation by non-affiliate EESPs. TNMP was opposed to the establishment of contractor criteria for participation, because the market should set the criteria for participation through a competitive solicitation.

PURA §39.905 contemplates that the goal be achieved through standard offer contracts. Standard offer contracts are not compatible with a competitive solicitation. The commission does not agree that under a standard offer system, the market is a sufficient mechanism to control the quality of contractors, particularly in the short term. The commission finds that minimum criteria for contractor participation are necessary to ensure reliable service, and assures customers a minimum level and quality of service that should increase customer participation. Ultimately, the success of the program in achieving the 10% savings goal depends upon the capability of the EESPs. The commission acknowledges that criteria for contractor participation may be subject to manipulation to favor a utility's affiliate or create barriers for new EESPs. The commission therefore finds that the rule should specify criteria to ensure a fair process for all participants. The code of conduct adopted by the commission and the adoption of the business separation plans by utilities should also help assure that the criteria are fairly applied. The commission finds that the criteria proposed by the commenters are fair and reasonable and adopts: 1) all applicable licenses required under state law and local building codes; 2) evidence of all building permits required by a governing jurisdiction; 3) evidence of all necessary insurance; and 4) evidence of good credit rating. The changes have been made under §25.181(i) (previously §25.181(h)).

The commission does not find it necessary to require that contractors be accredited by the state or through NAESCO as a condition for participating in the program. Such a requirement might unduly limit the number of eligible contractors and impair competition in the energy efficiency market envisioned in this rule.

Issue Number 5: Under the standard offer program (SOP), contracts will be awarded in the order that they are received. How should the rule encourage broad participation by all eligible contractors?

EGSI, NAESCO, Reliant, PUB, and TXU generally did not have additional comments for the rule to encourage participation, but stated that utilities will recognize their responsibilities but need some flexibility. They also suggested that market forces would ensure maximum participation. EGSI commented that the commission should not insert itself into the market such that it controls contractor participation beyond what is necessary to assure market neutrality and non-discrimination. EGSI stated that a utility should determine the best manner in which contractor encouragement should be accomplished because the utilities will also be required to work within the limitations of §25.272 (relating to affiliate code of conduct rules). NAESCO commented that the utilities will recognize their responsibility to market their contracts as a necessary part of achieving their energy efficiency goals. Reliant and TXU commented that the proposed rule language requires the utility to conduct informational activities designed to explain the standard offer programs and market transformation programs to EESPs and vendors and requires that all customer classes have access to a proportional or equitable share of the incentive funds. Reliant commented that standard offer contracts will be developed to reach each customer class and therefore will also reach a wide range of contractors. PUB commented that the market would ensure maximum feasible participation by all eligible contractors, so there is no need for additional benefits to contractors.

CSW commented, consistent with its arguments that the rule is too prescriptive, that the rule should not encourage broad participation by eligible contractors. CSW commented that easily accessible information should be all that is required and requiring anything more than properly disseminating information would simply impose regulations in an unregulated energy efficiency market.

Enron and Joint Public Interest Groups commented that the rule needs to have more safeguards. Enron commented that standard offer programs should be market-based and that the rule invites abuse and manipulation because it does not outline how the request for bids is to be announced. Enron suggested a competitive bid process whereby all energy efficiency service providers are simultaneously notified of the request for bids and given a deadline by which to respond. Enron further suggested that the rule should incorporate specific qualifying criteria detailing what constitutes contract awards so that preference is not given by a utility to any one energy efficiency service provider. Joint Public Interest Groups commented that they would like to see a more formal requirement that includes multiple avenues for providing information about the program to encourage contractor participation. Joint Public Interest Groups commented that formal notice, coordination with contractor associations, and training for prospective contractors on the rules of the standard offer program are necessary. Joint Public Interest Groups argued that the training should also include information on how to participate in the programs and should ideally be conducted jointly by the utility and trade associations. Joint Public Interest Groups argued that the utility should be required to provide a detailed proposal in its energy efficiency filing regarding outreach to generate interest in its programs by energy service companies and other entities it will rely on to implement the contract successfully.

TESCO commented that broader participation will be assured by providing sufficient incentive for participation of customers and providers, and keeping program participation simple. TESCO argued that the utilities should provide workshops periodically for contractors, and even do some outreach to contractors to be sure they have access to information about programs.

TNMP, OPC/Cities, and SPS commented that the current limitation preventing an energy efficiency service provider from receiving more than 20% of available standard offer contract funds should encourage broad participation and circumvent the dominance of a few contractors. TNMP commented that efforts to broaden dispersion of funds could direct funds to inefficient EESPs. SPS commented that the design and marketing of the program would have a considerable impact on participation rates. SPS stated that burdensome M&V requirements, onerous contractor participation requirements, long delays in the distribution of incentive funds, and lengthy application guidelines will limit participation by smaller contractors. SPS, however, argued that the foregoing are largely "program design" issues that should not be addressed in the rule.

The commission notes that some parties may misunderstand the legislative requirement for standard offer programs. Under a standard offer program, utilities offer a standard monetary incentive for kWs and kWhs saved by any eligible measure the contractor chooses to install. EESPs will compete with each other for the business of an electric customer that has an energy efficiency need. The legislature adopted the requirement of standard offer programs and the commission does not have broad latitude to restructure the program adopted by the legislature. The commission agrees with Enron and Joint Public Interest Groups that there must be notification of the standard offer contract opportunities and has modified the rule to incorporate such a requirement. The rule directs utilities to conduct informational activities directed toward potential EESPs designed to explain the standard offer and market transformation programs in §25.181(h)(1)(A). These activities are to be funded out of the utility's administrative budget, and should be explained in the utility's proposed energy efficiency plan, which must be approved by the commission. The commission concludes that it is not necessary to further prescribe the level, types, or methods of information activities. The limitation of 20% of the funds available to any one energy service provider for standard offer contracts should ensure maximum contractor participation. However, the 20% limit should not be applicable to market transformation programs due to their unique nature, and §25.181(h)(3) is revised accordingly.

Issue Number 6: As of January 1, 2002, very low-income customers will receive targeted energy efficiency services through the System Benefit Fund. The language in PURA §39.903(f)(2) (relating to the System Benefit Fund) does not require that the program be cost-effective, nor does it require verification of energy savings. Should these savings be tracked and counted towards the goal in PURA §39.905?

CSW, EGSI, Reliant, SPS, TNMP, PUB, Shell, NAESCO, TIEC, and OPC/Cities responded that the savings should be tracked and counted toward the goal in PURA §39.905. CSW stated that neither PURA §39.903(f)(2) nor §39.905 explicitly state that the System Benefit Fund energy efficiency program should be excluded from the PURA §39.905 energy efficiency goals. CSW argued that it is reasonable to assume that the Legislature intended that, wherever possible, measurable energy efficiency savings derived from the programs funded through the System Benefit Fund should be counted. In addition, CSW argued that subjecting System Benefit Fund energy efficiency to the cost-effectiveness standard in PURA §39.905 is a reasonable interpretation of PURA §39.903(f)(2) and §39.905 because it merely applies a general economic efficiency standard to a program under the System Benefit Fund. NAESCO and OPC/Cities stated that these savings should be counted in order to achieve the goal at the lowest reasonable cost. Shell and TIEC stated that counting these resources would also ensure that there would be no resource overlap. EGSI, SPS, TNMP, ESL, and OPC/Cities contend that the TDHCA already monitors and measures the energy savings through the Princeton Scorekeeping Method (PRISM) and it would not create an undue burden to track the savings for the purposes of the energy efficiency goal. SPS pointed out that since the programs are consistent from year to year, these savings could be tracked through deemed saving calculations.

TXU, TESCO, TDHCA, and the Joint Public Interest Groups commented that the savings should not be measured and tracked for the purposes of PURA §39.905. TESCO stated that this would be contrary to the intent of the legislation, for PURA §39.905 clearly requires utility administrators to acquire "additional cost-effective energy efficiency equivalent to at least 10% of the electric utility's annual growth in demand." The word "additional", according to TESCO, was intended to mean in addition to whatever else the law may require, as well as in addition to whatever else was already being acquired by customers without this initiative. TXU, Joint Public Interest Groups, and TDHCA (the administering agency for weatherization under the System Benefit Fund) maintained that such a task would not be cost-effective. These parties stated that the programs strike a delicate balance between monitoring activities and measure installation, while maintaining the cost-effectiveness of the overall program. Both Joint Public Interest Groups and TDHCA stated that while TDHCA does monitor energy savings on a statewide basis, doing so on a utility-by-utility basis would increase the cost of administration. Moreover, TDHCA comments that the programs are designed to reduce energy costs, not capacity costs, and while these savings are very meaningful to the program participants, the actual energy savings are not great and the capacity savings are minimal. TXU, Joint Public Interest Groups, and TDHCA agreed that it therefore would not be cost-effective to track these savings and imposing such a requirement would jeopardize the overall cost-effectiveness of the program.

In reply comments, OPC and EGSI agreed with SPS that utility-specific extrapolations can be made, based on statewide data, especially if deemed saving calculations are applied. OPC also questioned why parties would allow utilities to count the savings achieved under current low-income energy efficiency contracts, but are opposed to counting the savings achieved under the System Benefit Fund. Joint Public Interest Groups countered that the Legislature recognizes energy assistance, including weatherization, as part of the safety net that must be offered to assure affordable service to low-income customers. Therefore Joint Public Interest Groups believes that the

System Benefit Fund recognizes that the low-income programs are different from other demand-side management programs and should not be subject to the same standards as other demand-side programs.

During the APA hearing, GETCAP, a local weatherization provider, emphasized that the low-income program is already overburdened by regulations and is already monitored more intensely than any other program. GETCAP expressed the concern that additional requirements would harm the program's ability to deliver the services.

The commission believes that the energy efficiency goal should be achieved at the lowest possible cost in order to preserve the competitive headroom. Until December 31, 2001, utilities will be allowed to count any additional savings achieved under all current contracts that meet the requirements of §25.343, relating to Competitive Energy Services. The primary purpose of the current low-income programs is to reduce the energy consumption and energy costs of low-income customers. The programs are, therefore, designed to reduce energy, not capacity, and the capacity savings may, in fact, be minimal. However, to the extent that the programs do reduce capacity, these savings should be counted towards the goal.

As of January 1, 2002, PURA §39.903(f)(2) allows for funds collected under the System Benefit Fund to be used to provide weatherization services to low-income customers in coordination with the TDHCA Weatherization Assistance Program. PURA §39.905 calls for energy efficiency savings equivalent to at least 10% of a utility's demand growth through market-based standard offer programs and limited, targeted market transformation programs. At this time, the TDHCA weatherization program installs only energy efficiency measures that produce kWh savings benefits greater than the cost of the measure. The design for the programs under the System Benefit Fund should maintain a cost-effectiveness standard that will encourage energy savings and maintain the current level of quality of service. This cost-effectiveness standard may be a different standard from the cost-effectiveness standard in this rule. In addition, the programs to be offered under the System Benefit Fund should not substantially affect the current service delivery and contracting structure. The commission, therefore, finds the program under the System Benefit Fund as it pertains to the contracts between TDHCA and local weatherization providers qualifies as a standard offer contract, and that the savings under the System Benefit Fund should be counted towards the energy efficiency goal under PURA §39.905. The commission has revised the definition of standard offer contract under subsection (c) to reflect that the TDHCA weatherization program will be considered a standard offer contract for the purposes of this section.

Issue Number 7: The goal of the market transformation program is the increased adoption of energy efficiency technologies, services, and practices. Should utilities be allowed to continue to count the savings after the market has been transformed? How should market transformation be evaluated and should the rule address evaluation of market transformation programs?

Cardinal and Joint Public Interest Groups strongly supported market transformation programs and commented on various differing requirements for these types of programs. Cardinal commented that savings from market transformation programs may continue after the market has been transformed and that such savings should be deemed in advance and credit given in each year that the contract is properly implemented. Cardinal commented that specific M&V should not be required for market transformation programs and that such programs should be encouraged as a counterpart to a standard offer program for the same type of technology. Joint Public Interest Groups commented that organizations implementing market transformation programs must first establish goals and objectives for each market being transformed, and then develop a baseline characterization of that market. The baseline characterization typically includes projected energy use in the absence of a program and characteristics of the market, which include market structure, market actors, key strategies to influence market actors, etc. Joint Public Interest Groups recommend that the rule require that a market transformation program plan should include the goals and objectives of the program, estimated energy savings, and measurement and evaluation metrics and methods. The plan should be submitted with the energy efficiency plan filing. Joint Public Interest Groups further commented that if market transformation program goals are met before a program sunsets, utilities should be allowed to count the additional savings that accrue between the time the goal is achieved and the end of the program.

CSW, EGSI, Reliant, TNMP, and PUB commented that utilities should generally be allowed to continue to count the savings beyond the end of the program. CSW commented that utilities are just learning how market transformation programs operate and how they are evaluated. CSW commented that the rule should not address how market transformation programs should be evaluated, but rather utilities should have the flexibility to learn about market transformation programs and try new programs. EGSI commented that if savings from a market transformation program have been used to satisfy PURA §39.905 goals, there should not be an attempt to retroactively "take-away" those savings. EGSI argued that this would create an administrative nightmare and impose an unreasonable requirement. Reliant commented that the impacts of market transformation programs might take years to achieve, with considerable investments in the early years. In its view, long-term savings are necessary for these programs to be cost-effective. Reliant further commented that it might be premature to specifically address the evaluation of market transformation programs in the rule because at this time even basic determinations such as baseline efficiencies have not been established. Reliant further commented that such issues might be appropriate for the Working Group (energy efficiency implementation docket) to address. TNMP commented that utilities should be allowed to continue counting savings for the life of all incremental measures installed. TNMP commented that the method for determining incremental measures should begin with the hypotheses proposed by the market transformation bidder who illustrates the normal market transformation curve of the proposed technology, then justifies a new market transformation curve that results as a consequence of the proposed program. TNMP commented that the value of the benefits could include the cumulative present value energy savings for all incremental kWh savings produced.

NAESCO, TXU, and OPC/Cities commented that utilities should not be allowed to continue to count the savings beyond the end of the program. NAESCO commented that there is no reason to hold market transformation programs to a lower standard of performance than the standard offer programs. NAESCO commented that utilities should get credit only for the specific energy savings that its programs produce and not the general "halo effect" of changes in the marketplace. NAESCO noted that giving utilities credit for more savings than the specific savings that can be measured from their programs should be avoided because determination of such additional savings involves a level of market research and analysis that is well beyond the technical and economic resources of the programs envisioned by the proposed rule. TXU commented that the prospects for market transformation programs in this new energy efficiency market is uncertain at best. TXU argued that there is no firm understanding of how and when to count savings from market transformation programs, so the most conservative approach is not to allow utilities to count savings after the market has been transformed, because once the market has been transformed, the objective of the market transformation program has been accomplished. TXU further commented that the Working Group (energy efficiency implementation docket) should address evaluation of market transformation programs, not the rule, because the programs will vary greatly in their substance and methodology, which makes the evaluation process complex and in need of flexibility. OPC/Cities commented that utilities should only continue to count the savings if they modify the programs in such a way to generate an increased degree of market transformation or if the market is transformed to a higher efficiency after the original target has been met.

Joint Public Interest Groups, SPS, and TESCO commented that market transformation programs must be evaluated on a case-by-case basis. Joint Public Interest Groups commented that because markets and intervention strategies for different products and services vary substantially, it is critical that the information provided in the energy efficiency plan specifically address energy savings and how they will be credited toward the goal. SPS commented that the broad and diverse spectrum of market transformation efforts requires a different evaluation approach and different means of quantifying impacts. SPS commented that providers who wish to propose market transformation programs should be required to include an M&V approach and some means of quantifying the impacts of their program. TESCO commented that although utilities should be encouraged to pilot different market transformation programs, commission approval should be required before savings associated with a particular program are allowed to count toward the utility's goal. TESCO commented that generally, each market transformation program will be different, and each should be implemented under an overall plan that identifies its particular target audience or technology, the mechanism to overcome market barriers, savings anticipated, how the savings will be monitored or verified, and the time period over which program costs and savings will be measured.

The commission concludes that market transformation programs need special consideration in their design and M&V. The commission also agrees that the expertise of independent bidders regarding market transformation programs should be utilized in developing program proposals and that the rule should not be too prescriptive regarding program details. The commission believes that the only way to measure savings is if a baseline that is relevant in time and geographic region is first established, and that it is appropriate to require such a baseline in market transformation program proposals. A proposal must also include criteria for determining that the market has been transformed and when savings cease to be counted. A market transformation program proposal must also include projected savings throughout its implementation until the goal is reached, and a mechanism for assessing the program's success. The commission will allow utilities to count a program's savings towards the mandated reductions in energy consumption for the relevant time period, if the savings can be verified. The commission reaffirms that the ultimate goal of market transformation programs is behavioral changes that result in energy and capacity savings. A follow-up study may be necessary to evaluate the actual savings achieved. Accordingly, the commission modifies the rule under §25.181(j) to reflect the changes.

Issue Number 8: Should the rule be prescriptive in setting goals or participation levels for individual customer classes? If so, should these goals be expressed in terms of the share of energy savings or in the share of incentive funds allocated to each customer class?

CSW, EGSI, Reliant, SPS, TNMP, TXU, PUB, and Nucor responded that the rule should not be prescriptive in setting participation goals for customer classes. They further stated that setting specific goals by customer class would be arbitrary and could increase the cost of achieving the goal. According to these parties, participation by customer class should be determined by the competitive market place and be driven by achieving the 10% savings goal at the lowest possible cost. SPS and Reliant did, however, recognize that some classes of customers or market segments might be difficult to reach because no energy efficiency provider will seek to serve them. Nucor argued that PURA §36.003 forbids applying rates among customer classes in an insufficient, inequitable, or inconsistent manner and forbids the establishment of unreasonable differences concerning rates between classes of service. Therefore, Nucor argued that setting goals for participation levels is inconsistent with Texas law.

TESCO and NAESCO stated that some level of incentive funding should be reserved for the hard-to-reach customer, such as residential customers. OPC/Cities also recognized the importance of program penetration across all customer classes. All three parties cautioned that the rule should remain flexible enough for the programs to respond to the marketplace. Joint Public Interest Groups and EDF stated that the rule should be prescriptive in setting participation goals. EDF believed that an allocation among customer classes is appropriate and should be established in the rule because PURA §39.905 was established to account for market failure in the provision of energy efficiency services. EDF also argued that the degree of market failure is far greater for residential customers than industrial customers. Joint Public Interest Groups agreed with EDF. Joint Public Interest Groups proposed that, initially, the incentive funds be allocated based on each sector's contribution to revenues as reflected in the Statewide Integrated Resource Plan. If the commission adopts participation goals, TXU and OPC/Cities agreed that the goal should be set in terms of share of the funds, rather than share of energy savings per customer class. Only PUB proposed setting the goal in terms of the energy savings.

In its reply comments, NAESO commented that no party has offered factual proof that the proportional allocation of funds by customer class makes the energy efficiency goals more achievable.

Frontier agreed with Nucor that it is a basic rate-making principle that cross-subsidies among rate classes should be minimized. Consequently, Frontier agreed that each customer class should receive incentive payments in proportion to the percentage of funds contributed by that class for energy efficiency programs.

Both NAESCO and TESCO expressed concern over breaking up standard offer programs into smaller programs targeted at customer classes. NAESCO argued that broader programs allow for greater flexibility and increased creativity, and recognize the geographical disparity of available energy efficiency resources.

The Coalition commented that the rule should require utilities to demonstrate through their Energy Efficiency Plans how they will ensure that all customers in all customer classes have access to energy efficiency funds, but it disagreed that allocation by classes is appropriate.

PURA §39.905 states that *all* customers, in *all* customer classes, are to have a choice of and access to energy efficiency alternatives that allow *each* customer to reduce energy consumption and energy costs. Therefore the commission finds that that the rule should deliver equity of energy services among customer classes, but maintain maximum flexibility for the utilities to meet the goal in a cost-effective manner. The commission finds that a specific energy efficiency requirement should only be required for the hard-to-reach customers. At this time, the definition of hard-to-reach customers is limited to customers who have an annual household income at or below 200% of the federal poverty guidelines. The rule does not require strict individual customer income verification. Utilities may use other methods as long as they reasonably assure that participants are income eligible. Such methods may include self-certification for individual customers or sponsoring projects where over 75% of the customers residing in a multi-family complex are income-eligible. Should the annual energy efficiency reports show that other groups of customers, such as tenants, are not served, the commission may expand the definition to include these under-served customers at that time. Access to energy efficiency services by other customer classes is encouraged through varying incentive levels. However, the rule does not require that each utility implement separate standard offer or market transformation programs for each customer class. Utilities may design programs that serve multiple classes of customers, as long as the program design removes the barriers to energy efficiency services for individual customer classes. The commission has revised §25.181(g)(2) accordingly.

Issue Number 9: The rule requires that residential and small commercial customers have access to a list of participating energy efficiency services providers for the purpose of soliciting multiple bids for services. How should such a list be made available?

TESCO was strongly opposed to the creation of such a list, because it would imply utility endorsement of a particular contractor and might violate §25.272 (relating to the Affiliate Code of Conduct). TXU commented that the utility would be in the best position to compile the list, but expressed concern that making the list available to the customer would require a customer contact that would violate §25.272. CSW, EGSI and Shell commented that such a list would be an unnecessary intrusion into the market because market participants will publicize the program. CSW and TNMP commented that customers may access the information through the Yellow Pages. Reliant stated that it would make the list available in any manner the commission deems appropriate. SPS and Shell commented that the commission's customer education campaign should incorporate information on energy efficiency opportunities. TXU, PUB, Shell, and OPC/Cities stated that the commission should make the list available. In addition, OPC volunteered to make the list available to customers. OPC/Cities, Cardinal, and Joint Public Interest Groups suggested that the list be made available through retail electric providers (REPs). Cardinal stated that in addition to the REPs, the utility should also make the information available.

In its reply comments, TESCO stated that retail competition is what the law relies upon to deliver the efficiency services to customers. NAESCO agreed with TESCO that the EESP couldn't be expected to provide a potential customer with a list of its competitors.

Joint Public Interest Groups, in its reply comments, recognized the opportunity for potential abuse of §25.272 (relating to the Affiliate Code of Conduct) in the distribution of a list. It believed that the rule could be designed to provide assurances that abuses will not occur. Joint Public Interest Groups proposed that the listed information should be limited to the name, address, and phone number of each contractor that meets minimum requirements for participation. Joint Public Interest Groups proposed that the list also contain appropriate disclosures to avoid liability of the party providing the list. Joint Public Interest Groups argued that providing easy access to a list will encourage customers to seek multiple bids and compare product services and prices and make economic choices.

The commission agrees that customers should have easy access to a list of participating providers. The list will allow customers to solicit multiple bids from EESPs and shop around for the best deal. It will also encourage competition among providers and result in more of the incentives being passed on to the customer. The commission agrees that it would be unrealistic to require EESPs to share a list of its competitors with customers. It would not be a violation of §25.272 (relating to the Affiliate Code of Conduct) for a utility to distribute a list compiled by the commission or OPC. The utility should inform the EESPs wishing to participate in the program that they should contact the commission to have their names placed on the list compiled by the commission. The commission has deleted the requirement from §25.181(n) (relating to customer protection) and revises §25.181(h)(1) to reflect this change.

Issue Number 10: There is the potential under the standard offer programs for residential and small commercial customers to fall victim to unreliable or fraudulent companies. How should the rule address customer protection in that area?

CSW, EGSI, Reliant, SPS, TNMP, TXU, PUB, Shell, TESCO, NAESCO, ESL, OPC/Cities, and Joint Public Interest Groups responded to the issue. These comments are addressed below under the discussion of §25.181(n) (previously §25.181(l)).

Miscellaneous:

OPC filed comments suggesting introducing a "compliance allowance" trading mechanism. OPC suggested that utilities that develop highly effective programs should be allowed to increase their savings beyond the goal requirement, and sell the excess savings to utilities that do not achieve their savings goal. According to OPC, this would help both the customers of utilities supplying allowances as well as those purchasing allowances.

The suggestion by OPC was presented fairly late in the rulemaking process and has not been properly explored by the parties. The commission may explore OPC's concept of a "compliance allowance" trading mechanism as a result of the evaluation performed by the independent M&V expert in 2003.

Specific Sections of the Rule

(a) Purpose.

Schiller commented that the general purpose in the proposed rule provides a clear directive in the allocation of budgets among customer classes. SPS commented that although the rule requires that standard offer programs be offered, the purpose states that standard offer programs and/or market transformation programs may be offered. SPS recommended that the rule be reworded for consistency with the purpose.

As discussed under Preamble Issue Number 8, the commission finds that §25.181(a) does not provide a clear directive to allocate budgets to individual customer classes. The purpose of the rule as stated in §25.181(a) properly reflects the intent of PURA §39.905; however, the commission revises §25.181(a) to clarify that utilities may offer either standard offer programs or market transformation programs, or both.

(b) Application.

Shell commented that the commission should clarify that the rule applies to both electric utilities and to their successor T&D utilities. EPE proposed to revise the language in

§25.181(b) regarding utilities subject to PURA §39.102(c), to make it consistent with similar language adopted in §25.211(a) relating to Interconnection of On-Site Distributed Generation (DG).

The commission disagrees with Shell's comment concerning the definition of electric utility. When competition begins, an electric utility will be a regulated transmission and distribution utility. However, the revision suggested by EPE does not materially change the intent or meaning of §25.181(b) and will contribute to the overall consistency between the rulemakings implementing SB 7. Therefore, the commission revises §25.181(b) accordingly.

(c) Definitions

EGSI, Nucor, Planergy, Schiller, SPS, TESCO, UCONS, TNMP, Joint Public Interest Groups, TXU, and Frontier filed comments on §25.181(c) regarding definitions. Frontier suggested generally that the terms "program," "contract," and "customer class" are used inconsistently. Frontier also commented that the terms "energy efficiency," "cost-effectiveness," "large commercial," "small commercial," and "peak demand" are poorly defined, and that some terms are defined, yet never used in the rule, or are inconsistent with their use in the rule. Joint Public Interest Groups also noted that some defined terms were not used in the rule.

The commission has revised or removed the relevant definitions to correct the problems noted by Joint Public Interest Groups and Frontier.

Demand side management (DSM)

Nucor wanted to clarify that load management, including interruptible service and curtailable rate programs, qualifies as an energy efficiency measure, and suggested changing the definition for "demand side management" to "activities that affect the magnitude or timing of customer electrical usage or demand or both."

The commission concludes that the proposed definition for "DSM" adequately reflects load management. The definition of "DSM" is included insofar as "DSM" programs currently approved in rates may qualify for achieving the energy efficiency goal and, therefore, rejects Nucor's recommended modification.

Energy efficiency

Several parties commented that the definition of "energy efficiency" should be changed. Nucor recommended that the definition be changed to "programs that are aimed at reducing the intensity of electric energy usage equipment or processes," to be sure that the definition includes interruptible and curtailable rates and other load control and load management programs. Planergy and SPS also commented that the definition should be modified to encompass load management, since the text of the rule recognizes load management as a qualifying energy efficiency measure. SPS commented that the definition was ambiguous and did not appear to capture the meaning of the term as it is used in the rule. SPS questioned why "devices" must be "customer owned."

SPS commented that "total system cost" was undefined; TNMP commented that since energy efficiency has nothing to do with "total system cost," this phrase should be omitted. TXU commented that it is unclear which "system" is being referred to in this definition; "system" could refer to the unbundled T&D company, the formerly integrated utility, or the customer's energy system. TXU added that, as the proposed rule expressly requires energy efficiency programs to be cost-effective, it is unnecessary to reiterate the cost-effectiveness concept in this definition. Accordingly, TXU proposed that the cost-effectiveness concept be removed from the definition, or in the alternative, that "system" be more specifically defined.

SPS commented that energy efficiency could encompass the efficient use of energy resources other than electricity. SPS and TNMP also commented that energy efficiency is not necessarily a "program," and that a separate definition is already included in the proposed rule to address "energy efficiency programs."

TNMP recommended replacing the definition of "energy efficiency" with "A reduction in required energy or capital resources necessary to achieve an intended unit of work." TNMP argued that because a unit of work encompasses productivity, comfort, and convenience, these qualities could be omitted, thereby simplifying the definition. This change clearly permits load management options to achieve the legislative goal. Finally, TNMP commented that the current definition muddles economic efficiency, efficacy, and energy efficiency.

For the most part, the commission does not agree that the role of load management requires additional clarification in the definition of energy efficiency. The proposed definition is comprehensive and adequately defines the complex meaning of energy efficiency as contemplated in PURA §39.905. The commission finds, however, that the terms "intensity" and "total system cost" are not clear. The commission revises the definition in §25.181(c) accordingly to remove these terms.

Energy efficiency incentive programs

TXU commented that the term "energy efficiency incentive programs" is never used in the rule and is unnecessary, because it is merely a general term that could encompass more specifically defined standard offer programs and market transformation programs. TXU recommended that this definition be eliminated, and that the rule should refer specifically to "standard offer programs" and/or "market transformation programs" as appropriate. Nucor also noted problems with this definition.

The commission agrees with TXU that this definition is unnecessary and has eliminated it from the rule.

Energy efficiency measures

Nucor commented that this definition should be revised to include load management.

The commission finds that the proposed definition properly describes energy efficiency measures. Load management is separately defined and, therefore, the commission declines to revise the definition of energy efficiency measures.

Energy efficiency project

Nucor and TESCO commented that this definition should be revised to include load management. Specifically, TESCO commented that the term does not include demand reductions, even though the rule apparently anticipates load management and load control contributing some portion of savings. TESCO suggested the commission replace energy efficiency wherever needed throughout the rule by efficiency and load management, and further claimed that modification of "energy efficiency project" related definitions to include "consumption and/or peak demand savings and a reduction in costs" might repair this oversight more simply. TESCO also stated that if the commission's intent is only to allow load management measures that also save energy, then different revisions are required than if the commission intends purely load shifting or load control measures to be permitted.

TESCO commented that the language of the rule confuses the idea of, or the terms for, "energy efficiency project," "standard offer contract," and "standard offer program." TESCO stated that energy projects are composed of one or more energy measures for a single customer; a standard offer contract is the agreement that a utility and energy service provider; and a standard offer program is a utility's entire administrative structure or process for making standard offer contracts available to service providers, including reviewing proposed projects and savings reports, and inspecting installations. TESCO also commented that while it is true that a model "standard offer contract" is the centerpiece of such a program, when discussing the model "contract" or the utility's administration of a standard offering generally, using the word "program" would relieve some of the confusion.

TXU commented that the proposed definition of energy efficiency project requires a reduction in energy consumption and in individual customer costs in order to have a project qualify as energy efficiency. TXU expressed concern that the requirement that customer costs be reduced is unenforceable and unnecessary because SB 7 does not include such a requirement. TXU added that this additional qualification would be difficult, if not impossible, to document because there are innumerable variables that could account for fluctuations in customer energy costs. TXU also expressed concern that the proposed definition fails to allow for demand-reduction projects, which were clearly intended to be part of the energy efficiency program envisioned by SB 7. TXU suggested that the definition be revised to include reference to a reduction in customers' demand or energy consumption, and the reference to costs be deleted.

The commission disagrees with the commenters that the definition should be revised to include load management. However, the commission agrees with TESCO that the terms energy efficiency project, standard offer contract, and market transformation contract need to be clearly and consistently used in the rule. The commission concludes that the definition is sufficient as proposed; however, the definition of standard offer contract has been revised to reflect that the standard offer program is the structure under which the utility administers standard offer contracts and funds an independent M&V expert. The commission also revises the proposed rule to eliminate any inconsistencies in the use of the terms of "program" and "contract." The commission disagrees with TXU that customer costs should be deleted from the definition for energy efficiency project, because PURA §39.905(b) explicitly states that projects should allow customers to reduce energy costs.

Energy efficiency service provider

Schiller and TXU commented that the current definition limits the definition of an EESP to those who actually install measures or perform other energy efficiency services at a customer site, which will disallow many other types of providers through which programs could deliver significant, cost-effective savings. Schiller, therefore, recommended that the definition be broadened to allow any type of provider to qualify to receive incentive payments. TXU recommended that the definition include all persons who will potentially provide energy efficiency measures or market transformation programs.

TESCO commented that the definition should be clarified to include retail service providers. TESCO also commented that modifying other definitions to include energy efficiency and load management would expand the definition of EESP to include a company, or do-it-yourself customer who provides load control or other demand reductions.

The commission concludes that the proposed definition of EESP includes a REP. The commission finds that the definition of EESP may also include customers who install energy efficiency measures, and therefore revises the definition and the rule under subsection (k) to reflect that customers taking advantage of a standard offer contract may use independent third-party inspectors to comply with the rule. The commission concludes that defining EESPs in terms of the installation of energy efficiency measures is reasonable, to ensure significant reductions in demand that can only be achieved consistently through the use of long-lived measures. To allow the definition to include *anyone* who could merely sell an energy efficiency product or service does not ensure the permanency of the measures. Moreover, it would be difficult to measure and verify the savings, if any, realized through the sale of energy efficient products. The commission concludes that revising the definition of EESP in the manner suggested by Schiller, TESCO, and TXU would not be in the public interest because energy and capacity savings could not be achieved on a reliable basis. However, the commission agrees that limiting the installation of measures or services to a customer site would hinder implementation of load management and market transformation projects and has deleted the requirement from the definition.

Growth in demand

SPS and TNMP commented that the definition should be clarified that load involved in wholesale transactions is excluded from the calculation.

The commission agrees with SPS and revises the definition of growth in demand.

Hard-to-reach customers

TESCO commented that the broad definition of hard-to-reach customers should be revised, consistent with the consensus reached in earlier drafts to include lower-income, residential and commercial tenants, and new homebuyers.

The commission finds that the definition of hard-to-reach customers is too broad, and therefore limits the definition to include customers who are at or below 200% of the federal poverty guidelines. The commission has revised the definition accordingly.

Incentive payment

TNMP commented that aside from the definition, nothing in the rule suggests that end-use customers will receive incentive payments, except in their role as EESPs. TNMP noted that incentive payments would only be made to EESPs, or REPs, and recommended revising the definition to "Payments made to EESPs in exchange for deemed or verified electricity savings."

The commission disagrees with TNMP. The definition clearly states that incentive payments are a funding mechanism. The mechanics of incentive payments under the standard offer contract are more appropriately dealt with in the implementation portions of the rule. The commission concludes that it is unnecessary to revise the definition.

Inspection

TXU commented that the proposed definition requires utilities not only to verify installation of projects installed by EESPs, but also to evaluate and certify that the providers used proper workmanship. While TXU did not object to verifying that projects it paid for are actually installed, TXU expressed concern with the burden of workmanship assessment that this definition creates because "proper workmanship" is an undefined and ambiguous concept. Furthermore, TXU stated that it did not have the expertise necessary to evaluate proper workmanship of energy efficiency measures and believes that this is a matter that should be handled between the customer and the provider. CSW, SPS, TNMP, TESCO, Reliant, Shell, and Enron agreed with TXU that it is an inappropriate task for a utility to verify "proper workmanship." SPS, TESCO, and TNMP agreed that it is ambiguous. Shell and Enron expressed concern that the utility could use this oversight to engage in anti-competitive behavior and is thus an inappropriate role for utilities.

Schiller commented that the definition for inspections should be modified to include all types of possible inspections, and should not indicate that administrators are responsible for workmanship. Schiller maintains that in the deregulated market the intent is to place customer protection and quality assurance requirements with the EESPs and their customers, and to place the utilities in this role indicates the potential for unfair market competition and increased administrative costs. EGSI agreed with CSW, Schiller, TESCO, and TXU.

The definition as proposed emphasizes a policy of ensuring that the various subcontractors who actually install the measures for end-use customers do so in a workmanlike manner. The commission concludes that using substandard materials and cost-cutting methods would undermine energy savings, significantly shorten the life and usefulness of installed measures, and undermine the value of the products and services to customers. Measures that are installed improperly and do not achieve the promised savings under the contract should not receive incentive payments. The commission replaces "proper workmanship" with "installed and capable of performing its intended function." The commission concludes that the utilities should have the burden of ensuring measures have been "installed and capable of performing their intended function." Many end-use customers are not sophisticated with respect to construction and appliance installation and may not know that a product has been improperly installed for some time after installation, if ever. Customer protection standards set out in §25.181(n) are intended to safeguard the end-use customer against poor workmanship and abusive practices, and provide information to permit them to make intelligent decisions with respect to energy efficiency services.

Large commercial customers and small commercial customers

SPS commented that these definitions should be refined or deleted because an industrial, municipal, or wholesale customer would be categorized as a "large commercial customer" under these definitions. TESCO commented that large commercial customers should be defined to include businesses in the aggregate, so that large customers such as Wal-Mart would qualify. TXU commented that while it could be taken for granted that the definition refers to "commercial" customers only, it would be wise to add the term within the definition so that an argument could not be made that the term includes all customers, regardless of class, with a maximum demand that exceeds 300 kW.

SPS commented that this definition should be refined to exclude residential customers or deleted. TESCO commented that the definition should be amended to include aggregated customers, similar to their comments regarding large commercial customers.

The commission agrees that the proposed definitions should be revised to clarify which customers are included in this class. The revised definitions clarify that only retail commercial customers are included, and that load is aggregated. However, the commission finds that demand level for small commercial customers should be lowered to 100 kW. The definitions have been revised accordingly.

Low-income customers

TESCO commented that the definition was unnecessarily confusing, given the treatment of "low-income electric customer" in PURA §39.903(l). Furthermore, TESCO pointed out that the proposed rule redefines "low-income" for the purposes of this rule only, and then calls "low-income" customers as defined by PURA §39.903(l) as "very low-income." TESCO suggested that the term "lower income" or some new term should be coined to designate working poor customers not covered by the definition.

TNMP commented that the definition of a low-income customer was established by the legislation and is defined as an electric customer whose household income is not more than 125% of the federal poverty guidelines. TNMP contended that there is no provision in SB 7 for creation of a new class of low-income customers whose household income is more than 125% of federal poverty guidelines, or for redefining the legislature's target sector as very low-income customers. TNMP claims that SB 7 prohibits establishing different sub-classifications, except to the extent that different sub-classifications exhibit unique load profiles for a particular end use, such as office lighting versus residential lighting. TNMP also claims that the legislation's requirement that the incentives be non-discriminatory precludes singling out "hard-to-reach" customers or any group simply according to how they may respond to what would otherwise be market-based programs.

TNMP recommends that all references to very low-income customers be revised to reflect the legislature's definition of the low-income class of customers and that all references to the new low-income customer class be eliminated.

TXU added that not only is it improper to change the definition of the low-income customer class and create two categories of low-income customers, it is also unadvisable to do so because the "low-income customer" class will create additional burdens on utilities that SB 7 clearly did not intend, as evidenced by its single definition of "low-income customers." Furthermore, TXU commented that the additional class will increase administrative costs because the creation of an additional category of low-income customers means that a utility would have to design special programs to be offered to that new "class" of customers and would have the continuing burden of ensuring that the new class of customers receive their proportional and equitable share of the incentive funds spent on energy efficiency programs. TXU strongly urged the commission to revise the proposed rules to include only one class of low-income customers and to define that class according to the guidance given by the definition of low-income customers in SB 7.

Very low-income customers

TXU commented that, consistent with its comments regarding low-income customers, this definition should be eliminated and that the class it includes actually be redefined as low-income customers. TESCO commented that very low-income customers should be simply "low-income customers" to be consistent with PURA §39.903(l). TNMP commented that this is an artificial customer class that serves no purpose within the context of the energy efficiency rule. TNMP recommended that all reference to very low-income customers be modified to refer to low-income, and that the references to the newly created "low-income" class be stricken from the rule.

The Coalition commented that a new consensus had been reached on nine topics, the definition and inclusion of low income and very low-income customers. The Coalition commented that although the rule should require utilities to demonstrate through their Energy Efficiency Plans how they will ensure that all customers in all customer classes have access to energy efficiency funds, there is no need to define "new" customer classes in the rule. The group did not oppose the rule's highlighting "hard-to-reach" customers to encourage the utilities to include special populations in the program design process, but recommended the elimination of the proposed "redefinition" of "low-income" and "very low-income."

OPC, Cities, Enron, and Shell (Joint Reply) made joint reply comments to the Coalition's oral comments, stating that SB 7 only requires that customer classes have a choice and access to energy efficiency options, not funds. Joint Reply contended that by making the rule stricter than PURA directs, the overall process becomes less efficient and favors the EESPs because more money will be spent to comply with the rule, harming customers. Moreover, the Joint Reply contended, the inefficiency will promote the interests of entrenched suppliers, raising the costs of programs, and possibly decreasing the competitive headroom.

Joint Public Interest Groups replied that energy efficiency programs must provide a fair share of the benefits to residential and low-income customers and tenants. Joint Public Interest Groups commented that the rule should encourage residential standard offer programs to be offered as pilot projects because residential standard offers have met with limited contractor participation and limited success in other parts of the country. Joint Public Interest Groups also commented that the System Benefit Fund under PURA §39.903 recognizes that the programs serving very low-income customers are different than other demand-side programs and should not be subject to the same standards as other demand-side programs. Joint Public Interest Groups commented that a substantial portion of residential customers have no energy efficiency programs available because they are income-ineligible for very low income programs but are too poor to have disposable income for energy efficiency investments. Joint Public Interest Groups further stated that to be fair, there should be a program to provide energy efficiency benefits to those in the 125% to 200% of poverty income range, which includes more than 1.8 million customers or 30% of the Texas population.

At the APA hearing, ORNL presented an analysis of the characteristics and barriers faced by low and very low-income customers. ORNL studied data related to customers at 60% of the median federal income (MFI), which in Texas is approximately the equivalent of 150% to 180% of the federal poverty guidelines. According to the ORNL study, low-income customers at 60% of MFI still spend a greater percentage of their income on energy than middle to upper income customers do. These customers, ORNL argued, face many of the same barriers that prevent these customers from participating in residential energy efficiency programs as customers below 125% of the federal poverty income guidelines do. Public Citizen, CCST, and GETCAP supported the ORNL study citing many instances in which they must turn low-income families away because their income narrowly exceeds the eligibility guidelines of the weatherization programs.

The commission eliminates the distinction between "low-income" and "very low-income" as offered in the published rule. The commission agrees that these income distinctions are too prescriptive and burdensome within the context of this rule. However, the commission finds that customers at or below 200% of the federal poverty guidelines face market barriers that prevent them from participating in the energy efficiency programs. The commission concludes that customers at or below 200% of the federal poverty shall be targeted as hard-to-reach customers.

Market transformation program

UCONS commented that the definition of market transformation has been misused and confused, and to be certain under-served markets are served, the term should be defined to include any new DSM program that can remove or reduce these barriers successfully.

The commission finds that the proposed definition adequately addresses the removal of market barriers and declines to revise the definition.

Peak demand, peak demand reduction and peak period

TXU commented that the proposed definition of peak demand is insufficient because it does not adequately state how peak demand will be measured. TXU stated that the definition defines peak demand as "electrical demand at the time of highest demand on the system," however the "time" of highest demand in the system could be measured in numerous different ways. TXU proposed that peak demand be precisely defined as the average electrical demand on the system between noon and 8:00 p.m. during peak periods because customer usage patterns traditionally show that this is the time when peak demand occurs.

TESCO commented that because the parties have agreed to move toward an energy- and capacity-based incentive payment, it is not necessary for this rule to define peak period. TESCO suggested the definition of "peak demand" would alleviate the confusion some utilities may have regarding the issue of the period during which peak reductions must be in place to count toward their efficiency goal. TESCO further noted that the off-peak period definition is important because it will define the energy value of savings.

The commission finds that the peak demand and peak period should be more specifically defined, and revises the definitions accordingly; the commission also adds a new definition for peak demand reduction.

Spot market benchmark price

TESCO commented that the definition should be modified to specifically identify the source of data to be relied upon for the spot market benchmark price, and recommended using Megawatt Daily until January 1, 2002, and data from the Independent System Operator for 2002 and later years. TXU commented that the definition should be eliminated because the term is not used in the rule.

The commission agrees with TXU and deletes this definition from the rule.

Standard offer contract

TESCO commented that the language of the proposed rule confuses the terms for "energy efficiency project", "standard offer contract," and "standard offer program," and that a standard offer contract is the agreement that a EESP signs with the utility to deliver savings in return for payment. A standard offer program is a utility's entire administrative structure or process for making such models, or standard, contracts available to service providers, as well as, for reviewing proposed projects and inspecting completed work and savings reports. TESCO further clarified, that although it is true that a model "standard offer contract" is the centerpiece of such a program, when discussing the model "contract" or the utility's administration of a standard offering generally, using the word "program" would relieve some of the confusion. TESCO therefore recommended that the definition for standard offer contract should be clarified or amended to recognize it is not the business of the EESP to carry out a standard offer program, but only to comply with the requirements of its specific contractual agreement with the customer and the administering utility.

The commission agrees that the definition for standard offer contract is too broad and revises the definition accordingly.

(d) Cost-effectiveness standard

EGSI, TXU, and TESCO *suggest* eliminating the ten-year maximum under the cost-effectiveness standard.

The commission finds that payments should be limited to ten years of savings. The ten-year limit is consistent with the CPL standard offer contract recently approved by the commission and with consensus during the workshops. The commission declines to adopt the suggested change.

EGSI suggested changing the language to reflect that project costs should include the cost of other energy sources in the case of fuel switching.

The commission finds that, although other energy sources are consumed when fuel switching occurs, electricity is saved. The commission declines to adopt the suggested change.

Reliant stated that the customer's incentive level is too high. It feared the lost revenue effect will increase rates and favored an overall limit on program costs. TIEC, OPC/Cities, Enron, and Shell raised concern about the impact on rates. In reply comments, TESCO stated that, to be cost-effective, efficiency measures should cost customers less than a new power plant. It also stated that the cost of the energy efficiency program will be too small to affect the "headroom" for concerned competitors like Enron and Shell.

The commission finds that it is sufficient to limit the cost of implementing the energy efficiency program by putting caps on incentives. The commission declines to make the suggested change.

Joint Public Interest Groups believed that paying off-peak spot energy prices for energy saved at peak is lower than a fair market price. Joint Public Interest Groups suggested using the average annual market benchmark prices for firm energy and capacity as an alternative. Reliant suggested tying payments to demand reduction and not energy savings. In reply comments, TESCO disagreed with Reliant's proposal that there should be payment for peak savings but not energy savings. TESCO noted that the issue was debated and the rule reflects a compromise, and it would not be fair to pay the same incentive for measures that have no energy savings and those that do. Reliant also proposed to set the value of saved energy on the basis of the spot price of energy at off-peak hours during the off-peak period. TESCO disagreed that the off-peak hours of the off-peak period reflect real energy prices, and supported the spot off-peak energy daytime prices currently included in the draft rule. TESCO suggested that the specific reference for spot market prices should be included in the rule to avoid confusion and promote consistency. CSW proposed a fixed capacity avoided cost of $570/kW, and a fixed energy avoided cost of $0.188/kWh in 1999 dollars.

EGSI, EDF, and Joint Public Interest Groups commented that avoided costs related to T&D should be included in the cost-effectiveness calculation. EDF argued that it would base the avoided cost on a statewide embedded cost and include transition charges. EGSI favored including reserve margins and ancillary services. Joint Public Interest Groups would include line losses of 15%, avoided reserve margins of 15%, T&D avoided costs of 20%-30%, and an environmental adder of 20%. Shell Energy stated that avoided costs should not be based on avoided capacity.

The commission finds that to streamline the April 1, 2000 cost unbundling proceedings, it is preferable to establish an avoided cost proxy in the rule. The estimated construction cost of a new gas turbine is $400/kW. Taking into account a 30-year life, 10% discount rate and a 3.0% inflation rate, the commission therefore sets the annualized capacity cost at $66/kW. The commission further finds that the avoided cost for energy should be based on the recent off-peak value of 2.5 cents/kWh. The commission finds that line losses of 7.0% (based on an approximate average for Texas utilities) should be included in the calculation of avoided energy and capacity costs and that reserve margins of 12% should be included in the calculation of avoided capacity costs for energy savings measured at the customer's meter. Other ancillary services and T&D avoided costs should not be included. The commission therefore concludes that the "cost-effectiveness" cap for the purposes of this statute shall be a proxy of total avoided capacity cost of $78.5/kW (($66)(1+7%+12%)) and a total avoided energy cost of 2.68 cents/kWh saved ((2.5 cents)(1+7%)). The commission finds that an environmental adder of 20% should be included only in non-attainment areas where targeted energy efficiency programs would enhance air quality or electric reliability of services. The environmental adder reflects the commission's concerns about maintaining reliable electric service as new air emission standards are adopted. The 20% adder should be used only to acquire additional energy efficiency that would not be cost-effective without the adder, and should only apply to all program and standard offers. The 20% adder is to be calculated as an increment over the incentive levels established in subsection (g)(2)(F). The commission has revised §25.181(d) accordingly.

TNMP, CSW, and TIEC objected to a cost-effectiveness standard that is higher than 100% (as for low-income customers). However, TIEC would not strike it from the rule provided two safeguards were added. Joint Public Interest Groups supported 125% of avoided costs for hard-to-reach customers.

The commission finds that a payment equal to 125% of avoided costs is not justified at this time. The commission has eliminated the provision from the rule.

(e) Annual growth in demand and energy efficiency goal.

Reliant stated that the rule does not clarify how peak demand is to be determined. Reliant suggested that the maximum demand reduction of an energy efficiency project should count toward the 10% goal provided it occurs within the defined peak period of May 1 through September 30.

The commission finds that the rule should clarify how the maximum demand reduction is to be counted, and so defines "peak demand reduction." The definition of peak demand has been clarified to indicate that peak demand is the maximum demand measured in 15-minute intervals, that occurs on a utility system.

EDF and Joint Public Interest Groups wanted energy and demand components in the goal for energy efficiency. Joint Public Interest Groups supported a 10% reduction goal for both energy and peak demand. In reply comments, EGSI referred to the language in PURA directing a 10% reduction in demand. OPC/Cities recognized that the methodology stated in the rule represents a compromise achieved during the rulemaking process. Nevertheless, they opposed the use of five-year historical data to forecast growth in demand because there will be a high likelihood that the growth in demand will be overstated.

The commission finds that a 10% demand reduction goal is consistent with the statute and represents a consensus reached during the workshops. However, the commission recognizes that unforeseen, dramatic fluctuations in demand growth during one year may understate or overstate demand growth in subsequent years. The commission finds that the utility may request a good-cause exception from the commission to use an alternate calculation method under these exceptional circumstances.

TNMP argued against setting arbitrary interim goals for achieving the energy efficiency goal. It argued that the legislature specified that the goal be achieved through market-based programs – so the market should be relied on for distributing incentives and attaining goals in the most efficient manner possible.

The commission finds that an interim goal of 5.0% reduction in demand growth by January 1, 2003 is reasonable and necessary to ensure progress toward the legislatively mandated goal of 10% reduction in demand growth by January 1, 2004.

EGSI suggested the utility should submit its projected growth in demand as part of its annual energy efficiency report.

The commission finds that the reports should be consolidated. The annual growth in demand projection will be part of the annual energy efficiency report due April 1 of each year. The commission has revised §25.181(g) accordingly.

(f) Basic program elements

CSW commented that all references under §25.181(f) to kW *and* kWh saved should be kW *and/or* kWh saved.

The commission agrees with the change and has made revisions throughout the rule accordingly.

Nucor commented that proposed §25.181(f) should be revised to delete unnecessary language regarding energy efficiency because that term is defined in §25.181(c). TESCO and the Coalition commented that §25.181(f) should be amended to note that both energy consumption and reductions of demand are sought. TESCO further commented that §25.181(f) should be expanded to require utilities to spend any funds granted within their rates for efficiency programs at present to continue to spend such funds on efficiency in the transition period.

The commission disagrees with Nucor's proposed change, because energy efficiency programs are not defined. The commission agrees with TESCO and the Coalition that both reductions in energy consumption and reductions in demand are sought; however, this is not required. Payments are made separately for energy and demand savings. The commission further includes language similar to TESCO's proposal regarding the expenditure of funds currently in utilities' rates.

EGSI, Reliant, TESCO, and TNMP commented that different segments in proposed §25.181(f) needed modification. EGSI commented that §25.181(f) should be clarified by adding "administered by the utility" after programs. Reliant commented that §25.181(f) should be clarified in accordance with its stated position regarding §25.181(d)(2) because paying for kWh savings to reach a kW-based goal can unnecessarily inflate the cost of the overall program. Reliant further commented that an overall cap on dollars per kW of demand reduction should be considered. TESCO commented that §25.181(f) should be amended to clarify that any program which includes an incentive component *shall* separately pay out incentives for both kW and kWh saved, as appropriate. TNMP commented that the second sentence of §25.181(f) should be changed to focus on efficacy and economic use of resources in preference to arbitrarily establishing incentive structures and cost-effectiveness criteria. TNMP contended that establishing varying incentive levels is not market neutral, is discriminatory, and is in violation of PURA §39.905(a)(1).

The commission declines to incorporate EGSI's proposed change because the rule addresses only programs administered by the utility. The commission has addressed the changes suggested by Reliant in connection with §25.181(d). The commission finds that the rule adequately addresses TESCO's concern that incentive payments are made for kWs and kWhs saved. The commission disagrees with TNMP that varying incentive levels are discriminatory and in violation of PURA. Based on the discussion of Preamble Issue Number 8, TNMP's proposed changes are not adopted.

TXU and Joint Public Interest Groups commented that proposed §25.181(f) needs modification to clarify its application to market transformation programs. TXU commented that §25.181(f) requires that *all* programs offer incentive payments for kW and kWh saved, and because "programs" is not a defined term, it is unclear whether such programs are intended to include market transformation programs. TXU disagreed that incentives should be paid for all market transformation programs in order for their savings to count towards the energy efficiency goal, arguing that this might place a restriction on reaching the energy efficiency goal cost-effectively and might unnecessarily block good projects from being offered to customers. TXU argued that the incentive requirement should authorize, but not require, incentive payments. Joint Public Interest Groups commented that §25.181(f) should be modified to state that market transformation programs shall offer incentives or other benefits as approved by the commission in the utility's energy efficiency plan, instead of incentive payments for kW and kWh saved as required for standard offer programs. Joint Public Interest Groups argued that market transformation programs may include incentive payments for marketing, education, training, financing, and many other services and benefits to increase customer uptake of energy-efficient technologies and practices. However, Joint Public Interest Groups argued that under the current proposed language a program, which has no direct kW or kWh incentive, may not qualify even if it is a more cost-effective option.

The commission agrees with TXU and Joint Public Interest Groups that incentives for market transformation programs should be structured differently from standard offer programs and that special provisions are needed for market transformation programs to be effective. Accordingly, the commission modifies §25.181(f)(2).

TNMP and TXU commented that the reference to customer protection provisions in proposed §25.181(f) should be stricken. TNMP commented that the competitive market, combined with existing customer protection provisions in law, provides adequate protections without placing utilities in the position of establishing contractual requirements that ultimately require the utility to act as an ombudsman. TXU commented that customer protection is already legally provided through such avenues as contract law and the Deceptive Trade Practices Act. TXU argued that incorporating an inclusive list of customer protections in the rule could be interpreted as creating a special standard for energy efficiency customers, thus removing them from the protections of tested, potentially broader established protections.

The commission declines to delete the reference to customer protection provisions for the reasons discussed in connection with §25.181(n).

EGSI, Nucor, Cardinal, and Joint Public Interest Groups commented on various parts of proposed §25.181(f) regarding inspections and M&V. EGSI commented that §25.181(f) should be modified to reflect that inspections are needed to ensure that energy savings are achieved, but the M&V will be used only to improve future energy savings estimates rather than to ensure that energy savings are achieved. Nucor commented that §25.181(f) should be revised to add "as necessary" to the inspection, measurement, and verification requirement, because unnecessary inspections simply add to the cost of the program. Nucor argued that the necessary level of M&V could be determined for each project when the commission reviews the utilities' plans. Nucor further recommended replacing "energy savings" with "project/program goals" because it is a more specific reference. Cardinal and Joint Public Interest Groups commented that §25.181(f) should be modified to allow flexibility for market transformation programs. Cardinal commented that market transformation programs and programs utilizing deemed savings should be subject only to verification that the program was properly implemented and, in the case of standard offer programs utilizing deemed savings, that the actual measure was installed. Joint Public Interest Groups commented that market transformation programs should be evaluated according to the specific evaluation methods approved in a utility's energy efficiency plan or within statewide pre-approved market transformation programs.

The commission clarifies that inspections will be conducted by the utility and are limited to a statistically significant sample. The commission agrees with EGSI that inspections are needed to ensure the savings are achieved. The commission further clarifies that M&V is carried out by the EESP. The commission agrees with Cardinal and Joint Public Interest Groups and changes §25.181(f)(4) to allow appropriate flexibility for market transformation programs.

TXU commented on the scope of the proposed Working Group (energy efficiency implementation docket) referenced under §25.181(f) (now subsection (m)), recommending that the proposed rule be revised to allow, not require, the commission to consider and act on the recommendations of the Working Group (energy efficiency implementation docket).

The commission agrees with TXU that it should not be compelled to act on any and every recommendation of the energy efficiency implementation docket and adopts appropriate modifications to that end. The commission also concludes that it is more efficient to create an energy efficiency implementation docket to carry out the responsibilities previously proposed for a working group.

(g) Schedule and required filings

CSW commented that throughout §25.181(g) the rule references "energy *and* demand" and it should reference "energy *and/or* demand" and "kWs *and/or* kWh."

The commission agrees with the change and has made revisions throughout the rule accordingly.

CSW, TXU, EGSI, and TESCO generally commented that there should not be mandatory goals prescribed in the rule and noted concerns over recovery of expenditures associated with interim goals. CSW commented that utilities should be afforded the flexibility to optimize their programs. TXU argued that SB 7 does not authorize this compulsory requirement and if not removed entirely, the goals should not be mandatory. TESCO commented that expenditures above the amount currently in a utility's rates expended on efficiency programs in order to meet interim goals should be recoverable in post-January 2002 rates.

Shell supported the interim goal requirement and noted that numerous utilities have energy efficiency expenses in rates. Shell commented that the commission and other parties have recognized that meaningful energy efficiency improvements will take time, and utilities may not reach the statutory goal if they wait until 2002 to begin these programs. Shell further commented that language referring to interim goals being consistent with approved funding should be deleted because it implies that a utility without energy efficiency expenses in its base rates need not devote any resources to this mandate. In reply comments, Shell argued that although SB 7 may not expressly require interim goals, the power clearly exists by necessary implication to secure attainment of the overall statutory goal, and therefore lies within the commission's discretion.

Additional arguments by parties regarding the issue of timely cost recovery are addressed in the discussion of Preamble Issue Number 2 and those arguments are not reiterated here.

The commission finds that interim goals are voluntary until January 2002, and that new rates will be approved by that date. In 2003 the mandatory goal is only half of what the commission must ensure will be met the following year. The commission agrees with Shell that it has the authority to set interim goals to ensure that utilities meet their legislative mandates, and has revised the rule to clarify that utilities shall have energy efficiency funds in their rates by January 1, 2002. However, utilities that do not have money in their base rates today for energy efficiency or DSM are encouraged, but not obligated to expend the funds for that purpose. Therefore, the commission declines to revise the language regarding interim goals. For organizational purposes §25.181(g)(1) (relating to interim goals) has been moved to §25.181(e). Expenditure levels and funding mechanisms are discussed in greater detail under §25.181(h)(5) and (g)(3).

CSW and SPS commented that proposed §25.181(g)(2)(A) (relating to the schedule) requires utilities to file goal targets by January 15, 2000, which is before the final rule will be adopted. SPS commented that it believes that the April 1, 2000 filing should be used for 2000, and that a January 15th annual date will work starting in 2001. TXU commented that proposed §25.181(g)(2)(A) should be revised to specifically require reporting of projected energy and demand savings. TESCO and Shell commented that proposed §25.181(g)(2)(A) should clarify whether the "projected annual growth in demand" represents the five-year historic demand growth rate identified in proposed §25.181(e)(1). Shell commented that, assuming the utility does not revise its next year's goal, the odd result could occur that a utility met all its yearly goals but missed its overall goal. Shell commented that in proposed §25.181(g)(2)(A), the commission should describe the methodology that the utility must use to convert from kWs to kWhs. Shell recommended a 35% conversion factor for the first two years, and thereafter apply a factor based on actual experience, as used in Project Number 20944, *Renewable Energy Mandate.* TESCO commented that proposed §25.181(g)(2)(D) should be modified to note that programs should be adopted by 2002 that are accessible to all customer classes.

The commission agrees with CSW and SPS regarding the possibility for confusion regarding the required filing schedule and revises the rule accordingly under

§25.181(g)(1). The commission agrees with TESCO and Shell that annual growth in demand should be calculated using a five-year historical average and finds that this is adequately addressed under §25.181(e). The commission disagrees with Shell's comments that the rule should prescribe the methodology for converting kW to kWhs. The conversion factor for renewable energy programs is not applicable to energy efficiency programs. In energy efficiency programs the kW and kWh savings vary by type of measure. In the case of load management, the conversion factor would be zero. The commission declines to incorporate TESCO's proposed change to §25.181(g) regarding all customer classes because this is addressed elsewhere in the rule and would not add any meaning if inserted in this subsection.

CSW commented that throughout proposed §25.181(g) references to standard offer contracts *and* market transformation programs should be revised to refer to standard offer contracts *or* market transformation programs.

The commission agrees with CSW that PURA §39.905 allows standard offer programs or market transformation programs and modifies the language throughout this rule where applicable. The language is modified to use the words "contract," "project," and "program" correctly throughout this section.

Joint Public Interest Groups commented that certain aspects of the proposed §25.181(g) should be amended to: 1) specify the types of informational activities utilities must plan to encourage participation by prospective energy service providers as discussed in

Preamble Issue Number 5; 2) define how the share of incentive funds allocated to various customer classes should be determined; and, 3) require the utility to fully describe and provide a detailed plan for market transformation programs.

The commission agrees with Joint Public Interest Groups with regard to informational activities and adds language in §25.181(h)(1). Allocation of incentive funds by customer class is addressed under Preamble Issue Number 8. The market transformation program provisions have been revised under §25.181(j).

TNMP, Nucor, and Cardinal suggested language changes to proposed §25.181(g), regarding existing contract obligations. TNMP commented that §25.181(g) should refer to validated energy and demand savings instead of verified savings. TNMP argued that use of the term "verified" excludes energy and demand savings produced by energy efficiency service providers under the deemed savings provisions of the rule. TNMP commented that because the commission will validate deemed savings prior to adoption, there is no reason to re-verify these savings. Nucor commented that energy efficiency measures that are extended or expanded (not only installed) should be allowed to count towards the goal. Nucor noted that nothing in SB 7 limited energy efficiency to new programs and that the continuation of existing programs should be counted towards the statutory goal. Nucor further commented that load management programs initiated or expanded after the original contractual obligations have expired should count toward the statutory goal. Cardinal commented that language for market transformation projects should be included to allow estimated savings, if approved by the commission before commencement of the project, to count towards the amount of energy and demand savings actually achieved each year.

The commission agrees with TNMP regarding reporting "validated" savings so utilities can count deemed savings, and has modified §25.181(g)(4) and (l). The commission disagrees with Nucor that projects that are renewed, extended, or expanded after the date of this rule should count towards the energy efficiency goal. PURA §39.905 explicitly states that utilities must acquire *additional* energy efficiency savings. The commission agrees with Cardinal and incorporates appropriate modifications for market transformation programs under new §25.181(j).

Shell commented that the commission should change proposed §25.181(g) to require the utility to spend amounts included in current rates for both DSM and energy efficiency, to the extent that any rate orders may distinguish these categories. Reliant commented that the expenditures associated with the new programs may lag implementation by 12 to 18 months or more due to the time required to verify savings.

The commission agrees with Shell that both DSM and energy efficiency activities should be included. The commission has revised §25.181(g)(3) to address this concern. The commission finds that customers should continue to receive the benefits flowing from any DSM or energy efficiency programs that are already in utilities' budgets. The rule directs utilities to report on funds expended and funds committed on energy efficiency projects, so it adequately addresses Reliant's concern.

TESCO commented that the proposed duration of standard offer contracts and market transformation programs should be amended to include some direction to utilities to include information about the nature of the efficiency programs and whether they plan to implement new programs or continue programs approved by the commission. TESCO commented that this would make this section consistent with the rule's intent that utilities be encouraged to use pre-approved programs that are similar statewide.

The commission agrees with TESCO's proposed changes and adopts the appropriate language to broaden the scope of §25.181(g)(2)(D) (previously §25.181(g)(3)(E)).

EGSI, CSW, and TXU commented regarding the references to customer classes in proposed §25.181(g). EGSI commented that the references should be removed because the changing industry will be changing the definitions for customer classes and that the utility's customer classes may not be the same customer classes served by the REP. CSW proposed deleting the specifications of low and very low-income groups from the residential class. TXU commented that it cannot describe the size of customer classes because it does not know, nor does it have a way to know, the income level of its customers or the ownership status of its customers.

NAESCO, Schiller, TXU, TNM, TESCO, and Shell disagreed with the requirement in proposed §25.181(g) that all customer classes must have access to a "proportional or equitable share" of the incentive funds. NAESCO commented that utilities should be given reasonable flexibility in allocating program funds and determinations regarding sharing of program funds by customer classes are more appropriately considered and resolved by the Working Group (energy efficiency implementation docket). TXU commented that the term "proportional and equitable" is vague and this requirement goes far beyond the intentions of PURA §39.905(2) that only requires that every customer have a choice of and access to energy efficiency alternatives. TNMP commented that the rule inappropriately amends the legislation to establish new criteria for the distribution of incentive funds, adopting either a proportionality or equity standard. TESCO commented that a utility should not have to assure that incentive funds are actually spent on any one customer segment in any one year, especially given the variety of customer classes identified in this paragraph. Shell commented that the term is vague and parties could reasonably dispute what constitutes a proportional or equitable share. Shell commented that reaching the percentage energy efficiency goal on a cost-effective basis constitutes the rule's main purpose and that equity and proportionality concepts should not impair the cost-effectiveness requirement. Shell further argued that the commission should add "consistently with the section's overall goals" at the end of the subsection.

TIEC, Joint Public Interest Groups, Frontier, and SPS commented on the collection for the funding addressed in proposed §25.181(g). TIEC argued that if the spending on energy efficiency is to be proportional or equitable among classes, then so should the allocation and collection of the funding. TIEC argued that because the funding of this program will be done through a charge in regulated T&D rates, the costs associated with this program should be allocated according to cost causation principles typically used in setting rates and that the funds spent in a particular class should be collected from that class. Joint Public Interest Groups commented that the allocation of incentive funds to customer classes should be based on each class' contribution to revenues and that the allocation method be reviewed on an annual or bi-annual basis to review its success in achieving energy savings in each class. Joint Public Interest Groups noted the following allocation of incentive funds based on data in the 1998 Statewide IRP filing: 47% residential, 32% commercial, and 21% industrial. Joint Public Interest Groups further recommend revisiting the method of allocation every few years in light of the savings achieved through programs to each customer class. Frontier replied that the proposed requirement of proportional or equitable shares contradicts the inclusion of proposed incentive caps and that each customer class should receive incentive payments in proportion to the percentage of funds contributed by that class for energy efficiency programs. SPS commented that SB 7 established a System Benefit Fund to assist low-income families in meeting their energy needs. SPS argued that in determining whether the distribution of energy efficiency incentives is "proportional or equitable," the funds distributed through the System Benefit Fund should be considered.

The Coalition stated that the rule should require utilities to demonstrate through their energy efficiency plans how they will ensure that all customers in all customer classes shall have access to energy efficiency funds. In reply comments, OPC, Cities, TIEC, Shell, and Enron (Joint Reply) argued that the Coalition misstates the law because SB 7 does not require equal access to energy efficiency *funds*, but rather, equal access to energy efficiency options. The Joint Reply argued that an inefficient process naturally favors the EESPs, because the more money that is spent to comply with the rule, the more they will benefit. The Joint Reply further argued that additional funding promotes the interests of entrenched suppliers by raising the costs of programs and possibly decreasing headroom. Joint Public Interest Groups replied that energy efficiency programs must provide a fair share of benefits to residential and low-income customers and tenants. They proposed that the rule should encourage that residential standard offer programs be offered as pilot projects, because residential standard offers in other parts of the country have been met with limited contractor participation and limited success. Joint Public Interest Groups commented that incentive funds should be allocated according to the share of revenues contributed by each customer class. Joint Public Interest Groups argued that the System Benefit Fund language of PURA recognizes that the programs serving very low-income customers are different than other demand-side programs and should not be subject to the same standards as other demand-side programs.

For the reasons presented in the discussion of Preamble Issue Number 8, the commission concludes that the rule should only specify a share of energy efficiency savings achieved through contracts for hard-to-reach customers. As discussed under Preamble Issue Number 6, the programs under the System Benefit Fund, the arrangement between TDHCA and the weatherization providers can be considered a standard offer contract, and the savings achieved through the System Benefit Fund may be counted towards the energy efficiency goal.

EGSI commented that the reference in proposed §25.181(g) to a "ceiling established under §25.181(d)" is unclear because §25.181(d) does not appear to establish a ceiling. EGSI stated that if the reference is to the difference between benefits and costs, this should be explicitly stated.

The commission disagrees with EGSI and finds that §25.181(d) does establish a ceiling.

Numerous parties objected to the proposed incentive caps expressed as percentages of the cost-effectiveness limit in proposed §25.181(g). The parties generally believe the caps are arbitrary and that they will hinder market response and threaten the ability of programs to meet the legislative goal. SPS, Schiller, TXU, Reliant, TNMP, Nucor, and SPS objected in total to the incentive payment cap language in §25.181(g). Schiller argued that utilities need flexibility to meet the goals and that incentive payment caps will significantly limit market response to the programs. Schiller argued that the two reasons for having the cap, to minimize overall program costs and ensure that incentives do not cover the entire cost of cost-effective energy retrofits, could be handled by budget limits set in the utilities' T&D rate filings and different rule language. TXU, Planergy, Nucor, Frontier, and Joint Public Interest Groups commented that the arbitrary incentive level caps are unnecessary, needlessly rigid, and insufficient to encourage a level of energy efficiency projects that will enable utilities to satisfy the energy efficiency goal. TXU agreed that cost issues could be resolved in the energy efficiency plans in the April 2000 rate filing, which could include thought-out, custom-designed incentive levels. TXU commented that the energy efficiency market would not accept the proposed incentive level caps, including both EESP and their customers, at a level that will meet the energy efficiency goal. TNMP commented that the caps are in conflict with PURA §39.905(a)(1) by creating discriminatory incentive levels for different customer classes. Nucor commented this section treats customer classes differently in violation of PURA §36.003(b) and (c)(3). SPS commented that the different ceiling incentive levels plainly discriminate against certain customer classes and are in direct conflict with the requirement in §25.181(g) that "all customer classes must have access to a proportional or equitable share of incentive funds." SPS further commented that §25.181(g) conflicts with §25.181(d) (relating to the cost-effectiveness standard). TXU stated in reply comments that there are a number of negative implications from incentive level caps. They stated that it will result in overpayment for some savings and underpayment (or no payment if the incentive is too low to create market response) for others. Reliant argued in reply comments that equal incentive caps can only be workable as part of the definition of cost-effective; that for example, cost-effective could be defined as 50% of the calculated level for all classes.

OPC/Cities and TIEC commented that the ceilings for the incentive levels may be too high in certain categories. TIEC commented that the incentive payments should be capped, although the cap should be equal across customer classes, with the exception of the non-firm class. TIEC replied that it couldn't say with certainty what the cap should be, but would suggest that the issue should be studied to determine the proper cap for each customer class. TIEC also commented that the combined costs of the incentive payment, the M&V and administration should never equal more than the avoided cost as established in the rule. TIEC argued that this principle was agreed to in negotiations and reflected in §25.181(d)(1) of the rule. TIEC argued that given that M&V costs might be as high as 15% and administrative costs might be as high as 5.0%, then no incentive payment should ever be higher than 80% so that the *total* is equal to or less than 100% of avoided costs.

CSW, Joint Public Interest Groups, NAESCO, and TESCO objected to the proposed incentive levels in §25.181(g), and offered alternative levels. CSW and NAESCO proposed a 100% incentive level for each customer class, in order to attract energy service providers to participate in standard offer programs. NAESCO contended that the commission should only consider reductions in incentive payments after careful study by professionals with the qualifications and experience to make such recommendations and that the Working Group (energy efficiency implementation docket) should be given the responsibility to consider refinements in incentive payments once actual program experience can be evaluated. TESCO agreed with these arguments and also argued that residential customers may need relatively more incentive or entail relatively more administrative costs than other classes. TESCO recommended that programs designed to address each class of customer be allowed to vary to determine what levels of incentive work best. TESCO commented that spending caps might be better addressed, especially for standard offer contracts, by requiring that no more than 50% of the cost of a large commercial or industrial project be paid for with incentive funds, not more than 80% of residential and small commercial projects, and not more than 100% of projects for any hard-to-reach customer. Joint Public Interest Groups stated that utilities must pursue the most cost-effective options and not be forced to overpay for measures that would likely occur in the absence of the program. Joint Public Interest Groups commented that market transformation programs that leverage existing national and state activities and focus incentives upstream can be used to achieve maximum savings with minimal costs.

Planergy commented that the assumption that it is not necessary to provide customers with incentives for load management actions because they already have incentives to engage in such actions is untrue in today's market. Planergy commented that customers are generally assessed demand charges on the basis of their highest demand during a monthly period and the hour of the customer's highest demand is not necessarily coincident with the utility system's peak. Planergy argued that if a utility customer takes actions to reduce its demand at the time of the utility's system peak, the customer is unlikely to be rewarded for such actions in the absence of a load management program or a real-time pricing program. Planergy also commented that limits on load management may compromise reliability because the reliability councils serving the Panhandle, El Paso, and East Texas are lagging far behind ERCOT in the establishment of rules that would permit demand-side resources to compete in markets for generation and ancillary services. Frontier stated in reply comments that it supported Planergy's comments especially where a power region is not able to properly value load management and provide appropriate market-based incentives.

TIEC and Reliant supported incentive payments for load management programs in proposed §25.181(g). TIEC argued that load management programs are a cost-effective way of reaching a significant (but not overly large) portion of the overall goal. TIEC argued that at a minimum, these worthwhile programs should be incentivized at a level no less than the costs of administering them. Reliant stated in reply comments that it is generally accepted that load management is a cost-effective option and, within limits, is properly eligible for inclusion in the program. However, Reliant replied that many believe that the 5.0% incentive cap, as currently structured in the proposed rule, will effectively eliminate load management as an option. TIEC argued that although the statute speaks in terms of both energy and demand, it unambiguously sets the goal of the program as one that reduces demand.

NAESCO stated in reply comments relating to proposed §25.181(g) that no party has offered factual proof that the proportional allocation of funds by customer class makes the energy efficiency goals more achievable. NAESCO argued that the theoretical underpinnings of the proportional customer class allocation argument put forth by Texas ROSE, ACEEE, and others – that it is better for residential customers to spend more public funds on residential customers – may not be as obvious as it initially seems. NAESCO listed the preliminary findings of research by the Sierra Club in California that suggests that the public value of load reduction programs is substantially more than previously thought and that the value to the public far exceeds the average price of power or the avoided costs because in the competitive environment, savings are not the result of high prices, but instead result from a combination of large loads and the sensitivity of prices to load. NAESCO replied that commission should also be concerned whether breaking up standard offer programs into smaller programs targeted at customer niches will help or hinder utilities in meeting their energy efficiency goal. NAESCO noted that broader programs allow for greater flexibility and increased creativity and recognize the geographical disparity of available energy efficiency resources.

OPC stated in reply comments that it supports incentive caps. OPC argued that incentive levels need not be tied to avoided energy or capacity costs and that it prefers incentives set at a level that compensates for market failure resulting in under-acquisition of energy efficiency. OPC replied that the avoided cost methodology for setting incentive levels is acceptable as a compromise, if caps are placed on incentive percentages. OPC replied that it opposes the alternative suggested by TESCO that the rule should cap incentives as a percentage of project costs because raising the caps will only increase the costs of the program. OPC replied that the unduly high incentive levels cited by TESCO in California conditioned the market such that when incentive levels decreased, participation rates dropped dramatically. OPC cited Austin as an example where potential participants were conditioned to expect high incentive levels. OPC argued that the commission should avoid setting incentive levels too high in the beginning of the compliance period and if necessary, the commission could later raise incentive levels as future conditions warrant. OPC provided a report by Kennedy & Associates that concluded that the present caps are high and should be reduced further to ensure that the goal is achieved at the lowest cost. The Kennedy report states that standard offers for energy efficiency programs should not exceed 35% of avoided cost and standard offers for load management should not exceed 13% of avoided cost. The report asserts that the data shows that there is no need to differentiate incentive levels for customer classes, including residential customers. In reply comments, Enron, Shell, TIEC, and the Cities supported the Report's findings. The Joint Public Interest Groups, Good Company, TXU, TNMP, SPS, CSW, Planergy and Frontier filed comments disputing the Kennedy report findings and questioned the accuracy and consistency of the data and argued that the analysis does not differentiate between program types. The parties further questioned the methodology of the cost calculations. In addition, the Joint Public Interest Groups commented that the cost caps proposed by the report are counterproductive to the goals of the rule and the participation of residential customers in particular.

In addition to the above independently filed comments, the Coalition commented that incentive caps should be eliminated and that the allocation of incentive funds among customer classes should be according to the share of revenues contributed by each customer class. In reply comments, OPC, Cities, TIEC, Shell, and Enron (Joint Reply) argued that the deletion of incentive caps is completely at odds with the consensus agreement reached by parties, including members of the Coalition, during the energy efficiency workshops. Without incentive caps, OPC, Cities, and TIEC would not accept the cost-effectiveness methodology in the rule. The Joint Reply noted that the caps were an integral part to achieving consensus on the cost-effectiveness standards in the rule. Joint Public Interest Groups replied that residential customers face greater barriers to energy efficiency investments than large customers do, and should, therefore, receive a greater share of the funds. Joint Public Interest Groups also argued that those measures that are relatively short-lived and pay back rapidly (e.g., lighting) should be offered a lower incentive than those measures that are more complex, are more permanent, take longer to pay back, or are more comprehensive.

The commission applauds OPC's effort to provide objective information concerning the appropriate level for incentive caps. The commission is, however, concerned about the consistency of the underlying cost information that was the basis for the analysis in the report. The data source used to compile the report relies on voluntary reporting by utilities and does not provide details on the format or information that is included in the data reported by the utilities. In addition, the data source does not differentiate among program types, resulting in an analysis based on divergent programs, ranging from low-interest loan programs to full retrofit programs, that are primarily programs implemented by utilities, rather than market-based standard offer programs. The commission also concludes that the other parties have not presented any data to support the argument for increasing the caps for incentive payments to 100% of the avoided cost for all customer classes. Incentive caps are necessary to support the goals of providing programs for all customer classes and ensuring that programs are cost-effective. Different incentive caps for different customer classes reflect the commission's view that smaller incentives will be adequate to obtain savings from customers who are large consumers of electricity, while larger incentives will be necessary for small customers. The differentials in the incentive levels are not unduly discriminatory because they are necessary to achieve the statutory goals of ensuring that these programs are available to all customer classes and are cost-effective without compromising the competitive headroom. Moreover, despite the weaknesses in the OPC analysis, the report does convincingly show that the caps may be lowered from the caps presented in the proposed rule, and still encourage a competitive market in the energy efficiency industry. The commission therefore finds that the caps should be set 100% for hard-to-reach customers, 50% for residential and small commercial customers, 35% for large commercial and industrial customers and 15% for load management programs. The commission notes that utilities have the opportunity to petition the commission to adopt different ceilings for incentive levels. The commission revises §25.181(g)(2)(F) (previously §25.181(g)(3)(G)) accordingly.

CSW, Shell, and TNMP offered changes to proposed §25.181(g) regarding the annual budget to be contained in the energy efficiency plan. CSW proposed changing the language to reflect that the utility could use standard offer programs or market transformation programs. Shell commented that the commission should clarify that even if a utility's annual budget changes, rates set to recover these expenses will not change. Shell addressed this issue in more detail in Preamble Issue Number 2. Shell commented that if the commission allows flow-through cost recovery, the utility should propose not only the annual budget, but also the appropriate rate charge. TNMP commented that the specific reference to hard-to-reach customers should be deleted. TNMP argued that the legislature's requirement that incentives be nondiscriminatory eliminates the need to detail incentives, except to the extent as may practically be required to monitor progress towards the efficiency goal and to prevent exceeding annual budgets.

The commission agrees with the commenters that additional language is necessary to clarify that approval of the projects, with appropriate budgets, will occur as a result of the

April 1, 2000 filings. The commission has added language to §25.181(g)(1). The commission declines to delete the reference to "hard-to-reach" customers. These are customers that are difficult to reach through traditional energy efficiency programs, and it will probably require higher incentives to make the energy efficiency programs available to them.

The commission adds three provisions to the energy efficiency plan in response to these comments. The first requires the utilities to discuss the types of informational activities they will use to encourage participation in standard offer programs or market transformation programs by prospective EESPs. The second requires the utilities to state the manner in which they will provide notice for standard offer contracts. The third requires the utilities to state the manner in which they will post the notice for solicitation of market transformation projects, and any other facts which may be considered when evaluating a market transformation project. These additions are made in accordance with suggestions of the parties discussed under Preamble Issue Numbers 5 and 7. The rule is revised to incorporate CSW's suggested change, relating to the use of standard offer and market transformation contacts. The commission has revised §25.181(h) and added subsection (i) to reflect these changes.

Under proposed §25.181(g), SPS, CSW, TNMP, and TESCO objected to the "material change" provision concerning revisions to the energy efficiency plan. SPS commented that it is far too ambiguous. CSW proposed revising the standards regarding material changes to reflect a change in funding by more than 10% instead of over 5.0% for individual contracts to increase the utility's flexibility in order to meet their goals. TNMP commented that a material change should be if the utility expects to fall short of, or exceed, its annual goal for peak demand reduction or its annual budget by more than 10%. TNMP argued that so long as programs are market-based and the incentive programs are nondiscriminatory, whatever happens in the market will be consistent with the legislature's intent, and there is no need to continually file at the commission for exceptions. TNMP argued that utilities could be reasonably expected to encourage a small number of EESPs to each contract for as much as 20% of the funding in order to avoid a constant stream of revisions to their energy efficiency plan. TXU replied that it generally agrees with TESCO and CSW that the rule needs to be revised to allow the utility to adjust its funding for incentives between programs in order to meet customer demand and meet its energy efficiency goal. TXU replied that it believes the proposed rule is too restrictive in limiting a utility's flexibility to make the changes necessary to meet its energy efficiency goal. Reliant commented that §25.181(g) needed to be expanded to include specific provisions regarding the commission's approval process for both the energy efficiency plan and any proposed revisions. Reliant argued for the need for the timely recovery of additional costs that may be incurred in implementing such revisions. Reliant argued that the commission was given a significant responsibility by the legislature in SB 7 and it must provide oversight and adopt rules and procedures to ensure that the goal is achieved by January 1, 2004. Reliant commented that the rule must provide the utilities every opportunity to accomplish the demand reduction goal and highlighted the fact that programs will require incentives and will be expensive. Reliant argued that if a utility must file a rate case or divert funds from another area, programs will be delayed and the energy efficiency goal will be jeopardized. Reliant recommended revising §25.181(g) to provide for commission approval of energy efficiency plans prior to implementation, and timely recovery of expenses incurred to achieve the goal.

The commission adds new subsection (g)(3), relating to the process for approval of standard offer contracts, deemed savings values, and measurement and verification plans. The commission clarifies that the process is intended to provide a *minimal* regulatory oversight and approval over the individual performance contracts between the utility and the energy efficiency service provider.

The commission finds that the proposed rule's criteria for material changes are too detailed. It has revised §25.181(g)(4)(I) to reflect that only a decrease of more than 10% in total program costs constitutes a material change. The commission declines to adopt Reliant's suggestion to prescribe the process by which the commission will approve a material change.

EGSI commented that the submission of annual energy efficiency reports requirement should be modified for a utility which does not currently have energy efficiency costs in current rates, and does not implement its energy efficiency plan until 2002, and would therefore not have any savings to report until March 1, 2003.

The commission declines to incorporate EGSI's recommended change, because the commission needs to know whether a utility is implementing energy efficiency programs.

In the event a utility does not implement programs during the transition period, the annual energy efficiency report would show only data regarding growth in demand.

Joint Public Interest Groups commented on proposed §25.181(g)(4) that the reporting requirements fail to properly recognize the differences between standard offer and market transformation programs and that too much emphasis is placed on peak demand and not enough emphasis on energy savings. Joint Public Interest Groups recommend structuring the reporting requirements to track both energy and demand savings and all annual savings including customer bills reductions. Joint Public Interest Groups further commented that the requirements in the description of ongoing and completed energy efficiency projects are too specific, particularly, listing the numbers of customers served by each project would impose undue burden on the implementers of retail- or distributor-oriented market transformation programs.

The commission agrees that special consideration must be given for the unique circumstances surrounding market transformation programs and revises §25.181(h) and added subsection (i) to reflect these changes.

Reliant commented that the comparisons in the annual report of projected savings and verified savings for each contract from the previous year, as well as statements showing funds expended and funds committed but not spent, may not be meaningful. Reliant commented that, for example, there may be contracts entered into during the previous year for which funds have not been expended, either because the installation of all measures has not been completed or because installed measures have not been in place long enough to allow savings to be verified. Reliant argued that this section assumes that projects can be planned, installed, verified, and paid all in the course of a year and this may not be the case.

The commission agrees with Reliant and modifies the language to lessen timing problems under §25.181(g) and (l) (previously subsection (j)) accordingly.

Reliant, TXU, and TESCO commented that the reporting requirements under proposed §25.181(g)(4) inappropriately calls for a comparison of deemed savings and verified achieved saving as verified by the independent auditor (independent M&V expert). Reliant argued that the state auditor (independent M&V expert) should not verify deemed savings. Reliant commented that, by definition, deemed savings may be used instead of savings determined through M&V activities. TXU argued that an independent verification of savings is necessary. In the alternative, TXU proposed a revision to include verification as a separate duty in the independent auditor (independent M&V expert) subsection of the rule, instead of as a required part of the March 1 annual energy efficiency reports. TXU noted that it does not disagree with including in the annual energy efficiency reports a comparison of deemed savings and achieved savings that it verifies, but it does not believe that an "audit of the audit" performed by an independent auditor (independent M&V expert) is necessary or cost-effective. TXU and TESCO objected to having to include a comparison made by an independent auditor (independent M&V expert) in its annual energy efficiency report because it cannot control whether the audit will be performed timely such that the results will be available for inclusion in the energy efficiency report. TXU and TESCO argued that the rule should only require a comparison of deemed savings and utility-verified achieved savings, rather than a comparison that has been verified by the independent auditor (independent M&V expert). In the alternative, they recommended that the verification requirement be moved to the section of the rule prescribing the responsibilities of the independent auditor (independent M&V expert).

The commission adopts language to clarify the timing and reporting of funds and energy savings under §25.181(g) and (l) (previously subsection (j)) accordingly. The independent M&V expert is addressed in the discussion under §25.181(l).

TESCO commented that the reporting requirements under proposed §25.181(g)(4) uses the term "independent M&V," when it appears to mean "M&V" because there is no requirement for an independent M&V contractor. TESCO further commented that because utilities are to bear a share of the cost of the independent auditor (independent M&V expert) and their portion of M&V expenses, the cost of the auditor (independent M&V expert) can be added to the calculation if this is what the commission intended. TESCO commented that §25.181(g)(4) should be modified to avoid burdensome costs in report preparation and record keeping. TESCO commented that the annual report should be aggregated data, perhaps by customer class or by program, and the state auditor's (independent M&V expert) report should validate the data that makes up the aggregated data in the annual report of the utility administrators, because any more detail drives administrative costs up unnecessarily.

The commission agrees with TESCO and clarifies the language under §25.181(g). The commission disagrees with TESCO that the annual report should use aggregated data, because the commission expects administrators to assess individual contracts or projects, and there should be little incremental burden to include that information in the report.

TXU and CSW commented on the annual energy efficiency report under proposed §25.181(g)(4), requiring utilities to submit "project expenditures" in their annual energy efficiency reports. TXU commented that it does not believe that information regarding all project expenditures is necessary to adequately determine compliance with the rule, but rather, the cost-effectiveness standard considers only costs associated with incentives, program administration, and M&V. TXU further commented that a requirement to produce all such information is likely to discourage participation from EESPs who see this requirement as extremely burdensome and potentially invasive of confidential information. CSW commented that §25.181(g)(4) should be clarified to include the amount of project expenditures by the utility.

The commission disagrees with TXU and finds that project expenditures are an important and necessary component of the report, and finds that the rule clearly provides that the expenditures refer to expenditures by the utility, and therefore, declines to revise the rule.

(h) Utility administration, and standard offer and market transformation programs

This subsection has been broken out into three subsections: (h) Utility administration; (i) Standard offer programs; and, (j) Market transformation programs. All commission findings and conclusions regarding former subsection (h) reflect the new subsections.

Several parties commented that throughout proposed §25.181(h), use of the words "contract," "project," and "program" create confusion. TNMP argued that all references to "contract" should be directed at the relationship between utilities and the EESPs or REPs. CSW commented that throughout proposed §25.181(h) "standard offer programs and market transformation programs" should be changed to "standard offer programs or market transformation programs" to more accurately track the language of PURA §39.905. CSW commented that throughout this subsection, "energy and demand" should be changed to "energy and/or demand."

The commission agrees the words "contract," "project," and "program" were interchanged throughout this section, and modifies the language throughout the rule to clarify these terms. The commission further agrees that PURA §39.905 allows for standard offer contracts or market transformation programs, or both, and modifies the language throughout the rule to clarify that utilities can choose either or both. The commission agrees with CSW and has revised the rule to reflect that energy and/or demand saving are allowed.

EGSI commented that proposed §25.181(h) regarding utility administration, should include language to clearly specify the ability of a utility to recover costs in accordance with its comments in response to Preamble Issue Number 2.

The commission declines to modify the proposed rule language for the reasons set forth in the discussion under Preamble Issue Number 2.

Enron commented that the language in proposed §25.181(h) which calls for utility inspection and compensation to the EESP contingent on the utility inspection may serve as a disincentive for standard offer contracts. Enron commented that this gives the utilities the power to delay compensation and that compensation should not be tied to any form of inspection. Enron commented that independent third parties should perform the inspections and that a sound, enforceable contract will mitigate the commission's concerns and the market will serve as a primary enforcement for compliance.

The commission disagrees with Enron and finds that limited inspections are necessary to ensure that the energy savings are achieved. This issue is further discussed under §25.181(i).

Reliant, SPS, TXU, TNMP, and Shell objected to the "proper workmanship" requirement in proposed §25.181(h).

For the reasons discussed under §25.181(c)(15), regarding inspections, the commission agrees with the parties that the term "proper workmanship" is vague and replaces it with "installed and capable of performing its intended function." As discussed in §25.181(c)(15) and (k), the commission finds that inspections are necessary for the utilities to ensure that measures are installed in this manner. Some level of inspection, including inspection of installation work, is essential to ensuring that contractors achieve energy and demand savings.

TESCO commented that because individual programs may vary greatly, the language of proposed §25.181(h) should be modified to take into account that inspections may or may not be required by a particular standard offer program or market transformation program, and may or may not be appropriate prior to a payment. TESCO commented that assuring that customers and ratepayers receive what they pay for should be part of the individual program design and not part of the rule. EGSI commented that §25.181(h) should be modified to include language to allow some contact between the utility and the customer in connection with inspections so that such contacts are not deemed to violate §25.272 of this title (relating to the Affiliate Code of Conduct).

The commission agrees that the level of inspection may vary between market transformation projects and modifies §25.181(j) and (k) to account for these differences. The commission finds that some level of inspection required for standard offer programs is necessary to ensure that the goals of the program are met. The commission also agrees with EGSI and modifies the language to account for PURA §39.157 and §25.272, (relating to the Affiliate Code of Conduct) under §25.181(h)(1)(C).

Joint Public Interest Groups commented that proposed §25.181(h) should be modified to give flexibility to market transformation programs, specifically to only require inspections if mandated in approved market transformation programs instead of as a standard course of action before payments are made. Joint Public Interest Groups argued that utilities should be required to develop a monitoring and evaluation plan, to competitively bid out the evaluation, and to review and approve the resulting evaluation report.

The commission notes that a savings monitoring mechanism should be incorporated in the market transformation programs. The commission has adopted requirements in this rule that market transformation programs must include a baseline study, a timeline and goals, and that progress must be reported in the annual energy efficiency report under §25.181(g) and (j). The commission does not, however, find it necessary that the evaluation be conducted by an independent third party, because the market transformation programs will be subject to review by the independent M&V expert (formerly the independent auditor).

TXU, SPS, and TESCO commented that proposed §25.181(h) is overly expansive in its prohibition on utilities providing energy efficiency services. TXU argued that the proposed section should only prohibit utilities from providing *competitive* energy efficiency services. SPS and TESCO commented that there should be an exception for competitive energy services for which the utility has successfully petitioned the commission for permission to conduct.

Section 25.343 of this title (relating to Competitive Energy Services) allows the utility to petition the commission to allow it to provide a competitive energy service. Accordingly, the commission revises §25.181(h)(2) for consistency with §25.343.

Cardinal commented that proposed §25.181(h) is too limiting, especially with respect to market transformation programs. Cardinal noted that in California's market transformation programs, the utilities were actively involved, and even instrumental, in the program.

The commission declines the suggestion by Cardinal related to utility participation, because the Texas statute mandates that utilities not be involved in the competitive energy efficiency programs.

TESCO and TNMP commented that proposed §25.181(h), regarding reallocation of funding if a provider does not complete a project as contracted, should not include the same customer class restriction on the reallocation of funds. TESCO commented that it preferred for program changes to be made as part of the annual review process, if necessary, when programs need to be redesigned to reach certain markets. TNMP argued that the distribution of funds according to customer class should be determined by the market as required by the legislation.

The commission finds that the revised reporting requirements and revision criteria under §25.181(g) provide adequate oversight regarding proper expenditures. The commission has eliminated the referenced provision.

Schiller, SPS, TXU, TESCO, TNMP, Cardinal, and Joint Public Interest Groups all objected to the limit in proposed §25.181(h) that applies a 20% cap on the total incentive payments available to a single contractor for a particular standard offer or market transformation contract, with the majority focusing on its particular inappropriateness for market transformation programs. Schiller commented that it could be a problem in markets or geographic areas where there are a limited number of providers or for programs with limited budgets. TXU commented that the inappropriate result of this participation cap is that all market transformation programs must be implemented by at least five entities. TXU commented that some market transformation programs target specific technologies or installation practices, with the goal of increasing their use or installation and it would be imprudent to have multiple providers each offering a competitive program to increase the use of the same technology. TNMP suggested revising the rule to refer to budgets, as opposed to payments, to prevent utilities from becoming subject to an after-the-fact violation of the rule that is completely out of the utility's control. TNMP commented that the language proposed in the rule presupposes that utilities will themselves design and solicit market transformation programs, and that a minimum of five bidders will have the capability to competitively bid a viable response. TNMP argued that a market-based approach to market transformation programs would leave design in the hands of prospective bidders and not require successful bidders to share allocated funds at a 20/80 rate and such a requirement is a disincentive to prospective bidders. Cardinal commented it will be extremely difficult for a prospective bidder to somehow craft the proposal to account for the fact that they can accept no more than 20% of the funding for a market transformation contract.

The commission declines to modify the 20% cap for standard offer contracts because this cap provides a mechanism to stimulate market competition as discussed under Preamble Issue Number 5. The commission further notes that the utility may petition the commission for a waiver of this limitation if the utility determines that it is necessary. The commission agrees that the 20% limitation may not be appropriate for market transformation programs and has revised the language under §25.181(h)(3) accordingly.

NAESCO commented that proposed §25.181(h) should replace "standard offer contract" with "standard offer program" with regard to the percentage limitation of incentive payments available to an individual EESP.

The commission disagrees with NAESCO. The 20% limitation should encourage participation by multiple EESPs under individual contracts to assure that customers have a choice of multiple EESPs. The commission declines to make this change.

Reliant, TESCO, SPS, and TXU proposed various language clarifications to proposed §25.181(h). Reliant commented there is no process or timeline for approving programs or how they will be made available to utilities in time to be incorporated into the energy efficiency plan filings due by April 2000. TESCO recommended removing language suggesting that multiple niche standard offers would be appropriate. TESCO commented that industrial interruptible contracts have no business in the energy efficiency programs envisioned by SB 7. Although it believes that some load management capacity is beneficial to customers and all ratepayers, TESCO argued that the energy efficiency considered in this rule should increase the efficiency of use or improve the load profile on a continuing basis. SPS commented that it is unclear what a customer class is in §25.181(h). TXU commented that statewide standard offer contracts might not be effective because they would remove important, regional differences in standard offer programs and ignore customers' unique needs and preferences. TXU further commented that language should be included in the "first-come, first-serve" method in §25.181(h) to clarify that it applies only to the extent that the utility has budgeted for the standard offer program.

The commission declines to make modifications as suggested by Reliant concerning the process and timeline of the filings, for the reasons discussed under §25.181(g). The commission declines to make the modifications suggested by TESCO, because the rule allows for 15% load management, and interruptible contracts are a form of load management. In response to TXU, the commission finds that statewide standard offer contracts may be effective and declines to modify this provision. The rule does not require that contracts be awarded if a utility has exhausted the budget for a standard offer program. This issue is addressed under §25.181(g).

TNMP commented that proposed §25.181(h) should be modified to delete the provision that different standard offer contracts may be developed to address hard-to-reach customers, because the legislature did not provide for favoring any particular group of customer, but instead required that incentives be nondiscriminatory. TESCO commented that it should be very rare that niche market standard offers be created. It preferred that supplemental efforts to reach the "hard-to-reach customers" be considered through market transformation programs.

The commission does not require that different standard offer contracts be developed for different customer classes. The rule requires that standard offer contracts be developed that eliminate the market barriers that prevent customer classes from participating in standard offer contracts. The commission finds that hard-to-reach customers necessitate special attention. The commission declines to make the change suggested by TNMP and TESCO.

TESCO and TNMP argued that the proposed §25.181(h) should be modified to reflect the requirement that all measures must produce both capacity and energy savings and are therefore always going to be eligible for both capacity and energy avoided cost-based incentives. TNMP commented that the subject of this subsection is to describe how standard offer programs work, i.e., that they include a standardized contract template with common terms and conditions applicable to all participating EESPs and retail electric providers. TNMP commented that changes to the level of incentives, subject to the cost-effectiveness cap, should be market-based, reflecting how the market responds to the amount of incentives offered. TNMP further commented that the incentives should not vary by customer class since it conflicts with the legislation.

The rule does not require that all measures produce both capacity and energy savings. EESPs will be compensated separately for the capacity and energy savings, and measures that do not achieve capacity savings will not receive incentives for capacity savings. The commission, therefore, declines to make the revision suggested by TESCO and TNMP. The commission also declines to make the changes noted by TNMP regarding incentive levels in accordance with the discussion under §25.181(g)(2)(F).

Schiller and TXU commented that the rule should allow incentive payments to vary within a customer class and between technologies because differential pricing by technology type will improve the cost-effectiveness of programs. Schiller and TXU further argued that failure to allow for customization of incentive payments according to different technologies would discourage the installation of certain technologies. NAESCO commented that the commission should clearly establish the requirement for neutrality regarding technologies, equipment, and fuels. NAESO recommended that the commission should stress the importance of comprehensive treatment of buildings employing multiple technologies to ensure that optimal energy savings are achieved. TNMP argued that market-neutral is market-neutral, and if standard offer programs are to allow switching away from electricity, they should allow switching to an electric technology from an alternate fuel. In its view the rule should not single out natural gas as the only alternate fuel deserving of protection.

The commission agrees that the rule should be technology neutral, but declines to adopt the suggested language regarding fuel switching. The commission finds that switching from electricity is consistent with the legislative goal to reduce consumption of electricity while improving efficiency.

OPC/Cities disagreed with the requirement that all standard offer contracts must result in a reduction in energy consumption and reductions in energy costs for end use customers. OPC/Cities noted that an end use customer may switch from an electric appliance to a gas appliance that saves energy, but if gas prices increase after the switch such that the energy savings are not sufficient to cover the increase in price, it may result in higher energy costs. OPC/Cities submitted that as long as the initial analysis showed both energy and cost savings, unexpected fluctuations in fuel prices should not disqualify a project.

The commission agrees with OPC/Cities that if the initial analysis shows both energy and cost savings, unexpected fluctuations in fuel prices should not disqualify a project. Standard offer projects should be designed to reduce energy consumption and energy costs for the end use customer, in accordance with the legislative requirement. This is what the rule requires, so the commission declines to modify the language.

TNMP commented that the rule should include the requirement that all measures must result in a reduction in peak demand because the legislation clearly indicates that energy efficiency is to produce savings in demand growth. TNMP argued that because the legislation established the measure of energy efficiency according to load growth, the emphasis of this subsection should be on demand reduction, not energy reduction. In reply comments, Shell commented that the commission should reject the utilities' and industrial customers' comments emphasizing the focus be on peak demand. Shell agreed with OPC's and Joint Public Interest Groups' comments that the commission should focus on energy savings because demand reductions do little to reduce total energy consumption. Shell argued that the commission should limit demand reduction programs and not expand the percentage savings beyond 15% and should not subsidize interruptible customers by encouraging utilities to transfer money to them in the guise of energy efficiency programs. Shell argued that although interruptibility may offer social benefits, energy efficiency is not one of them. Shell noted that the commission has encouraged eliminating or reducing interruptible rate classes, and the Legislature imposed a 150% stranded cost allocation to interruptible classes, so the commission should not take the opposite position and subsidize those customers through devoting energy efficiency payments to them.

PURA §39.905 requires a reduction in energy for the end use customer, but expresses the goal in terms of a demand reduction. The commission notes that as a compromise position, the parties agreed to allow load management to comprise 15% of the energy efficiency measures, and that load management focuses on peak demand. Accordingly, the commission declines to modify the language.

Joint Public Interest Groups commented that they oppose prescribing ceilings on incentive payments and limiting lighting to 65% of the savings of each project because these approaches are arbitrary and will result in economic inefficiencies. Instead, Joint Public Interest Groups suggested that the incentive funds be allocated by customer class and that within a customer class, differential incentives be used to encourage the acquisition of cost-effective energy savings with multiple end-uses. Schiller, TNMP, and NAESCO also objected to the limit on 65% of savings from lighting measures. Schiller commented that it accepts the overall goal of encouraging comprehensive projects; however, that the cap on lighting savings at the project level will restrict many projects that cost-effectively contribute towards meeting the energy efficiency goal. TNMP commented that the cap is in conflict with PURA §39.905(a)(1) and (3) that requires incentives to be nondiscriminatory and programs to be market-based. TNMP further commented that although PURA §39.905(b) requires the commission to provide oversight and adopt rules and procedures to ensure that the goal is met, the legislation does not provide for policy-setting by the commission with respect to the energy efficiency goal. NAESCO commented that although it agrees that 100% lighting programs are not desirable, it is concerned that there may be circumstances where the proposed language would impair program development. NAESCO believed that a better approach would be to let the Working Group (energy efficiency implementation docket) resolve the problem.

The commission finds that the 65% limitation on lighting was a compromise made by the parties during the workshops held during the development of this rule. The commission determines that this is a reasonable means for encouraging comprehensive energy efficiency projects; accordingly, the commission declines to modify this section.

Joint Public Interest Groups, Nucor, TIEC, EGSI, and TESCO commented on the limitation that savings achieved through load management programs, including interruptible rates, may not exceed 15% of the total savings. Joint Public Interest Groups commented that although they support a compromise position allowing load management to count for up to 15% of total demand savings, they are opposed to allowing interruptible loads to count toward the energy efficiency goal. Nucor suggested that the limitation should be deleted, because it is an unreasonable restraint. Nucor argued that there is nothing in PURA §39.905 that would restrict the use of these programs and these programs are very cost-effective. In the alternative, Nucor argued that the level of savings achievable through load management programs should be raised to a more substantial percentage. TIEC noted that the 15% cap on load management reflects a consensus on one of the most debated issues in the negotiations. TIEC argued that interruptible power reduces energy consumption during critical on-peak times and reduces energy costs of both the individual customer and the system. TESCO commented that industrial interruptible contracts have no business in the energy efficiency programs envisioned by SB 7. EGSI replied to TESCO that it believes that interruptible rates should be allowed to count toward energy efficiency goals because SB

7 also contemplated the legitimacy of load management as an effective means of reducing peak energy demand and impacting customer costs.

The commission finds that allowing load management to comprise 15% of total demand savings is an acceptable compromise position and that interruptible service is appropriately a part of load management. Interruptible service is likely to be provided by competitors in the market and it does not provide lasting efficiency benefits; therefore, the 15% cap is reasonable, and the commission declines to modify this section.

EGSI, TXU, SPS, Schiller, NAESCO, ESL, and Nucor suggested removing the ten-year useful life standard. EGSI commented that the ten-year useful life requirement might eliminate valid energy efficiency programs such as compact florescent lighting and other new technologies that might become available. Schiller argued that more flexible language should be used that would allow incentive payments to be based on a reasonable estimate of the useful life of a project, not to exceed ten years. Schiller commented that the inclusion of a wide variety of measures would be necessary in order for the utilities to meet the overall goal. SPS argued that the ten-year life for market transformation programs might be problematic. NAESCO commented that the language should be deleted, or at minimum, additional language should be added that allows reasonable assumptions in the calculations of useful lives so that standard maintenance such as bulb replacement and proper preventive maintenance do not become barriers that limit qualifying efficiency measures. ESL commented that this provision would also require all utilities to track all projects for ten years to ascertain if measures are still installed and working. ESL commented that in addition to fluorescent lamps, water heaters, air-conditioners, a percentage of refrigerators, and other equipment will fail before ten years.

The commission disagrees with the parties and finds that the requirement for a useful life of ten years is necessary to ensure quality programs. The ten-year life requirement was by consensus agreement. It is also a requirement under the commission approved CPL standard offer program. The commission declines to change the requirement. The commission does not agree with ESL's interpretation that the rule requires that a project be tracked for ten years, or its implication that the rule precludes program participants from making reasonable assumptions about the useful life of energy efficiency measures.

SPS commented that the rule should clarify that only customers taking T&D services from a utility can participate in its energy efficiency programs. SPS commented that it is concerned about limiting program participation to T&D customers in multiple-certificated service areas. SPS argued that the utility is not obligated to provide DSM incentives for customers who do not receive T&D service from the utility. Shell commented that it should be clarified to state that it does not reduce or replace any obligations under §25.272 (relating to the Affiliate Code of Conduct).

The commission agrees with SPS and incorporates language under §25.181(i)(2)(J) so that only customers taking T&D services from a utility can participate in its energy efficiency programs. This is necessary to ensure that proper customers receive the intended benefits.

TNMP and NAESCO objected to the environmental impact provisions in proposed §25.181(h). TNMP stated that measures with deemed savings should be exempt from the environmental impact provisions. TNMP argued that if a project proposal is required to include this information the administering utility should act on it; however, the rule only prohibits incentive funds for projects that have a negative environmental or health impact. TNMP argued that such measures are extremely vague and subject to interpretation. With respect to deemed savings, TNMP argued that it expects that the commission will have considered environmental and health impacts for those common and well-understood measures included in the deemed savings program component. TNMP argued that residential contractors could rely on the deemed savings components to simplify their participation. NAESCO commented that this section could be construed as requiring an Environmental Impact Statement and if such a statement were required, it would be so costly to implement that it would discourage participation. NAESCO argued that it cannot identify any discernible benefit associated with this requirement and that energy efficiency measures are benign with regard to environmental impact and certainly should have less impact on the environment than the generation alternative.

The commission determines that it is necessary for projects to identify potential environmental or health impacts associated with the measures installed. The intent is to protect customers from potential health and safety hazards associated with the installation of certain measures. The commission anticipates that utility inspections to verify that the measures are installed and capable of performing their intended function will also reduce the risk to the customer. The commission notes that this is not a requirement for a full-scale Environmental Impact Statement, as such is not required in the rule. Accordingly, the commission declines to modify the language in §25.181(h)(4)(C).

Shell commented that under the proposed §25.181(h), in addition to stating whether any environmental or health impacts exist, the applicant should also state whether it has requested permits from any other regulatory agencies and whether any such permits are required. Shell noted that the commission has imposed a similar requirement for certificate of convenience and necessity applications, requiring the applicant to identify all necessary regulatory approvals and to state whether it has obtained those permits. Shell argued that doing so would give the utility some ability to evaluate the seriousness of potential risks.

The commission accepts the suggestion made by Shell. The requirement has been incorporated under §25.181(i)(2)(M).

ESL commented that the rule will be difficult to enforce unless the commission adopts strict requirements about the M&V plan such as are contained in the TECC/SECO "Texas Guidelines for Energy Performance Based Contracts."

The commission may consider these standards in the energy efficiency implementation docket.

Shell commented that the requirement that projects result in "reliable" energy and demand savings does not add the intended meaning and some parties could confuse the term with its use to describe system reliability. Shell infers that it instead means that projects should lead to consistent and predictable savings.

The commission agrees with Shell and changes the wording from "reliable" to "consistent and predictable" under §25.181(i)(2)(G).

TNMP commented that the proposed rule should be modified so that the standard offer contract templates state the minimum criteria for contractor participation to assure compliance with state and federal codes, licensing, and customer protection requirements. TNMP further recommended that these standard terms and conditions prohibit incentive payments if it is determined that an EESP has failed to comply with the applicable codes, licensing requirements, truth-in-lending statutes or other applicable law, regulation, or ordinance. TNMP commented that with this change, the customer protection provisions could be eliminated, removing a significant administrative burden. EGSI commented that the customer protection references in proposed §25.181(h) should only direct the attention to upcoming customer protection rules and the specific customer protections should be removed from this section. TXU commented that proposed §25.181(h) provides that standard offer contracts must state the minimum criteria for contractor participation and must include the customer protection contract provisions required in the rule. TXU agreed that standard offer contracts should include minimum requirements for contractors recommending the following criteria: 1) evidence of financial strength and capability (10-K's for public companies and audited financial statements for private companies); 2) demonstrated professional experience of the Project Sponsor; 3) demonstration of a solid work plan that covers the design, implementation, operation, and management of the project; 4) proof of insurance; and 5) a performance bond.

The commission, as discussed under Preamble Issue Number 4, has added criteria for contractor participation and has revised §25.181(i) accordingly. The commission finds that the customer protection provisions in §25.181(n) remain necessary.

TESCO commented that the complaint process should be modified to provide clarification. TNMP commented that standard offer contracts provide a complaint process that allows the EESP to file a complaint against a utility and that references to customer complaints should be deleted. TNMP commented that by providing a customer complaint channel, such a provision would also imply a complaint resolution mechanism. TNMP argued that it is not in a position to act in such a capacity, particularly since it could require the utility to step into the area of providing underlying competitive services in the form of technical assistance.

The commission determines that the customer must be able to file a complaint against the EESP. Any contractual complaints of an EESP against the utility may be filed with the commission. The filing of a complaint by a customer does not mean that the utility must resolve the complaint, but it should use the complaint history in determining a contractor's eligibility to continue to participate in the standard offer or market transformation programs. This is an important component in creating a successful energy efficiency program. Accordingly, the commission declines to modify this subsection.

Several parties commented that more flexibility was needed regarding market transformation programs and this issue is also addressed in Preamble Issue Number 7. SPS commented that EESPs would not participate in a competitive solicitation for market transformation contracts if they have to agree to accept only 20% of the funding from the contract. TESCO commented that this section should clarify that utilities must be responsible for design of programs they administer, but should work with the other interested parties through the Working Group (energy efficiency implementation docket). TESCO argued that the rule should prescribe a workable process for discovering, developing, and adopting or endorsing market-transformation programs. TESCO commented that this section should be revised to reflect that utilities may pilot market transformation programs and are encouraged to work with any party to discover new potential programs, but pilot programs cannot count savings toward the utility's goal until approved for full implementation by the commission. It further commented that the Working Group (energy efficiency implementation docket) should solicit annually ideas for new market-transformation programs and recommend to the commission those that should be approved under this section, and the commission should consider whether to endorse such programs so that utilities may adopt them as tools toward their efficiency goals. TNMP commented that an additional criterion should be added to document the forecast market trend (including energy and demand) and the market-transformation market trend in order to establish how, and to what extent, energy and demand savings will be achieved. TXU commented that market transformation programs should not be required to be competitively bid. Joint Public Interest Groups concurred that market transformation programs should not be competitively solicited during the transition period to allow utilities maximum flexibility to develop programs in a timely fashion. Joint Public Interest Groups commented that each market transformation program should include a program plan developed by the Working Group (energy efficiency implementation docket), by an individual utility, or by a contractor responding to a request for proposals. Joint Public Interest Groups proposed that market transformation programs outline the program goals, market barriers the program aims to address, key intervention strategies, estimated costs and savings, deemed savings estimates (where appropriate), evaluation metrics, and a measurement and evaluation plan. Joint Public Interest Groups further commented that the rule should encourage testing of market transformation programs during the transition period, by encouraging each utility to pilot at least one market transformation program. Joint Public Interest Groups and Frontier commented that a 20% cap on total incentive payments for a given service provider is not appropriate for market transformation program providers. Joint Public Interest Groups commented that free-ridership should be limited through the design of individual programs and reasonable projections of baseline market activity in the absence of the program. TXU replied that it agrees with TESCO's argument that any entity that develops a special targeted, market transformation program should be able to negotiate adoption of the program without a solicitation. Frontier noted that in other states, payments to implementers of market transformation programs are normally made as milestones are completed, not as savings are verified.

In addition to the above independently filed comments, the Coalition argued that market transformation programs should not be offered through solicitations. In response, OPC, Cities, TIEC, Shell, and Enron (Joint Reply) filed joint comments stating that the rule needs to be amended to facilitate the development of market transformation programs. The Joint Reply commented that market transformation programs must be better defined and more clearly established in the rule. The Joint Reply argued that market transformation projects are typically implemented by a contractor solicited through a request for proposals, that the contractor delivers a program, and that a third-party program evaluator documents the implementation contractor's progress in achieving goals laid out in the program plan.

As noted in response to Preamble Issue Number 7, the commission agrees with the parties that market transformation programs need special consideration in their design, measurement, verification and savings credits. The expertise of independent bidders regarding market transformation programs should be utilized in program proposals, and the rule should not attempt to be too prescriptive regarding program details. The commission believes that the only way to measure savings is if a baseline is first established, and that it is appropriate to require such a baseline to be relevant in time and geographic region in market transformation program proposals. A proposal must also include a timeline with a date on which the market will be considered transformed and savings cease to be counted. The timeline shall also include projected savings throughout the timeline until the ultimate goal is reached. The commission will allow utilities to count interim energy savings along the timeline goals towards the mandated reductions in energy consumption. The ultimate goal of market transformation programs is behavioral changes that are accompanied by a predicted amount of kW and kWh saved. The commission further finds that a follow-up study is necessary to evaluate the actual savings received. Many of the other comments would be too prescriptive in establishing the terms and conditions for such programs. The commission modifies §25.181(j) to reflect the changes discussed above.

Schiller, TXU, NAESCO, TESCO, EGSI, and Reliant objected to the requirements regarding free-ridership restrictions under proposed §25.181(h). Several parties suggested deleting this section because it is impossible to determine on an individual project basis what would have been done in the absence of the program, and such requirement will increase administrative costs. Schiller proposed that the language should reflect that administrators should include program design features that discourage incentives being paid for projects that would have been installed in the absence of the program. TXU argued that this section over-corrects the problem by completely eliminating measures that might arguably contain some element of free-ridership. TXU recommended that the provision either be totally eliminated, or in the alternative, that the free-rider issue be moved from this prohibition section to the preceding rule section that addresses goals of energy efficiency program design. NAESCO agreed that incentives should only be paid where the incentive induces a customer to acquire an energy efficiency measure that he or she would not otherwise acquire, but NAESCO commented that "free-riders" couldn't be completely eliminated without incurring very high administrative costs. NAESCO believed that many, if not most, free-riders can be eliminated through program design. Reliant commented that a project to install measures that are already widely recognized as the industry standard should be used as the example. TESCO commented that the wording regarding free-ridership would prevent any utility from obtaining its efficiency goal. TESCO commented this is particularly problematic, in that it eliminates any measure or project that involves measures acceptable to most customers.

The commission finds that the language precluding incentives for energy savings that would have occurred in the absence of the proposed project is a necessary safeguard. Contracts must be designed to achieve savings that would not reasonably be likely to occur without the contracts. Accordingly, the commission declines to modify the language under §25.181(h)(4)(B).

TESCO commented that references to environmental impact in proposed §25.181(h) should be reworded so that it is reasonable to enforce, because it is not always possible to know in advance whether a project may somehow lead to some negative environmental or health impacts. TESCO argued that the language should be clarified to address any known or obvious environmental impacts, because there are already sufficient laws dealing with asbestos, ballast, and transformer chemicals. TNMP commented that all reference to environmental impact should be removed, because a utility is not in a position to determine whether a project will result in negative environmental or health impacts, or to establish whether there is a likelihood that materials or equipment will be disposed of improperly.

The commission finds that the language precluding incentives for projects that result in negative environmental or health impacts is a necessary safeguard for customers. Accordingly, the commission declines to modify §25.181(h)(4)(C).

TESCO, TNMP, and CSW commented that the language under proposed §25.181(h), regarding the commission's consideration of the relative cost-effectiveness of a program, should be modified or deleted. TNMP commented that it should be modified to allow the commission to first consider the relative cost-effectiveness of a program and its contribution in meeting the legislative mandate when deciding whether to approve a program because the cost-effective achievement of the energy efficiency goal was the primary charge given the commission within PURA §39.905. CSW suggested deleting this language because it is unnecessary.

The commission finds that it is reasonable to consider the relative cost-effectiveness of a program and its contribution in meeting the legislative mandate when deciding whether to approve a program. However, the commission agrees this need not be prescribed in the rule and has eliminated the language.

(k) Inspection, measurement and verification.

EGSI and the Coalition requested that the purpose of M&V be limited to improving future estimates and program delivery. CSW, TNMP, Enron, and NAESCO stated that the M&V of energy savings should not be prescribed in the rule, but should be incorporated in the individual standard offer contract designs.

The commission finds that limiting the purpose of M&V to improving future estimates leaves the program open to abuse. Where companies are contracting to provide energy efficiency measures that reduce energy consumption or demand, or both, there must be systematic evaluation of whether they deliver what they have agreed to.

NAESCO and ESL recommended that the rule adopt the USDOE IPMVP as the standard M&V protocol. ESL also recommends the adoption of ASHRAE Guideline 14 to be published in the spring of 2000.

The commission may consider these standards in the energy efficiency implementation docket.

Joint Public Interest Groups argued that the requirements under proposed §25.181(i) could not be applied to MTPs and that MTPs require different evaluation methods. Joint Public Interest Groups proposed that market transformation programs be developed in coordination with the utility or Working Group (energy efficiency implementation docket). The Joint Public Interest Groups further suggested that the program design outline the key market barriers that the program aims to address, the goals of the market transformation program, key intervention strategies, evaluation metrics, and a measurement and evaluation plan. Joint Public Interest Groups further suggested that these plans should be developed on a case-by-case basis and included or referenced in the utility's energy efficiency plan.

The commission agrees with the proposed changes and revises §25.181(j) and (k) accordingly.

CSW and NAESCO supported the requirement that makes the EESP responsible for M&V of energy savings. Schiller and UCONS stated that placing the responsibility of M&V onto the EESP may be appropriate for large companies, but may form a barrier to smaller companies who lack the expertise. UCONS stated that this would be particularly the case for residential programs where M&V costs are prohibitive. UCONS recommended heavy reliance on deemed savings. Schiller commented that some parties may suggest that the level of M&V rigor be reduced to account for this issue, but offered a solution to maintaining a consistent level of M&V rigor. Schiller proposed allowing the M&V to be conducted by an independent, third-party with the proper expertise.

The commission finds that requiring the EESP to conduct its own M&V may create a barrier to smaller companies who lack the expertise. It has therefore revised §25.181(k)(1) to reflect that the M&V may be conducted by an independent third-party when necessary.

Enron stated that an independent, third-party should be required to perform inspections, because utilities may manipulate inspection to favor their affiliate EESPs and create barriers to non-affiliate EESPs participation.

Under §25.181(h)(4) an EESP or its affiliates may not receive more than 20% of the incentive payment under the standard offer program. This provision will require the utility to use non-affiliated EESPs for at least 80% of each contract, and it is in the utility's interest that they are successful. This provision should protect non-affiliate EESPs from "unfair" inspections. The commission also finds §25.181(k)(1) states that the utility is responsible for performing inspections, but may contract this activity out to an independent third party. The commission declines to revise the language.

EGSI, Reliant, and TXU argued that the requirement of inspection to ensure that all measures installed are operating properly under proposed §25.181(i) places an undue burden on the utility, because the requirement is subjective and potentially unenforceable. Reliant and TXU argued that this is an issue between the provider and the customer. The Coalition also objected to the term "proper workmanship" as ambiguous and subjective, and expressed concern that this may expose the utility to legal liability. At the APA hearing, GETCAP, CACST, Texas ROSE, and TDHCA commented that TDHCA as the administering agency for the federal Weatherization Assistance Program, inspects at least 10% of weatherized units, and that the inspection does include an evaluation of workmanship. Joint Public Interest Groups commented that withholding payment pending inspection is the only way for the utility and the customer to ensure that the project is properly installed. Once payment has been made the utility and the customer lose the leverage for corrective action.

This issue is discussed under §25.181(c)(15), regarding inspection. There the commission concluded that the standard of performance should be that measures be "installed and capable of performing its intended function." Ascertaining that measures have been installed in this manner is absolutely critical to achieving the energy efficiency goal. Residential and small commercial customers often lack the expertise to determine whether the measures have been installed in this manner. Proper installation of measures directly affects the energy savings potential of these measures. For example, faulty installation of a heating, ventilation, air conditioning system or insulation may actually increase energy consumption. Improper installation of certain measures also affect indoor air quality and may have an adverse health and safety impacts on the resident. Moreover, the program places heavy reliance on deemed savings, rather than verification of actual savings. Deemed saving estimates for installed measures can only be accurate if these measures are properly installed in a manner capable of performing their intended function. The commission also finds that the inspection requirement was a consensus agreement among the parties to allow for deemed savings rather than verified savings. Finally, proper installation is necessary to maintain customer confidence in the programs. However, to reduce the cost burden of inspections, the commission limits inspections to a statistical sample of residential and small commercial installations, and the size of the sample may reduce over time if a contractor under a particular contract has consistently yielded satisfactory inspection results and revises §25.181(i) accordingly.

EGSI and TXU also requested a revision in proposed §25.181(i) so that inspections would occur within 30 days of notification of installation.

The commission agrees with this change and revises §25.181(k)(4).

TESCO and Joint Public Interest Groups recommended overall revision of proposed §25.181(i) to eliminate redundancy and conflicting language.

The commission has reviewed and eliminated redundant and conflicting language from the rule.

(l) Independent measurement & verification expert (formerly the independent auditor)

TXU suggested that the section regarding independent auditor (independent M&V expert) be eliminated. EGSI and Shell disagreed with TXU. CSW, SPS, TXU, TESCO, NAESCO, and Joint Public Interest Groups commented that the role of the independent auditor (independent M&V expert) as envisioned in the rule is too broad. TXU, in reply comments, stated that if the commission chooses to maintain the independent auditor (independent M&V expert), its activities should be limited to review of the utilities' energy efficiency reports. Joint Public Interest Groups stated that the role of the independent auditor (independent M&V expert) should consist of a limited number of spot checks within a program or utility. CSW, SPS, TXU, TESCO, and NAESCO argued that the role of the independent auditor (independent M&V expert) should be limited to evaluation of overall program performance and administration and to make recommendations from a process evaluation perspective. The Coalition proposed that the independent auditor's (independent M&V expert) role be limited to a performance audit, review of M&V plans and reports, select field trials, investigations or inspections, and a report of its findings, conclusions, and recommendations to the commission and to the Working Group (energy efficiency implementation docket) on an annual basis. Joint Public Interest Groups responded that the function of the independent auditor (independent M&V expert) should be to conduct spot checks on a sample of installations and a macro overview of the program.

Reliant, TNMP, and TXU argued that having the independent auditor (independent M&V expert) verify savings, particularly deemed savings, when utilities will follow an M&V protocol, would be duplicative. Cardinal suggested that verification of deemed savings by the auditor (independent M&V expert) should be limited to proper installation and project implementation under the MTP. EGSI, in its reply comments, agreed with the proposed change by Cardinal. Shell commented that utilities would possess an inherent motive to overstate program successes and costs. The specter of independent audits, according to Shell, will help ensure that utilities scrupulously maintain accuracy. TXU contended that the utilities can follow the approved protocol, while Shell argued that someone has to ensure that they actually do so.

CSW, EGSI, Reliant, TXU, Shell, TESCO, NAESCO, OPC/Cities, and Joint Public Interest Groups raised concerns over the cost allowance for the independent auditor (independent M&V expert). These parties stated that if the scope of activities of the independent auditor (independent M&V expert) is reduced, so would be the cost. TXU proposed a cost allowance of 1.0%; NAESCO proposed a cost allowance of 0.5%; and OPC/Cities proposed a cost allowance of 2.5%. Shell commented that in requiring all utilities to share the independent auditor's (independent M&V expert) funding requirements, the commission should specify the methodology by which it will determine each utility's responsibility. There are two possible methods: each utility could contribute according to its statewide load ratio share, or as a percentage of the auditor's (independent M&V expert) cost causation. Shell proposed a combination of both methods. Allocating responsibility based on the work that the individual utility creates would recognize the utility's quality control and reward it for establishing reliable and easily audited systems. The auditor (independent M&V expert) should spend relatively more time reviewing and correcting records of utilities that inadequately manage their programs, and relatively less time with those utilities that have implemented effective administrative procedures.

The rule allows the EESP to conduct its own M&V and allows for heavy reliance on deemed savings, rather than verified savings. Deemed savings often overstate energy savings and are particularly vulnerable to problems such as improper installation and climatic variation. For this reason, the parties reached a compromise in which the EESP could conduct its own M&V and projects could rely on deemed savings as long as the savings are subject to verification by the independent M&V expert. The commission finds that verification by the independent M&V expert does not constitute a duplication of effort. Verification of savings will discourage overstatement of savings, allow for proper adjustments of deemed savings values, and ensure that the energy goal is met.

The commission agrees that the allocation of 5.0% of the total budget to the cost of the independent M&V expert would divert too much funding from actual projects. Therefore, the commission assigns the cost of the independent M&V expert to the administrative allowance. In addition, the commission finds that the independent M&V expert review will initially be a one-time review during 2003, to evaluate the program results of 2002. The need for evaluation by the independent M&V expert in subsequent years shall be based on the results of the 2003 evaluation. The primary role of the M&V expert will be to verify savings, and the rule is revised to reflect that the expert will perform a *limited* process evaluation. A limited process evaluation is intended as a broad overview of the program, and this purpose is secondary to the savings verification. This will reduce the expense of a full process evaluation. The rule has been revised to reflect the primary purpose of the independent M&V expert. In addition, to clarify the role of the independent M&V expert, the term has been changed from independent auditor to independent M&V expert. The commission also finds that cost allocation for the independent M&V expert should be proportional to the size of the program. The commission has revised §25.181(l) accordingly.

CSW, Reliant, TXU, and TESCO objected to the requirement that allows only energy and demand savings verified by the independent auditor (independent M&V expert) to be counted towards the 10% goal. Reliant, TESCO, and TXU question whether the auditor (independent M&V expert) would be able to verify savings in a timely manner.

The commission agrees that the verification by the independent auditor would preclude utilities from reporting their energy savings in a timely manner. The commission concludes that energy savings reports should be adjusted based on the findings of the independent M&V expert. The language in the rule has been revised accordingly.

(m) Energy efficiency implementation docket (previously the Energy Efficiency Working Group)

CSW, NAESCO, Reliant, Joint Public Interest Groups, Schiller, TXU, and Frontier commented on the structure and duties of the Working Group (energy efficiency implementation docket). EGSI commented that although the Working Group (energy efficiency implementation docket) has been assigned the task of assisting in the development of guidelines under which a utility shall develop its April 1, 2000 energy efficiency plan filing, no schedule was provided in the rule, and this may lead to the utility being unable to obtain needed information for its filing without recourse.

Commenters generally agreed that the group was necessary to accomplish the energy efficiency goals, and they offered various comments on the overall structure and function of the group. Frontier generally stated that the role of the Working Group (energy efficiency implementation docket) should be better defined, but offered no specific suggestions. NAESCO commented that the rule should delegate more of the responsibilities for program design to the Working Group (energy efficiency implementation docket) because the stakeholders, who will make up the Working Group (energy efficiency implementation docket), have more experience in this area. In particular, NAESCO recommended that the M&V requirements and level of inspection, resolution of proportional and equitable sharing of program funds by customer classes, review of incentive payment structure, and the level of lighting that should comprise comprehensive measures should be addressed by the Working Group (energy efficiency implementation docket), and not be spelled out in the rule. Reliant also commented that the criteria and standards for participating in the standard offer program should be within the aegis of the Working Group (energy efficiency implementation docket). Joint Public Interest Groups recommended that information about best practices in market transformation programs in other states be provided in the energy efficiency filing for review and approval by the commission.

Reliant commented that the rule should specify that the minimum criteria regarding licensing, relevant experience, financial strength and reliability, technical qualifications, and management oversight for contractor participation should be established by the utility administrator with input from the Working Group (energy efficiency implementation docket). Reliant also commented that the evaluation of market transformation programs might be appropriate for the Working Group (energy efficiency implementation docket) to address as market transformation programs develop.

TESCO commented that the participating utilities must be active, cooperative members of the Working Group (energy efficiency implementation docket) to ensure the success of the Working Group (energy efficiency implementation docket). TESCO also expressed concern that the role of the Working Group (energy efficiency implementation docket) in trying to identify potential market transformation programs should be clarified to protect proprietary ideas from possible improper use by the state or potential competitors. TESCO contended that the Working Group (energy efficiency implementation docket) or utilities should solicit market-transformation programs from providers, but should offer the winning program ideas out for bid to other providers.

TXU commented that the Working Group (energy efficiency implementation docket) of persons interested in energy efficiency programs could provide valuable insight and assistance to the energy efficiency program. CSW also supported an open and collaborative process; however, CSW and TXU commented that the rule appears to give the Working Group (energy efficiency implementation docket) too much responsibility for technical issues for a voluntary group. CSW further commented that the potential activities listed under the Working Group (energy efficiency implementation docket) are too detailed, and should be strictly limited to reviewing utility administration plans and recommending program improvements. Therefore, CSW proposed deleting all responsibilities of the Working Group (energy efficiency implementation docket). TXU expressed concerns that the proposed rule gives the Working Group (energy efficiency implementation docket) improper authority over certain decisions, especially considering that members of the Working Group (energy efficiency implementation docket) will be interested persons. TXU also recommended that the Working Group (energy efficiency implementation docket) not be given the authority to recommend the independent auditor (independent M&V expert), because it carries large financial implications and potential liability for the voluntary members who are also stakeholders. Schiller suggested that the commission carefully review the roles of each party to ensure that they align with their role in the marketplace and the balance between assignment of responsibility and authority, particularly with regard to the Working Group (energy efficiency implementation docket). Schiller also commented that the Working Group (energy efficiency implementation docket) is granted some responsibility but no set membership, compensation mechanism, governance, or accountability.

The commission notes that the stakeholders acknowledged in the workshops that the commission staff cannot accomplish the list of duties in §25.181(m) without the voluntary support and input from the stakeholders, particularly in view of the complex technical task of implementing PURA §39.905 in the short time mandated by the statute, and invites active participation from all parties. To maintain the necessary staff management within the overall agency docket structure, the commission finds that it is more appropriate to establish an energy efficiency implementation docket to carry out the responsibilities listed in §25.181(m).

The commission agrees with Reliant that the evaluation of market transformation programs may be an appropriate function of the energy efficiency implementation docket, and revises §25.181(m)(2) accordingly. The commission further agrees with TESCO that there is a potential chilling effect on the market transformation program development should proprietary ideas be made available to competitors through the solicitation process. The commission finds that the revised language in §25.181(m), which provides for confidential filings, sufficiently protects the proprietary market transformation programs that may be filed in the implementation docket. The commission agrees with TESCO that §25.181(m) should be revised to replace "avoided cost" with "cost-effectiveness."

(n) Customer protection

CSW, SPS, TNMP, and TXU commented that there is already a wide body of law to protect customers from fraudulent practices, such as the Texas Deceptive Trade Practices Act. In addition, TXU stated that such a restatement could create a different standard of relief for energy efficiency customers, which would be less tested and possibly narrower than existing protections. EGSI and Reliant commented that a separate rulemaking will address customer protection. Although TESCO and NAESCO advocated for the removal of the entire section, they specifically requested that certain paragraphs be removed or modified.

EGSI and TXU stated that placing the burden of customer protection on the utility places the utility in an improper contractual relationship with customers. They further stated that if the commission maintains the customer protection provisions, the language should be changed to reflect that these protections would be placed in the contract between the

EESP and the customer, rather than between the utility and the EESP. In addition, EGSI stated that the courts are the proper forum for redress.

PUB, Reliant, and OPC/Cities suggested that the providers should be required to register with the commission. NAESCO suggested that the rule should establish qualifications of EESPs. PUB suggested that the commission should assess penalties against fraudulent companies. OPC/Cities would have the commission remove a company's registration if there is a record of verified fraud.

TNMP, TESCO, NAESCO, and ESL all to a certain extent would rely on the market to ensure customer protection. TESCO, NAESCO, and ESL argued that payments made in exchange for energy savings ensure adequate protection and minimize fraud. ESL further stated that quality of service should include indoor air quality, adequate lighting, and equipment maintainability, and that increased maintenance cost should be deducted from energy savings.

Joint Public Interest Groups stated that the customer protection provisions in the rule as proposed are necessary to protect customers and should be adopted by the commission, but that a number of other protections are necessary as part of the standard offer contract between utilities and EESPs.

The OAG generally supported the concept of regulations which delineate the customer protections available in the area of purchases of goods and services related to residential energy efficiency improvements. While the OAG accepted the proposition that there are laws that protect customers in this area, it argued that these laws operate primarily as customer remedies, rather than prospectively, as the proposed regulations do. The OAG reasoned that putting everyone on notice as to their rights and responsibilities at the outset of the transaction sets the ground rules for the market in this area and allows customers to make more informed decisions as to which products and services they should purchase. The OAG did not believe that this regulation can or will interfere with its authority to enforce existing statutory protections and may, in fact, assist in enforcement by increasing the awareness of those protections on the part of both customers and EESPs.

The OAG did not believe the rule imposes a significant regulatory burden on the utility or the service provider, or that it requires the utility to interact with the customer directly. The OAG stated that the utility is merely required to include certain provisions in its contracts with service providers that will make the disclosures a contractual obligation of those providers. In short, according to OAG, these provisions will be beneficial because they will assist the commission in establishing marketplace rules and in preventing abusive practices, rather than correcting them.

The Coalition stated that the energy efficiency programs, as envisioned by the proposed rule, would provide a number of customer safeguards that have not historically been present in this market. The Coalition argued that utilities will assure that participating EESPs possess all legally required licenses and permits. The Coalition further stated that the inspection, and M&V that the rule requires provide assurance that customers will indeed reap the energy savings promised, and may expose systemic problems in technologies and providers. The Coalition also stated that these protections, over and above those already afforded customers in the retail energy services market under existing law, are sufficient and that utilities are not in the position to offer such protections.

Public Citizen expressed alarm at the APA hearing at the proposal of the Coalition to eliminate the customer protection provisions in the rule. Public Citizen explained that residential customers often lack the expertise to sort through the promises and promotions made by manufacturers, and expressed concern that this will be the case in the energy efficiency market. Public Citizen suggested that customers will rely on the REPs and utilities to determine which EESP is giving accurate information. Public Citizen argued that it is therefore critical that utilities be given the tools and responsibility to help customers to evaluate proposals in a neutral fashion. Joint Public Interest Groups noted that information provided by the OAG indicates that nearly half of the complaints received by the OAG cannot be mediated or resolved. In addition, Joint Public Interest Groups illustrated the need for customer protection with the HL&P vs. Kimball Hill case (Docket Number 19005, *Complaint of Janette Arceneaux, et al., Against Houston Lighting and Power Company* and Docket Number 20115, *Complaint of Janette Arceneau, et al., Against Houston Lighting and Power Company Regarding Good Cents Home Program*) in which 243 homeowners and customers of HL&P (now Reliant Energy) brought suit against the company. The customers alleged that a utility-backed program delivered poor performance and faulty workmanship. OPC, Cities, TIEC, Shell, and Enron (Joint Reply) provided joint reply comments. The Joint Reply contended that the Coalition comments eliminate any vestige of customer protection, but insert protection for the financial interests of the utilities and the EESPs.

Overall the commission finds that customer protection is a key component to a fully functioning market. Customers who are informed and are protected against fraudulent practices will have greater confidence in the market and this will encourage competition. The commission also finds that the increase in customer complaints in the telephone industry after deregulation clearly indicates a need for customer safeguards. The requirements in the rule are not inconsistent with customer protection provisions for industries related to interest rates, credit cards, automobiles, home construction, pest control, nutrition, appliance energy usage and healthcare that require disclosures to the customers. These disclosure requirements and customer protection provisions came about because government recognized that the market alone would not make critical information readily available to the customers. These protections have allowed customers to make informed choices and discourage providers from engaging in fraudulent practices. The commission agrees with the OAG that these customer protections are largely preventive in nature. They do not supercede other rights available to customers, nor do they place utilities in an inappropriate relationship with the customers, as suggested by some parties. Accordingly, the commission declines to eliminate this section.

ESL stated that a 12-month warranty requirement is inconsistent with other language in the rule that requires a minimum of a ten-year useful life.

The commission finds that a 12-month warranty requirement is unnecessary because a 12-month warranty period is standard practice in the energy efficiency industry, and concludes that this provision should be eliminated.

NAESCO requested that the requirement of proposed §25.181(n)(9) that an "All Bills Paid" affidavit be provided to customers be eliminated unless it can be shown to be a standard form used throughout Texas. NAESCO cautioned that the creation of a new or unknown legal requirement would cause serious confusion, significant concern, and unquestionable delay in program implementation.

The commission finds that the provision merely protects the customer from any claims from subcontractors when the customer has paid the contractor in full for work performed. This should not delay program implementation. The commission declines to delete the language.

NAESCO and TESCO stated that the incentive disclosure requirement of proposed §25.181(n)(12) is not appropriate. NAESCO argued that this paragraph involves the disclosure of confidential, competitive pricing arrangements and potentially even proprietary information. According to NAESCO, the way EESPs calculate and present proposals to customers, which include incentives, vary widely and may or may not specifically identify incentives received by the EESP. In addition, NAESCO stated that the marketing approach used by EESPs to their customers might be proprietary. There is no legitimate reason for the commission to impose requirements in this area. NAESCO argued that the commission's concern should focus on assuring that customers receive the energy efficiency measures that customers contract for and that the utility realizes the energy savings it pays for. TESCO objected to the paragraph because the actual incentive payment may be less than the anticipated payment, based on the results of the inspection, and M&V.

EESPs will receive incentives from the utility in exchange for energy savings. These incentives are consistent and will not vary among contractors within a given customer class. The incentive structure is transparent in that there are no confidential pricing arrangements between the EESPs and the utility. The commission finds that the notice concerning incentives does not require disclosure of how much the EESP expects to receive for a particular installation. Having the EESP disclose the standard incentive amount to the customer will encourage contractors to pass the benefits along to the customer. Disclosure that this is a ratepayer-funded program will encourage customers to participate in the program. The commission concludes that this will also allow the customer to comparison shop for energy efficiency services and encourage competition. The commission declines to delete the language.

Joint Public Interest Groups proposed that EESPs who provide financing for services should be prohibited from transferring the note during the period in which any warranties are in force. Joint Public Interest Groups argued that this would protect the customer from the situation in which the customer has a warranty claim but the note has been sold to a third party against whom the warranty is unenforceable.

The commission finds that the disclosure that a customer's sales agreement may be sold provides adequate protection. The commission declines to adopt the suggestion.

Joint Public Interest Groups proposed that EESPs should be required to provide customers with all written disclosures that are required under federal and state law regarding home construction contracts and customer credit transactions, if the customer intends to finance any services. Joint Public Interest Groups cites §53.255 of the Texas Property Code as an example of how a contractor is supposed to make a number of specific disclosures to the homeowner before a residential construction contract secured by a lien against the homestead is executed. These disclosures explain the homeowner's rights and responsibilities with regards to the transaction under Texas law. Joint Public Interest Groups argued that creating a contractual responsibility for EESPs to make all applicable legal disclosures will go a long way towards ensuring that customers are adequately informed about these transactions and their legal rights regarding them. Towards that end, Joint Public Interest Groups proposed that EESPs should be required to provide all potential customers with a utility approved information packet that includes a list of all organizations that provide energy efficiency services; copies of brochures produced by the Attorney General on home repairs and contract cancellation rights; and, other "customer tip sheets" designed by the utility to inform customers about appliance consumption, energy efficiency measures, etc., and that such information must be fuel-neutral. TESCO requested the removal of the requirement relating to the distribution of a list of participating providers.

The commission acknowledges the benefits to providing a customer with the information listed above. However, as discussed under Preamble Issue Number 9, the EESP or the utility may not be the ideal parties to provide such information. In the discussion under Preamble Issue Number 9, the commission finds that the list should be made available through the commission and the utility. The commission notes that OPC may also make the list available. The list can be made part of a larger information package that includes the information listed above. The contents of the information package may be developed in coordination with the energy efficiency implementation docket. The commission has revised the language to §25.181(h) and (m) and deleted the requirement from the customer protection provisions.

Joint Public Interest Groups proposed that there should be a provision requiring that advertisements or other communications by EESPs inform customers that the EESP is not part of, nor endorsed by the utility or the Public Utility Commission of Texas. Joint Public Interest Groups suggested this should prevent EESPs from relying on a perceived affiliation or endorsement as a means of procuring business from customers.

The commission agrees that the proposed language will protect the commission, the utility, and the customer. The commission has added this provision to §25.181(n).

Joint Public Interest Groups proposed that marketing programs and materials targeted at residential customers should be reviewed by utilities to assure that false or misleading claims of "utility savings" are not being made by service providers. Joint Public Interest Groups warns that without some review of claims regarding utility savings there will be a real temptation for service providers to overstate energy savings of various measures in order to procure more business.

The commission finds that the current customer protection provisions, in conjunction with the inspection requirements in §25.181(i) will provide an appropriate level of protection against false claims of "utility savings." The commission declines to add the language.

Joint Public Interest Groups proposed that where energy efficiency services are billed for through the utility, utilities should be prohibited from terminating electric service for nonpayment of that portion of the bill that is for energy efficiency services.

Under customer choice, the REP will not have an obligation to serve, and the customer may switch providers at will. In addition, §25.181(i)(2)(H) prohibits the utility from engaging in certain tying arrangements. Accordingly, the commission declines to adopt the suggestion.

Finally, Joint Public Interest Groups proposed that no payments from either the customer or the utility should be required (except for a deposit not to exceed 25%) until the customer and the utility have each inspected the work and determined that it has been satisfactorily completed.

The commission finds that §25.181(k)(3) and (4) ensures that the EESP will not receive final compensation until the customer signs off that the work has been completed and the utility has conducted any required inspection. The commission also finds that prescribing allowable deposit levels unduly interferes in the relationship between the EESP and the customer, and may form a barrier for small EESPs. The commission declines to add the language.

(n) Enforcement

TESCO commented that the enforcement language referencing general enforcement authority of the commission, is too vaguely threatening to utilities, and makes it unclear what method will be used for ensuring enforcement. TESCO claimed in its comments that this part of the rule was not discussed in any detail by the parties during the development of this rule, and that there was no clear consensus on how enforcement should be handled. TXU commented that the enforcement provision is unacceptably vague, broad, and is redundant because enforcement remedies for violation of the energy efficiency rules are already provided by Chapter 15 of PURA. TESCO commented that if utilities are trying hard, yet not reaching their goal, internal utility reviews, annual reviews and advice of the statewide auditor (independent M&V expert), review and advice of the Working Group (energy efficiency implementation docket), and advice from the commission staff should be used to adjust programs to be more effective. Shell commented that PURA requires penalties to be assessed on a case-by-case basis and that this review cannot occur in a rulemaking, and therefore, proposed §25.181(m) should remain unchanged.

The commission deletes §25.181(o) as discussed above in Preamble Issue Number 3.

All comments, including any not specifically referenced herein, were fully considered by the commission. In adopting this section, the commission makes other minor modifications for the purpose of clarifying its intent.

This section is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 2000) (PURA) which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, §39.101 and §39.905, which require the commission to ensure that customers have access to providers of energy efficiency services.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 39.101, 39.903, and 39.905.

§25.181. Energy Efficiency Goal.

(a) **Purpose**. The purposes of this section are to ensure that:

(1) electric utilities administer energy savings incentive programs in a market-based, non-discriminatory manner, and do not provide competitive energy efficiency services, except as permitted in §25.343 of this title (relating to Competitive Energy Services);

(2) all customers, in all customer classes, have a choice of and access to energy efficiency alternatives that allow each customer to reduce energy consumption and energy costs; and

(3) each electric utility provides, through market-based standard offer programs, or limited, targeted market-transformation programs, or both, incentives sufficient for retail electric providers and competitive energy efficiency service providers to acquire additional cost-effective energy efficiency savings equivalent to at least 10% of the electric utility's annual growth in demand by January 1, 2004, and each year thereafter, as mandated by the Public Utility Regulatory Act (PURA) §39.905.

(b) **Application.** This section applies to electric utilities, as that term is defined in §25.5 of this title (relating to Definitions). This section shall not apply to an electric utility subject to PURA §39.102(c) until the expiration of the utility's rate freeze period.

(c) **Definitions.** The following words and terms, when used in this section shall have the following meanings unless the context clearly indicates otherwise:

(1) **Calendar year—**January 1 through December 31.

(2) **Competitive energy efficiency services—**Energy efficiency services that are defined as competitive under §25.341(6) of this title (relating to Definitions).

(3) **Deemed savings**—A pre-determined, validated estimate of energy and peak demand savings attributable to an energy efficiency measure in a particular type of application that a utility may use instead of energy and peak demand savings determined through measurement and verification activities.

(4) **Demand—**The rate at which electric energy is delivered to or by a system at a given instant, or averaged over a designated period, usually expressed in kilowatts (kW) or megawatts (MW).

(5) **Demand side management (DSM)—**Activities that affect the magnitude or timing of customer electrical usage, or both.

(6) **Energy efficiency—**Programs that are aimed at reducing the rate at which electric energy is used by equipment and processes. Reduction in the rate of energy used may be obtained by substituting technically more advanced equipment to produce the same level of end-use services with less electricity; adoption of technologies and processes that reduce heat or other energy losses; or reorganization of processes to make use of waste heat. Efficient use of energy by customer-owned end-use devices implies

that existing comfort levels, convenience, and productivity are maintained or improved at a lower customer cost.

(7) **Energy efficiency measures—**Equipment, materials, and practices that when installed and used at a customer site result in a measurable and verifiable reduction in purchased electric energy consumption, measured in kilowatt-hours (kWh), or peak demand, measured in kWs, or both.

(8) **Energy efficiency project—**An energy efficiency measure or combination of measures installed under a standard offer contract or a market transformation contract that results in a reduction in customers' electric energy consumption or peak demand, or both, and energy costs.

(9) **Energy efficiency service provider—**A person who installs energy efficiency measures or performs other energy efficiency services. An energy efficiency service provider may be a retail electric provider or a customer, if the person has executed a standard offer contract.

(10) **Energy savings—**A quantifiable reduction in a customer's consumption of energy.

(11) **Existing contracts—**Energy efficiency contracts in effect prior to September 1, 1999, that expire on or after September 1, 1999.

(12) **Growth in demand—**The annual increase in load, measured on the transmission system, in the Texas portion of an electric utility's service area at time of peak demand, as measured according to subsection (e) of this section.

(13) **Hard-to-reach customers**—Customers with an annual household income at or below 200% of the federal poverty guidelines.

(14) **Incentive payment**—Funding that reduces the cost of installing energy efficiency measures, or provides a service or benefit that would otherwise not be available to the end-use customer for installing energy efficiency measures.

(15) **Inspection**—Onsite examination of a project to verify that a measure has been installed and is capable of performing its intended function.

(16) **Large commercial customers**— Retail commercial customers with a demand that exceeds 100 kW. For the purpose of this section, a customer's load within a service territory that is under common ownership shall be combined.

(17) **Load control**—Activities that place the operation of electricity-consuming equipment located at an electric user's site under the control or dispatch of an energy efficiency service provider, an independent system operator, or other transmission organization.

(18) **Load management**—Load control activities that result in a reduction in peak demand on an electric utility system or a shifting of energy usage from a peak to an off-peak period.

(19) **Market transformation program**—Strategic efforts to induce lasting structural or behavioral changes in the market that result in increased adoption of energy efficient technologies, services, and practices, as more fully described in subsection (j) of this section.

(20) **Measurement and verification (M&V)**—Activities intended to determine the actual kWh and kW savings resulting from energy efficiency projects as more fully described in subsections (k) and (l) of this section.

(21) **Off-peak period**—Period during which the load on an electric utility system is not at or near its maximum volume. For the purpose of this section, the off-peak period will be all hours from October 1 through April 30.

(22) **Peak demand**—Electrical demand at the time of highest annual demand on the utility's system, measured in 15 minute intervals.

(23) **Peak demand reduction**—peak demand reduction on the utility system during the utility system's peak period.

(24) **Peak period**—Period during which a utility's system experiences its maximum demand. For the purposes of this section, the peak period is from May 1 through September 30.

(25) **Renewable demand side management (DSM) technologies**—Equipment that uses a renewable energy resource, as defined in §25.5 of this title that, when installed at a customer site, reduces the customer's net purchases of energy (kWh), electrical demand (kW), or both.

(26) **Small commercial customers**—Retail commercial customers with a maximum demand that does not exceed 100 kW.

(27) **Standard offer contract**—A contract between an energy efficiency service provider and a participating utility specifying the standard

payment based upon the amount of energy and peak demand savings achieved through the installation of energy efficiency measures at electric customer sites, the measurement and verification protocols, and other terms and conditions, according to the program requirements. Multiple energy efficiency service providers may participate under a single standard offer contract. For the purposes of this section, the targeted weatherization programs under PURA §39.903 (relating to the System Benefit Fund) to be administered by the Texas Department of Housing and Community Affairs shall be considered a standard offer contract.

(28) **Standard offer program**—A program under which a utility administers standard offer contracts between the utility and energy efficiency service providers.

(29) **Transition period**—The period from September 1, 1999, through December 31, 2001.

(d) **Cost-effectiveness standard.**

(1) **Cost-effectiveness**. An energy efficiency project is deemed to be cost-effective if the cost of the project to the utility is less than or equal to the benefits of the project. The cost of a project includes the cost of incentives, the measurement and verification costs, and program administrative costs. The benefits of the project include the value of the purchased electrical energy saved, the value of the corresponding generating capacity requirements, and associated reserves displaced or

deferred by the project. The present value of the project benefits shall be calculated over the projected life of the measure, not to exceed ten years.

(2) **Avoided cost**. Incentives shall be set as a percentage of the avoided cost. The avoided cost shall be the estimated cost of a new gas turbine.

(A) Initially, the avoided cost of capacity savings shall be set at $78.5/kW saved at the customer's meter.

(B) Initially, the avoided cost energy savings shall be set at 2.68 cents/kWh saved at the customer's meter.

(C) The commission may adjust the cost effectiveness standard prescribed in subparagraphs (A) and (B) of this paragraph by using an environmental adder up to 20% for targeted projects conducted in an area that is not in attainment for air emission that is subject to the regulations of the Texas Natural Resource Conservation Commission. The environmental adder is available only for targeted energy efficiency projects that are designed to enhance air quality or the reliability of electric service in the non-attainment area, or both, and would not be implemented without the adder.

(e) **Annual growth in demand and energy efficiency goal.** Electric utilities shall meet the minimum mandate of 10% reduction in growth in demand through energy efficiency savings by January 1, 2004. During the transition period, each utility will set interim goals, consistent with approved funding, to provide a reasonable progression toward the 10% goal to be achieved by January 1, 2004.

Each utility is required to meet, at a minimum, 5.0% of its growth in demand through energy efficiency by January 1, 2003. Each utility's energy efficiency goal shall be specified as a percent of its historical five-year average rate of growth in demand, calculated as follows:

(1) Each year's historical demand growth data shall be adjusted for weather fluctuations, using weather data for the most recent ten years. The utility's growth in demand is based on the average growth in retail load in the Texas portion of the utility's service area, measured at the utility's annual system peak for the immediately preceding five years.

(2) The goal for energy-efficiency savings for a year is calculated by applying the percentage goal, prescribed in this subsection, to the average rate of growth in demand, based on the average of the five preceding annual growth rates. The baseline for calculating demand growth shall be reset each year.

(f) **Basic program elements**. Electric utilities shall administer energy efficiency programs designed to achieve reductions in the customer's purchased energy consumption or demand, or both, and lower energy costs through the implementation of standard offer programs or limited, targeted market transformation programs.

(1) Each electric utility shall submit energy efficiency plans and reports to the commission in accordance with subsection (g) of this section.

(2) Incentive payments shall be made under either standard offer contracts or market transformation contracts, or both, for kWs and kWhs saved. The amount of incentive payment may vary by customer class in order to effectively reach all customer classes, including hard-to-reach customers. Market transformation programs may offer other incentives or benefits as approved by the commission.

(3) Customer protection provisions shall be included in all electric utilities' energy efficiency programs in accordance with subsection (n) of this section.

(4) All projects performed under a standard offer contract shall be subject to inspections, measurement, and verification in accordance with subsection (k) of this section. Energy and peak demand savings under market transformation projects shall be verified in accordance with subsection (j) of this section.

(5) The commission shall establish an implementation docket, as described in subsection (m) of this section, to address program design, implementation and administration, and make recommendations to the commission.

(g) **Energy efficiency plans.**

(1) **Schedule**. Each electric utility shall:

(A) By April 1, 2000, file an energy efficiency plan for the transition period and for the years 2002 through 2004, with the utility's application for unbundled transmission and distribution rates. This filing may be supplemented by June 1, 2000 to reflect the results of the energy efficiency implementation docket, as described in subsection (m) of this section.

(B) By April 1, 2001, and annually thereafter, file its updated energy efficiency plan and an annual energy efficiency report as described in paragraph (5) of this subsection.

(C) By no later than January 1, 2002, implement standard offer programs or limited, targeted market transformation programs, or both, as described in subsections (i) and (j) of this section.

(D) Notwithstanding any other provision of this section, 170 days prior to the expiration of the exemption set forth in PURA §39.102(c), an electric utility that is subject to PURA §39.102(c) shall file its energy efficiency plan as a part of the cost separation proceedings package in accordance with §25.344 of this title (relating to Cost Separation Proceedings).

(2) **Energy efficiency plan**. Each electric utility's energy efficiency plan shall describe how the utility intends to achieve the legislative mandate and the requirements of this section. Beginning January 1, 2002, the plan shall be on a calendar year cycle and shall project at least a four-year period. The plan shall propose an annual budget sufficient to reach the 10% legislative goal by January 1, 2004, and annually thereafter. Each electric utility's energy efficiency plan shall include:

(A) A projection of the utility's annual growth in demand based on actual historical data calculated using the methodology and corresponding energy and peak demand savings goal to be achieved under the plan, as defined in subsection (e)(2) of this section.

(B) A description of existing contract obligations and an explanation of the extent to which these contracts will be used to meet the utility's annual energy efficiency requirements. Only additional energy and peak demand savings achieved as a result of projects installed after the effective date of this section may count towards the amount of energy and peak demand savings actually achieved on an annual basis.

(C) An estimate of the energy and peak demand savings to be obtained through each separate standard offer contract, market transformation contract, or both.

(D) The proposed design and plan for each of the utility's standard offer contracts and market transformation contracts, including measurement and verification plans when appropriate. For statewide standard offer contracts or market transformation contracts previously approved by the commission, the contract may simply be identified with a description of how it will be implemented in the service territory of the utility. Contracts not previously approved by the commission should be presented in detail, including baseline studies, for review and approval.

(E) A description of the customer classes targeted by the utility's energy efficiency contracts, specifying the size of the hard-to-reach, residential, small commercial, and large commercial and industrial customer classes, and the methodology used for estimating the size of each customer class.

(F) The proposed incentive levels for each customer class shall be set as a percentage of the avoided cost set forth in subsection (d) of this section. Unless the commission adopts different ceilings for incentive levels, incentive levels for standard offer contracts may not exceed:

(i) 100% for hard-to-reach customers.

(ii) 50% for other residential and small commercial customers.

(iii) 35% for large commercial and industrial customers.

(iv) 15% for load management programs.

(G) The proposed annual budget required to implement the utility's standard offer program, market transformation program, or both, broken out by contract for each customer class, including hard-to-reach customers. The proposed budget should detail incentive payments, utility administrative costs, including the independent M&V expert, and the rationale and methodology used to estimate the proposed expenditures.

(H) Savings achieved through programs for hard-to-reach customers shall be no less than 5.0% of the utility's total demand reduction goal.

(I) Savings achieved through load management programs, including interruptible rates, may not exceed 15% of the utility's total demand reduction goal.

(J) A discussion of the types of informational activities the utility plans to use to encourage participation in standard offer contracts or market transformation contracts, including the manner in which utilities will use to post notice of standard offer contracts, market transformation contracts, and any other facts that may be considered when evaluating a project.

(3) Prior to the implementation of the energy efficiency program, the commission shall:

(A) Approve market transformation programs and standard offer contracts.

(B) Maintain a list of qualified contractors.

(C) Review and approve measurement and verification plans, including deemed savings in accordance with the standard offer or market transformation contract guidelines. Projects that require installation-specific measurement and verification may have a measurement and verification process approved by the utility. At the utility's option, the measurement and verification process or deemed savings may be submitted for pre-approval by the commission.

(4) **Energy efficiency plan for the transition period.** The energy efficiency plan for the transition period shall cover the remainder of 2000 until December 31, 2001. The plan shall describe the utility's goals for the transition period, and include the information required in paragraph (2) of this subsection. The plan for the transition period shall be designed to use any revenue in the utility's current rates to cover the expenses of energy efficiency or DSM programs that were approved prior to the effective date of this section.

(5) **Annual energy efficiency report**. The annual energy efficiency report shall provide the information listed below:

(A) The utility's projected annual growth in demand calculated using the methodology prescribed in subsection (e) of this section.

(B) The corresponding energy and peak demand savings goal for the utility, as defined in subsection (e)(2) of this section, expressed in kWs and kWhs, for the current calendar year.

(C) The utility's actual annual growth in demand for the preceding calendar year.

(D) The most current information available comparing projected savings to reported savings for each of the utility's standard offer contracts and market transformation contracts.

(E) The most current information available comparing reported savings and verified achieved savings as verified by the independent M&V expert for all contracts.

(F) The most current information available comparing the baseline and milestones to be achieved under market transformation contracts.

(G) A statement of funds expended by the utility for incentive payments, program administration including inspections, and the independent M&V expert.

(H) A statement of any funds that were committed but not spent during the year, by project.

(I) Any decreases by more than 10% in total program cost, with an explanation for the decrease in cost.

(J) Any remaining program funds that were not committed during the year.

(K) The most current information available of ongoing and completed energy efficiency projects by customer class that includes:

(i) Number of customers served by each project.

(ii) Project expenditures.

(iii) Verified energy and peak demand savings achieved by the project, when available.

(L) A description of proposed changes in the energy efficiency plans.

(M) Any other information prescribed by the commission.

(h) **Utility administration.** Utilities shall administer standard offer programs, market transformation programs, or both, to meet the requirements of the energy efficiency goal in PURA §39.905. The cost of administration may not exceed

10% of the total program costs until December 31, 2003, and may not exceed 5.0% of the total program costs thereafter.

(1) Administrative costs include costs necessary for utility conducted inspection and the independent M&V expert as required under subsections (k) and (l) of this section, and the costs necessary to meet the following requirements:

(A) Conduct informational activities designed to explain the standard offer contracts and market transformation contracts to energy efficiency service providers and vendors.

(B) The utility shall inform energy efficiency service providers that they may contact the commission for inclusion in the list of energy efficiency service providers maintained by the commission and made available to customers from the commission or the utility.

(C) Review and select proposals for energy efficiency projects in accordance with the guidelines of the standard offer contracts under subsection (i) of this section, and market transformation contracts under subsection (j) of this section.

(D) Inspect projects to verify that measures under a standard offer contract were installed and capable of performing their intended function, as required in subsection (k) of this section, before final payment is made. Such inspections shall comply with PURA §39.157 and §25.272 of this title (relating to Code of Conduct for Electric Utilities and Their Affiliates).

(E) Review and approve energy efficiency service providers' savings monitoring reports for both standard offer contracts and market transformation contracts.

(2) A utility administering a standard offer program or a market transformation program shall not be involved in directly providing customers any energy efficiency services, including any technical assistance for the selection of energy efficiency services or technologies, unless a petition for waiver has been granted by the commission pursuant to §25.343 of this title.

(3) The utility shall compensate energy efficiency service providers for energy efficiency projects in accordance with the contract and the requirements of this section. An individual energy efficiency service provider and its affiliates may not receive more than 20% of the total incentive payments available for a particular standard offer contract. A utility may petition the commission for waiver of this limitation if the utility can demonstrate that the utility would not be able to meet its annual energy savings goal under this limitation.

(4) Projects or measures under either the standard offer or market transformation programs are not eligible for incentive payments or compensation if:

(A) A project would achieve demand reduction by eliminating an existing function, shutting down a facility, or operation, or would result in building vacancies, or the re-location of existing operations to locations outside of the facility or area served by the participating utility.

(B) A measure would be installed even in the absence of the energy efficiency service provider's proposed energy efficiency project. For example, a project to install measures that have wide market penetration would not be eligible.

(C) A project results in negative environmental or health effects, including effects that result from improper disposal of equipment and materials.

(D) The project involves the installation of self-generation or cogeneration equipment, except for renewable DSM technologies.

(5) **Cost recovery and unspent funds**. Funds for achieving the energy efficiency goal will be placed in each utility's transmission and distribution rates effective January 1, 2002. Each utility shall track its energy efficiency expenditures separately from other expenditures and report these in their annual energy efficiency report. Funds not spent within a given year shall be considered as a source of funding for the following year, and the commission shall consider utilities' requests to roll over unspent funds on a case-by-case basis in connection with the utilities' annual energy efficiency report filing under subsection (g)(5) of this section.

(6) Each utility shall meet its energy efficiency goal annually through the acquisition of cost-effective energy efficiency. A utility shall be deemed

to have met its energy efficiency goal if the utility achieves a 10% reduction, or if it is an interim goal, the reduction designated in that year in its demand growth through incentives for standard offer programs, market transformation programs, or both.

(i) **Standard offer programs.** A utility's standard offer program shall be implemented through standard offer contracts. The standard offer contract shall describe the terms and conditions according to the requirements of this section for energy efficiency service providers for the delivery of energy efficiency services. Standard offer contracts will be available to any energy efficiency service provider that satisfies the contract requirements within the commission approved contract parameters.

(1) Statewide standard offer contracts shall be developed as part of the standard offer program and submitted to the commission for approval. Utilities may use the commission approved statewide standard offer contracts without further commission review. Other standard offer contracts will require commission review for approval.

(2) A utility's standard offer program shall meet the following requirements:

(A) A standard offer contract shall be developed to address each customer class. Specific different contracts may be developed to address hard-to-reach customers. All customer classes must have access to an equitable share of the incentive funds.

(B) Each standard offer contract will offer a standard incentive payment and specify a schedule of payments. The incentive shall be set at a level sufficient to meet the goals of the program and shall be consistent with the ceiling under subsection (g)(2)(F) of this section, or any revised ceiling adopted by the commission. The standard offer incentive payments may include both payments for kW and kWh savings, as appropriate. Except for load management projects, the incentive payment may vary by customer class, but not within a customer class.

(C) Peak demand and energy savings for each project shall be identified in the proposals the energy efficiency service providers submit to the utility.

(D) Standard offer contracts shall not limit eligibility to specific technologies, equipment, or fuels, but shall be neutral with respect to such factors. Energy efficiency projects may lead to switching from electricity to another energy source, provided the energy efficiency project results in overall lower energy costs, lower energy consumption, and the installation of high efficiency equipment. Switching from gas to electricity is not allowable under the program.

(E) All projects must result in a reduction in purchased energy consumption, or peak demand, or both, and a reduction in energy costs for the end-use customer.

(F) Comprehensive projects incorporating more than one energy efficiency measure shall be encouraged. Lighting measures shall be limited to 65% of the savings of each project. When a project consists of lighting measures only, compensation shall not exceed 65% of the ceiling for that class under subsection (g)(2)(F) of this section.

(G) Projects shall result in consistent and predictable energy and peak demand savings over a ten-year period.

(H) A utility shall not condition the provision of any product, service, pricing benefit, or alternative terms or conditions upon the purchase of any other good or service from the utility or its competitive affiliate, except that only customers taking transmission and distribution services from a utility can participate in its energy efficiency programs.

(I) Projects shall disclose potential adverse environmental or health effects associated with the energy efficiency measures to be installed.

(J) Projects shall include the procedures for measuring and reporting the energy and peak demand savings from installed energy efficiency measures, consistent with the requirements under subsection (k) of this section.

(K) Standard offer contracts shall provide a complaint process that allows:

(i) The energy efficiency service provider to file a complaint against a utility.

(ii) A customer to file a complaint against an energy efficiency service provider. The utility may use customer complaints as a criterion for disqualifying energy efficiency service providers from participating in the program.

(L) Renewable DSM technologies are allowed.

(M) A standard offer program shall require contractors to provide the following:

(i) Evidence of good credit rating.

(ii) List of references.

(iii) All applicable licenses required under state law and local building codes.

(iv) Evidence of all building permits required by governing jurisdictions.

(v) Evidence of all necessary insurance.

(j) **Market transformation programs**. Market transformation programs are strategic efforts, including, but not limited to, incentives and education designed to reduce market barriers for energy efficient technologies and practices. Utilities should cooperate in the creation of regional or statewide contracts, consider statewide administration where appropriate, and where possible, leverage with existing effective national programs that have the potential to save energy in

Texas. Statewide market transformation contracts shall be developed under the implementation docket to address targeted customer classes, as described in subsection (m) of this section. The contracts shall be filed for commission review and approval. Utilities may use the statewide commission approved market transformation programs without further commission review. All other market transformation contracts will require commission review for approval. Market transformation contracts shall be conducted through projects that describe the terms and conditions as required under this section for the delivery of energy efficiency services. Market transformation contracts must meet the following criteria:

(1) Except for pilot projects implemented during the transition period, competitive solicitation shall be the preferred method for contract selection. Pilot projects may be developed by an individual utility, a group of utilities, or an energy efficiency service provider. A utility may request a waiver from the requirements of a competitive solicitation for good cause.

(2) A market transformation project shall identify:

(A) Project goals.

(B) Market barriers the project is designed to overcome.

(C) Key intervention strategies for overcoming those barriers.

(D) Estimated costs and projected energy and capacity savings.

(E) A baseline study that is appropriate in time and geographic region.

(F) Project implementation timeline and milestones.

(G) Method for measuring and verifying savings.

(H) Period over which savings shall be considered to accrue, including a date for final market transformation.

(I) Each proposed project shall include a description of how it will achieve the transition from extensive market intervention activities toward a largely self-sustaining market.

(3) The project must be cost-effective, under the standard in subsection (d) of this section.

(4) The project must be designed to achieve energy or peak demand savings, or both, and lasting changes in the way energy efficient goods or services are distributed, purchased, installed, or used.

(k) **Inspection, measurement and verification.** Each standard offer contract shall include an industry accepted measurement and verification protocol approved by the commission as part of the detailed energy efficiency plan that will be used to measure and verify energy and peak demand savings to ensure that the goals of this section are achieved.

(1) The energy efficiency service provider is responsible for the measurement of energy and peak demand savings using the approved measurement and verification protocol, and may utilize the services of an independent third party for such purposes.

(2) Commission approved deemed energy and peak demand savings may substitute for the energy efficiency service provider's measurement and verification where applicable.

(3) Each customer shall sign a certification indicating that the measures contracted for were installed before final payment is made to the energy efficiency service provider.

(4) An energy efficiency service provider may request a utility inspection at its own expense in the event a customer refuses to sign the measure installation certification.

(5) A statistically significant sample of installations for residential and small commercial customers will be subject to on-site inspection in accordance with the protocol set out for the project. Inspection shall occur within 30 days of notification of measure installation to ensure that measures are installed and capable of performing their intended function. The energy efficiency service provider shall not receive final compensation until the customer documents work completion and the utility has conducted its inspection on the sample of installations.

(6) The sample size for on-site inspections may decrease over time for a contractor under a particular contract that has consistently yielded satisfactory inspection results.

(l) **Independent measurement & verification (M&V) expert.** An independent M&V expert shall be selected to verify energy and peak demand savings, including deemed savings, reported by energy efficiency service providers statewide for the calendar year 2002.

(1) The independent M&V expert shall be selected by the commission by competitive solicitation.

(2) The independent M&V expert shall be funded from the utilities' program administration budgets.

(3) The independent M&V expert shall perform:

(A) A verification of energy efficiency service providers' reported energy and peak demand savings, based on a statistically representative sample of completed projects; and

(B) A limited process evaluation.

(4) By March 1, 2004, the independent M&V expert shall report its conclusions to the commission and make a recommendation whether the utilities' energy and peak demand savings should be adjusted.

(5) The independent M&V expert shall assist with the development of an oversight program for subsequent years.

(m) **Energy efficiency implementation docket**. The commission shall initiate an implementation docket to make recommendations to the commission for its consideration with regard to best practices in standard offer programs and market transformation programs. Material submitted to the commission in this docket believed to contain proprietary or confidential information shall be identified as such, and the commission may enter an appropriate protective order. The following functions may be undertaken in the energy efficiency implementation docket:

(1) Development and review of statewide standard offer programs.

(2) Identification, design, and review of market transformation programs.

(3) Determination of measures for which deemed savings are appropriate and participation in the development of deemed savings estimates for those measures.

(4) Recommendation to the commission of one or more independent M&V expert to conduct the audit in accordance with subsection (l) of this section.

(5) Review of and recommendations on the independent M&V expert's annual report with respect to whether utilities will meet the minimum legislative goal by January 1, 2004, and annually thereafter.

(6) Review of and recommendations on incentive payment levels and the adequacy to induce the desired level of participation by the energy efficiency service providers and customer classes.

(7) Review of and recommendations on the utility annual energy efficiency reports with respect to whether all customer classes have access to energy efficiency programs.

(8) Periodic reviews of the cost effectiveness methodology.

(9) Development of information packets for potential residential and commercial customers.

(10) Other activities as requested by the commission.

(n) **Customer protection.** The customer protection provisions under this section shall apply to residential and small commercial customers only. Each energy efficiency service provider shall provide:

(1) Clear disclosure to the customer of the following:

(A) The customer's right to a cooling-off period of three business days, in which the contract may be canceled, if applicable under law.

(B) The name, telephone number, and street address of the energy services provider, the contractor, and written disclosure of all warranties.

(C) The fact that incentives are made available to the energy efficiency services provider through a ratepayer funded program, manufacturers or other entities.

(D) Notice of provisions that will be included in the customer's contract as described in paragraph (3) of this subsection.

(2) A form developed and approved by the commission may be used to satisfy the requirements of paragraph (1) of this subsection

(3) Contractual provisions to be included:

(A) Information on work activities, completion dates, and the terms and conditions that protect residential customers in the event of non-performance by the energy efficiency service provider.

(B) Written and oral disclosure of the financial arrangement between the energy efficiency service provider and customer. This includes an explanation of the: total customer payments, the total expected interest charged, all possible penalties for non-payment, and whether the customer's installment sales agreement may be sold.

(C) Disclosure of contractor liability insurance to cover property damage.

(D) An all "All Bills Paid" affidavit be given to the customer to protect against claims of subcontractors.

(E) Provisions prohibiting the waiver of consumer protection statutes, performance warranties, false claims of energy savings and reductions in energy costs.

(F) Information on complaint procedures offered by the contractor, or the utility, as required under subsection (i)(2)(K) of this section, and toll free numbers for the Office of Customer Protection of the Public Utility Commission of Texas, and the Office of Attorney General's Consumer Protection Hotline.

(G) Disclosure that the energy efficiency service provider is not part of, or endorsed by the commission or the utility.

This agency hereby certifies that the rule, as adopted, has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that rule §25.181 relating to Energy Efficiency Goal is hereby adopted with changes to the text as proposed.

ISSUED IN AUSTIN, TEXAS ON THE 21st DAY OF MARCH 2000.

PUBLIC UTILITY COMMISSION OF TEXAS

Chairman Pat Wood, III

Commissioner Judy Walsh

Commissioner Brett A. Perlman