

SE Special
HD **Credits for Cutbacks; Connecticut hopes to expand its 'efficiency market' to households. If it's successful, be prepared for other states to follow.**

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Connecticut is in the forefront of states developing market incentives to encourage the biggest consumers of electricity—households—to use a little less.

Since 2007, the state has used something called an efficiency market to offer incentives to commercial and industrial electricity customers. Now it wants to make residential customers part of the mix.

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Here's how an efficiency market works: The state awards credits to electricity customers, or third-party companies that work with them, to permanently cut their consumption. These companies perform projects from changing light bulbs to replacing appliances, and receive one credit for each 1,000 kilowatt-hours saved. The companies then sell their credits to the state's electricity producers, which are required by law to purchase the credits in increasing numbers each year. The price of each credit is determined by supply and demand. Recently, credits were selling for around \$23 apiece.

Consumers will basically end up paying for the market, since energy suppliers for the most part can pass through the cost of buying the credits. But the expense for each electricity customer is a sliver when spread across the entire user base. Moreover, the program wasn't designed just with cost savings in mind. It really is about achieving larger climate-change and energy goals.

Open the Door

To achieve the emission-reduction goals that states and the federal government are discussing, the door needs to be thrown open to third parties, such as the companies that do efficiency projects in Connecticut, says Andy Frank, executive vice-president of business development at Efficiency 2.0, a New York-based start-up and provider of software that helps households and small businesses save energy. The old process of utilities proposing projects and regulators approving them is too small and clunky and slow, Mr. Frank says. To reach the needed scale, he says, market-based approaches are needed.

Connecticut's efficiency market "is important nationally," Mr. Frank says, "because it is proving a model for other states."

Indeed, the state's efforts are being closely watched by other state and federal policy makers, and by start-ups hoping to grab some of the expanded market. But expanding the market to residential power customers is no simple matter. For starters, it's much more difficult to measure cuts in usage by individual households than, say, by a factory. Plus, the savings will be far smaller on a case-by-case basis.

Connecticut regulators are finalizing new rules, but issues that still have to be worked out include how to measure the absence of electricity usage, and how to make sure reductions are permanent. Commercial and industrial projects have faced similar issues, putting in place specific measurement systems to track the reductions. Another question: where to cap the price of credits.

Who Will Compete?

A business entering this market could offer households a free service to replace incandescent light bulbs with more-efficient compact fluorescent lights, for instance. The business would make its money by selling the credits it earns to either a power supplier or a market middleman in the state's deregulated electricity industry.

Companies that already do this in the commercial part of the efficiency market focus on manufacturers, large retailers and other big consumers of electricity. These companies, sometimes referred to as energy-service companies, will change lighting, replace air-conditioner chillers and make other upgrades. For a business customer, the savings produced by such upgrades quickly erase the expense of the projects. Meanwhile, the energy-service companies earn their money in a variety of ways, sometimes being paid directly for the work, other times sharing in the revenue from the credits produced by a project.

But costs rise and savings shrink when the energy-service firms move from the factory floor to the living room. Reducing residential electricity demand means making a business out of delivering a few dollars a month in savings to thousands of homes. The rewards often aren't enough to make it profitable for an efficiency business or tempting for residents.

"If [residential] efficiency was such a great business, it would be happening," says Steve Mitnick, a partner in the energy practice of consulting firm Oliver Wyman Group, a unit of Marsh & McLennan Cos., and a former chief energy adviser to New York's governor.

Nevertheless, a handful of firms have submitted proposals to Connecticut regulators. Earth Markets LLC, a start-up based in Cromwell, Conn., plans to work with community groups to get into tens of thousands of homes to change incandescent light bulbs to more-efficient compact fluorescent bulbs.

Customers of Earth Markets would pay nothing, while the company would take the estimated savings that the bulbs produce, convert them into credits, and sell the credits in the efficiency market for a profit. Consumers would benefit by saving about \$150 a year in electricity costs, says Bryan Garcia, Earth Markets co-founder.

Once it gets its foot in the door, the company plans to help come up with ways for residents to make even deeper cuts in electricity use.

"When we're in the home, we want to start learning what's inefficient," says Mr. Garcia, who is also program director of the Center for Business and the Environment at Yale University in New Haven.

Retail Approach

Other companies are taking different approaches. New York City-based CPower Inc. wants to work with retailers to lower prices on energy-efficient models of home appliances and light bulbs. The company would calculate the energy savings produced when consumers opt for the products. Then it would sell the resulting credits and share some of the revenue with the retailers to offset its costs for lowering prices.

"Retail stores are in a spectacular position," says Gray Fromer, chief executive of CPower. "They are touching those consumers every day."

Efficiency 2.0 wants to use software to help people track and change how they use electricity at home. Homeowners would commit to certain cuts in consumption and share in the credits they help produce on top of lowering their electricity bills.

San Francisco-based Nexant Inc. is considering adding residential projects such as installing insulation to work it does already in Connecticut on commercial and industrial efficiency projects.

Role for Utilities

Power distributors like Connecticut Light & Power, meanwhile, an integral part of the state's commercial efficiency market, are also already helping households use electricity more efficiently. The company, owned by **Northeast Utilities** of Berlin, Conn., collected about \$70 million in electricity-rate add-ons last year for its work retrofitting homes and working with commercial customers on energy-efficient building designs.

Some energy-service companies say this threatens the development of the residential portion of the

efficiency market. The fear is that deep-pocketed utilities could end up doing so many efficiency projects that they flood the market with credits, thus lowering their value.

The utilities respond that the money they bring in selling credits simply increases the number of efficiency programs they can do.

Indeed, relying on utilities to reduce power demand is a traditional approach that some favor, especially because of the tedious nature of trying to increase efficiency one home at a time.

Broader Debate

The debate over efficiency markets extends well beyond Connecticut. To reduce emissions of greenhouse gases, national energy policy makers are considering whether to rely heavily on utilities and government programs, efficiency markets, or both.

One version of energy and climate-change legislation currently being debated in Congress includes a proposal to add an efficiency market to new national markets for carbon-dioxide emissions and renewable energy credits.

Mr. Mitnick says policy makers should focus on giving local utilities incentives to encourage efficiency, because they're connected with customers and have a strong understanding of a region's electricity needs.

Speed It Up

Slowly states are starting to change the incentive structure, rewarding utilities for cutting electricity consumption, but more work needs to be done, Mr. Mitnick says. "We have no chance to meet those lofty goals without the utilities going all-out," he says.

But advocates of efficiency markets see a need to widen the pool of companies working to cut energy use. They warn that utilities have a spotty record at cutting overall use.

"There are other approaches that may be more innovative," says Mr. Garcia, the Earth Markets co-founder, who favors more competition from entrepreneurs, start-ups and other new entries.

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