BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Examine the Commission's Energy Efficiency Risk/Reward Incentive Mechanism	R.09-01-019 (Filed January 29, 2009)

APPLICATION FOR REHEARING

OF DECISION 09-12-045

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APPLICATION FOR REHEARING

OF DECISION 09-12-045

Pursuant to Rule 16.3 of the Commission's Rules of Practice and Procedure, The Utility Reform Network (TURN) respectfully submits this Application for Rehearing. This Application for Rehearing is timely filed within 30 days of December 29, 2009, the date of issuance of D.09-12-045.

I. Introduction

Decision 09-12-045 authorizes the Second Interim Payment for energy efficiency program activities in 2006-2008 and purports to calculate total "maximum earnings" for the three-year cycle using the Energy Division Second Verification Report (SVR) based on verified and updated input numbers. The Decision calculates the second installment of shareholder incentives by subtracting a 35% holdback from the maximum earnings and then subtracting out the first payment authorized in D.08-12-059. However, the decision *in fact used verified numbers for calculating only one of the two key parameters of the incentive mechanism*. Thus, to the extent that the final Decision authorized additional shareholder incentives by artificially setting the earnings rates at 12% for all utilities, it commits the same errors that exist in D.08-12-059 and that are the subject of a pending Joint Application for Rehearing that TURN and the Division of Ratepayer Advocates (DRA) filed in that rulemaking.[1]

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[1] As noted below, TURN reiterates the same arguments here: the adopted amounts result in unjust rates and are not justified by any findings based on the record in this proceeding.

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II. The Decision Lacks Any Rational Basis for Using Unverified Self-Reported Numbers to Calculate Sharing Rates

A. The Decision Unequivocally Reiterates the Need to Use Verified and Updated Data for Incentive Calculation

The primary issue in contention in this first phase of R.09-01-019 was whether the calculation of shareholder incentives should be based on independently-verified and updated energy savings numbers or calculated by using different numbers and inputs, as proposed by the utilities and NRDC. In Decision 09-12-045 the Commission unequivocally reiterated the underlying principle that shareholder incentives for energy efficiency program performance should be paid only for actual independently-verified energy savings; and the Commission explained why it is appropriate to rely on Energy Division's Second Interim Verification Report to calculate shareholder incentives:

> We conclude that the Energy Division's Second Verification Report provides the appropriate basis for setting the second installment of interim incentive claims. The Commission officially adopted the Energy Division Verification Report by Resolution E-4272 on October 15, 2009. The Commission previously recognized the importance of independent verification in ensuring that ratepayers get value commensurate with their energy efficiency investment, that programs are well designed, and that energy efficiency is considered a reliable resource comparable to supply side resources.[2] The Energy Division Second Verification Report is the only source in the record that offers an independent assessment of earnings from a neutral perspective.[3]
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> We conclude that the methodologies and assumptions underlying the Verification Report offer the most reasonable basis for deriving interim incentives, particularly since the utilities will still be entitled to a final true-up payment next year.
>
> In view of the asymmetry in risks and rewards facing the utility, relying on the Verification Report provides an appropriate balancing of goals and interests between investors and customers. The utilities' risk of *understated* incentive claims, at most, will be limited to any lost time value of money associated with additional 2006-2008 incentive earnings, if any, identified through the 2010

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[2] D.05-01-055 at 112.

[3] D.09-12-045, *mimeo.* at 51-52.

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true-up. If the interim incentive payments were subsequently found to be understated, the utility would be made whole for the shortfall in the true-up.

On the other hand, if the interim incentive payment were to be based upon the Proposed Settlement, or upon SCE's self-reported RRIM earnings claims, the risk to ratepayers of overstated incentive payments would be much greater. In view of our adopted policy limiting any refunds for RRIM overpayments, the ratepayer would have little or no opportunity to be made whole if the 2010 true-up revealed that the final incentive awards were found to be less than the interim payments.[4]

In D.09-12-045 the Commission also distinguished between the circumstances at issue in its consideration of the second interim claim and those impacting the first interim payment authorized in D.08-12-059. The Commission explained why its first interim payment authorization in D.08-12-059 was an appropriate departure from the norm based on unique circumstances of timing:

We find the utilities' reasons for ignoring the second Verification Report in considering interim incentives to be unpersuasive. The utilities' characterization of the delay in the first Verification Report as a "process breakdown" was a one-time event. The one-time delay in issuing the earlier report was due to the Commission mandate for Energy Division to update DEER assumptions in the middle of the three-year program cycle. As a condition for allowing the utilities to retain incentive earnings awarded during the interim cycles, therefore, we required more timely DEER updates as the basis for those earnings, including net-to-gross ratios and expected useful lives. (D.08-01-042 at 16.) We based the first incentive payment on utility self-reported performance (with a 65% holdback to protect ratepayers) only because the Energy Division Verification Report was not available in time.

We face different circumstances now as we consider the second interim claim. Unlike the situation last year, the Second Verification Report has been completed in time to assess utility performance and the resulting second interim RRIM awards that are now due. A one-time event that precluded reliance on the first Verification Report does not

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[4] D.09-12-045, *mimeo.* at 56-57.

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justify ignoring the second Verification Report in determining the second interim award.[5]

The Commission rejected the settlement proposed by PG&E, SDG&E/SoCalGas and NRDC due to its use of *ex ante* utility inputs:

> The Proposed Settlement would partially reverse the D.08-01-042 requirement to update *ex ante* assumptions used to assess RRIM claims. The Settlement would thereby eliminate the balance achieved in D.08-01-042, by removing essential protections against ratepayers' risk of overpayment of incentives.
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> …
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> By not updating key *ex ante* assumptions, the Settlement fails to produce a reasonable basis for measuring incentives, but increases the risk of overpayment of interim incentives.[6]

The Decision also rejected SCE's separate proposal because it was based "upon its own self-reported performance without independent third-party verification."[7]

The Commission adopted findings of fact and conclusions of law supporting these conclusions.[8]

B. The Use of Unverified Self-Reported *ex ante* Inputs to Calculate the Sharing Rates Directly Conflicts with the Legal Conclusions in the Decision and Has no Basis in the Record

In spite of its unequivocal conclusions that using independently verified numbers is the most reasonable method to calculate both "the amount of actual energy savings, and the value of those savings," the Commission then turns around and completely

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[5] D.09-12-045, *mimeo.* at 52-53.
[6] D.09-12-045, *mimeo.* at 35.
[7] D.09-12-045, *mimeo.* at 51.
[8] See, for example, D.09-12-045, Findings of Fact 2, 8, 13 and 18, Conclusions of Law 2, 6, 7, 9 and 10, *mimeo.* at 76-78 and 81-82.

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ignores its own legal conclusions by adopting an earnings rate of 12% for all utilities that is based on utility proposals "using relatively unmodified ex ante assumptions"![9]

The adoption of a 12% sharing rate for all utilities was the primary difference between the Alternate Proposed Decision and the Proposed Decision in this proceeding. To understand the change made in the Alternate it is useful to summarize the nature of the "Risk/Reward Incentive Mechanism," as first adopted in D.07-09-043. The mechanism in its most basic form involves the following steps:[10]

- The total amount of gross energy savings due to all efficiency programs is calculated by summing the impact of all individual measures. The savings impact of each measure is based on the number of "installations" multiplied by an accepted value of per measure energy savings. The ***net savings*** due to utility programs are calculated by adjusting gross savings by a factor (net-to-gross) that accounts for free ridership inherent in certain programs (e.g. upstream rebates). The input values to these calculations are supposed to be updated and verified based on adopted EM&V protocols.
- The "shared savings rate" ("SSR") for each utility is calculated by comparing the ***net savings*** (as calculated in Step 1 above) to an established benchmark based on the savings goals adopted in D.04-09-060 (the "minimum performance standard" or MPS). Depending on the percentage of savings' goals accomplished, the utility may be subject to a penalty rate, fall in the

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[9] D.09-12-045, *mimeo.* at 67. See, also, Finding of Fact 31 ("Using unmodified ex ante assumptions for purposes of comparing the utilities' results with the Commission goals and setting the shared savings rate yields a shared savings rate for each utility of 12%.)
[10] Details of the mechanism are provided in D.07-09-043, as modified by D.08-01-042.

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deadband, or be subject to one of two earnings rates (9% for performance at 85-100% of goals or 12% for performance greater than 100% of goals).[11]

- The performance earnings basis ("PEB") is calculated as the "net benefits" of efficiency programs, calculated by subtracting program costs from the benefits of avoided energy and capacity as calculated based on the Standard Practice Manual. Avoided cost benefits are directly related to the ***net savings*** as calculated in Step 1 above.
- The resulting shareholder earnings are calculated as SSR * PEB.

The Proposed Decision of ALJ Pulsifer used the same net energy savings numbers, based on verified and updated data, to calculate sharing rates of 9%, 9%, 0% and 12% for PG&E, SCE, SDG&E and SoCalGas respectively.[12] But the Alternate Proposed Decision used different energy savings numbers to calculate the PEB and the SSR. The Alternate methodology was ultimately adopted in D.09-12-045.

Thus, Decision 09-12-045 determines that a 12% shared savings rate is reasonable by calculating the amount of savings achieved by each utility by "assuming certain key variables were not updated, consistent with the utility proposals."[13]

The rationale for adopting a 12% shared savings rate is provided in Section 4.4 of D.09-12-045 and in Findings of Fact 19 and 31. The Decision claims that "comparing utility results that reflect updated estimates and assumptions with Commission goals that do not reflect those same updates and assumptions appears to be an apples to oranges

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[11] See, especially, D.07-09-043, Figure 1, *mimeo.* at 8.
[12] See, Table 1 below for details.
[13] D.09-12-045, *mimeo.* at 68.

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comparison." The APD divines a difference in calculating the net savings accomplishments for the purpose of comparing to established goals versus for the purpose of determining the value of the savings:

> We have determined that ratepayer interests are best served by using updated assumptions and independently verified results to determine the amount of actual energy savings, and the value of those savings, to be shared between utilities and ratepayers. However, it is less clear that this is the appropriate means of comparing utility efforts with the Commission's goals in setting the shared savings rate. Those goals were established prior to the utilities carrying out their programs and prior to the updating of the assumptions at issue in this proceeding, and other than as proposed herein, those goals have not been revised to reflect updated information and assumptions. (APD, p. 68).

This artificial distinction which results in the calculation of two different energy savings numbers (one to set the sharing rate and one to calculate avoided cost benefits) using two different methods has no basis in the record and conflicts with the underlying principles of D.09-12-045. The incentive mechanism and the EM&V process as adopted in Decisions 07-09-043, D.08-01-042 and D.08-12-059 made no such distinction, and in fact explicitly called for the true-up of all input parameters for both the MPS achievement and the PEB amounts calculated in the final *ex post* true-up.[14]

C. The Outcome Conflicts with Previous Decisions To Use Updated Values For Goals Calculations and to Use Net Goals in 2006-2008

The Commission has addressed this very issue – whether updated and verified numbers should be used to measure goal performance – on at least two prior occasions.

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[14] See, D.08-01-042, *mimeo.* p. 3 ("Under D.07-09-043, both attainment of the MPS and the calculation of PEB net benefits are trued-up at the third (and final) earnings claim based on the results of *ex post* measurement of load impacts, including net-to-gross adjustments to remove free riders. That is, the savings and net benefit calculations for the 3rd Claim incorporate the Energy Division's verification of measure installations, verification of program expenditures and *ex post* measurement of load impacts for the full three-year program cycle.")

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Each time the Commission has provided rational justification for the need to use verified updated figures. D.09-12-047 reverses this policy without a rational basis, simply because now that the crunch time has come the real numbers proved less favorable than utilities wanted.

The utilities filed a petition for modification of D.07-09-043 and specifically requested that the evaluation and verification process be modified so that "achievement of the MPS [minimum performance standard, which sets the shared savings rate] be established based on verification of measure installations but using *ex ante* planning estimates of load impacts."[15] In D.08-01-042 the Commission adopted several changes that insulated the utilities from having to return any overearnings in the final true-up. The Commission explicitly modified the incentive mechanism in D.08-01-042 to allow for earnings at 9% even if the final true-up showed that the utilities did not reach the 85% MPS threshold but were in the deadband. This change *effectively* modified the comparison between actual results and established goals. However, the Commission explicitly rejected utility requests to rely on earlier utility planning assumptions that had since been superceded by the inclusion of more realistic *ex ante* values,[16] and the

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[15] D.08-01-042, *mimeo.* at p. 4.

[16] D.08-01-042, mimeo. at p.15: ("As TURN points out in its comments, the utilities do not specify in their Joint Petition (or in their joint reply to comments) the specific *ex ante* assumptions for measure savings to be used in calculating the 1st and 2nd interim earnings claims. It is particularly important to clarify this issue for the 2006-2008 program cycle because the utilities' compliance filing data is too aggregated to be useful for this purpose for a significant number of programs. Moreover, consistent with agreements reached during the development of the Case Management Statement (CMS), some of the utilities have already updated their *ex ante* savings parameters in consultation with Energy Division since submitting their compliance filings in order to reflect more recent and realistic values for net-to-gross ratios. It makes no sense to undo this work by

Commission required that *ex ante* values in the DEER database be updated for interim payment claims.

> For measures included in the Database for Energy Efficient Resources (DEER), however, we will update the values contained in the E3 calculators with the 2008 and 2009 DEER updates of ex ante measure savings parameters, including net-to-gross ratios and expected useful lives. [17]

The utilities repeated their request to use utility unmodified *ex ante* values for calculating savings and earnings. In D.08-12-059 the Commission *reinstated* the deadband for zero earnings because it granted the first incentive claim based on using utility *ex ante* earnings data.[18] But the Commission made clear that this was a one-time decision based on the delay in the First Verification Report. The Commission explicitly denied the utilities' request "to eliminate the existing requirement under which the *ex ante* values used to calculate interim claims are updated."[19]

Furthermore, similar utility requests have been rejected in the context of changing the goal numbers themselves. Using unverified self-reported numbers to calculate savings accomplishments has partially the same impact as changing the calculation of the goals

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relying on earlier planning assumptions that have since been superceded by the inclusion of more realistic ex ante values in some of the utilities' E3 calculators.")

[17] D.08-01-042, mimeo. at p. 16.

[18] D.08-12-059, *mimeo.* at p. 3 ("To further reduce the risk of overpayment, for the 2006-2008 period, we will adjust the framework to "reinstate" the deadband, such that if the *ex post* review indicates that utility performance falls between 65% and 85% of the adopted goals, rather then continuing to earn incentive payments at the 9% shared savings rate, as is current policy, no additional incentives will be earned beyond what they IOUs have already received in interim claims.")

[19] *Id.* See also, D.08-12-059, *mimeo.* pp. 15-18 (" ("At this point we do not think it would be reasonable to remove, in part or in whole, the requirement that the *ex ante* assumptions used to assess interim claims be updated.")

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from a net to gross basis. This is an issue that has been addressed before by the Commission. In D.07-10-032 the Commission rejected proposals to change the goals for the 2006-08 cycle by including any impact due to "spillover," though it indicated a willingness to reconsider this issue in the future.[20]

In D.08-07-047 the Commission did indeed adopt the use of gross goals on a going forward basis. But the Commission explicitly indicated that such a change would warrant reconsideration of the RRIM mechanism for 2009-11:

> At the same time, the concern of DRA and others about ratepayer impacts of changing to gross goals on the RRIM may be legitimate. We appreciate the comments of several parties that the relationship between the RRIM and changing the measurement of goals needs to be considered. It is possible that the change from net to gross energy savings goals for 2009-2011, while necessary to reflect realistic changes in the measurement of energy efficiency potential, may result in an imbalance of risks and rewards for utilities if other corresponding adjustments are not made, so that earnings are too easily achieved.[21]

The outcome in D.09-12-045 is at odds with the directives in D.07-10-032 and D.08-07-047. [I THINK I'D INSTALL THE REFERENCE TO THE PENDING APPLICATION

Commissioner Bohn's APD also contains an inherent assumption that the utility "unmodified *ex ante*" values are somehow more comparable to the input values used by the California Energy Commission and the Energy Division that were the basis for the potential studies originally used to set the goals in D.04-09-060. The record evidence provides no basis for evaluating this assumption.

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[20] D.07-10-032, *mimeo.* at 121-123.

[21] D.08-07-047, *mimeo.* at 30. The Commission explicitly suggested that maximum earnings and sharing rates may need to be adjusted downwards due to the use of gross goals.

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III. The Result of the Abandonment of Verified and Updated Data in D.09-12-045 is to Authorize Unjust and Unreasonable Shareholder Incentives

In D.09-12-045, the Commission decided to set all earnings rates to 12% (as well as making two revisions to increase the earnings for SCE and SDG&E even more than originally called for in the Alternate Decision). In order to do this, the Commission disregarded the figures set forth in the Energy Division report, which relied upon verified and updated data. The differences in the outcomes for the earnings rates, maximum earnings and second installment of earnings are shown in the following tables, which for comparison purposes also include the numbers from the Second Verification Report (without considering the impacts of interactive effects) and the Proposed Decision of the ALJ:

Table 1: Earnings Rates

Utility	Earnings Rate (% based on MPS target)			
	Verification Report (w/o interactive effects)	Proposed Decision	Alternate Decision	Final Decision
PG&E	0	9	12	12
SCE	0	9	12	12
SDG&E	0	0	12	12
SoCalGas	9	12	12	12

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Table 2: Maximum Earnings

Utility	Maximum Earnings (based on PEB)			
	Verification Report (w/o interactive effects)	Proposed Decision	Alternate Decision	Final Decision
PG&E	$0	$86,458,401	$115,277,868	$115,277,868
SCE	$0	$53,183,505	$70,911,340	$77,465,151
SDG&E	$0	$0	$15,744,765	$17,077,803
SoCalGas	$7,374,572	$9,832,762	$9,832,762	$11,247,724
Total	$7,374,572	$149,474,668	$211,766,735	$221,068,546

Table 3: Second Installment Incentives

Utility	Second Installment Earnings			
	Verification Report (w/o interactive effects)	Proposed Decision	Alternate Decision	Final Decision
PG&E	$0	$14,697,960	$33,430,614	$33,430,614
SCE	$0	$9,869,278	$21,392,371	$25,652,348
SDG&E	$0	$0	$0	$300,572
SoCalGas	$0	$1,191,296	$1,191,296	$2,111,021
Total	$0	$25,758,534	$56,014,281	$61,494,555

Decision 09-12-045 calculated maximum earnings for all utilities that are $71,593,878 higher than the earnings calculated on verified savings (as determined in the proposed decision), and awarded second interim payments for all utilities that are $35,736,021 higher than the verified savings-based approach underlying the proposed decision.[22] In doing so, the Commission committed the same legal error that is addressed in the Joint Application for Rehearing of D.08-12-059 filed in R.06-04-010. TURN has attached the earlier application for rehearing to this pleading as Appendix A, and incorporates it by reference as if were fully set forth herein.

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[22] The original APD calculates earnings $62,292,067 higher than the PD and second interim payments $30,255, 747 higher than the PD.

IV. The Commission Failed to Mitigate the Potential Impact of Overpayment

Decision 09-12-045 explained how the original first payment, using unverified utility data, was adjusted to mitigate ratepayer risk by increasing the holdback amount to 65%:

> Because the first installment of interim incentive payments was based on the IOU self-reported claims without independent verification, as required by D.08-01-042, the Commission expressed concerns about the added risk to ratepayers of overpayment. To mitigate this risk, the interim awards were subject to a higher 65% holdback.[23]

While the final decision, based on the alternate proposed decision, chooses to modify the verification process by calculating the sharing rate using unverified numbers, it does nothing to mitigate the increased ratepayer risk. In our comments on the alternate proposed decision, TURN suggested increasing the holdback to at least 50% if the shared rate is calculated using unverified numbers. The Commission made no such adjustment. TURN suggests that at a minimum the Commission should revise D.09-12-045 to increase the holdback commensurate with the increased risk of overpayment. We note, however, that such an approach can only *minimize* ratepayer risk. Given that the SVR shows that using the best available data SDG&E would be entitled to no earnings, any increase in holdback based on the adopted $17 million in incentives for SDG&E would still harm ratepayers.

V. Conclusion

The Commission adopted the revised Alternate Proposed Decision which purported to adopt a policy of using verified and updated inputs to the incentive

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[23] D.09-12-045, *mimeo.* at 12.

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calculation, but in fact used unverified *ex ante* numbers to calculate one of the two main components of the mechanism – the shared savings rate. The use of a 12% savings rate for all utilities resulted in unjustified shareholder incentives which have no basis in the record and violate explicit Commission policy.

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APPENDIX A

"APPLICATION FOR REHEARING OF DECISION 08-12-059"

Filed on February 2, 2009 in R.06-04-010

By The Utility Reform Network and the Division of Ratepayer Advocates

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Examine the Commission's Post-2005 Energy Efficiency Policies, Programs, Evaluation, Measurement and Verification, and Related Issues.	Rulemaking 06-04-010 (Filed April 13, 2006)

APPLICATION FOR REHEARING OF DECISION 08-12-059

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APPLICATION FOR REHEARING OF DECISION 08-12-059

I. INTRODUCTION

On January 2, 2009, the Commission issued Decision (D.) 08-12-059, "Decision Granting in Part and Denying in Part the Petition for Modification" (Decision). The Decision modified D.07-09-043 and D.08-01-042 by authorizing incentive payments to Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas)[1] for energy efficiency savings based not on Energy Division's independent verification report, but instead on the Utilities' self-reported energy savings. The Decision is therefore a radical departure from previous decisions that awarded incentives only for verified achievements/energy savings.[2]

In approving payment of $82 million in non-refundable energy efficiency incentives to the Utilities, notwithstanding the Energy Decision's draft Verification Report showing that three of the four Utilities were not entitled to incentives, the Commission disregarded its obligation to ensure that rates are just and reasonable and failed to follow its own standard for granting the relief requested in a Petition for

[1] DRA's Application for Rehearing refers to PG&E, SCE, SDG&E and SoCalGas as "Utilities."

[2] The Commission previously allowed Utilities to earn incentives for verified achievements, paid out over nine years as part of an "Annual Earnings Assessment Proceeding."

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Modification. The Decision was not supported by the findings of fact and conclusions of law necessary to support the $82 million award. For these reasons, the Decision is an abuse of discretion, and the Commission should grant rehearing and reverse the award of incentives.

Pursuant to Rule 16.3 of the Commission's Rules of Practice and Procedure, the Division of Ratepayer Advocates (DRA) and The Utility Reform Network (TURN) respectfully submit this Application for Rehearing. This Application for Rehearing is timely filed within 30 days of the date of the Decision's issuance.

II. BACKGROUND

A. Decision 07-09-043, as modified by Decision 08-01-042 aligned shareholder and ratepayer interests by directing the calculation of interim claims using the best *ex ante* data available, including the 2008 database for energy efficiency resource (DEER)[3] updates.

Recognizing the importance of energy efficiency as the least cost resource for serving California's energy needs and as an important tool to combat climate change,[4] the Commission designed the risk/reward incentive mechanism to encourage the Utilities to "'mine deeper' for cost-effective energy savings than ever before in California's history."[5] Decision 07-09-043 therefore established a shareholder incentive mechanism that attempted to align shareholder and ratepayer interests by (1) rewarding the Utilities for energy savings that approached or surpassed the Commission's energy savings goals and (2) by requiring the Commission's Energy Division staff and its evaluation, measurement and verification (EV&V) contractors to independently verify all

[3] DEER is a database developed jointed by the Commission and the California Energy Commission and funded by ratepayers that provides standardized estimates of numerous energy saving parameters, including unit energy savings for various energy efficiency measures. D.08-01.042, p. 16.

[4] D.07-09-043.

[5] D.07-09-043, p. 11.

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calculations of the net benefits and kilowatt (kW), kilowatt hour (kWh) and therm achievements using adopted EM&V protocols.[6]

Decision 07-09-043 adopted a risk/reward incentive mechanism that included a minimum performance standard (MPS) of 80-85% of the Commission's energy savings goals. Requiring that Utilities meet the MPS in order to earn incentives ensures that the Utilities are rewarded only for significant progress toward the Commission's goals of saving kW, kWh and therms.[7]

In order to provide timely feedback to the Utilities for their performance in achieving energy efficiency savings, the risk/reward incentive mechanism included two interim incentive payouts based on energy savings achieved before the end of the three-year program cycle.[8] The Commission adopted an earnings claim and recovery schedule in which the two interim claims would be based on Energy Division's Verification Reports reflecting measure installations and costs, followed by a final "true-up" claim that would include Energy Division's *ex post* evaluation of energy savings, consistent with established EM&V protocols. The final true-up process would help ensure that energy efficiency produced "sizable GWh [gigawatt hour], MW [megawatt], and Mtherm [megatherm] savings that resource planners can depend upon now and in the future"[9] and that ratepayers pay incentives only for savings that were real and verified.

The ink was barely dry on D.07-09-043 before the Utilities filed their first petition for modification on October 31, 2007,[10] which sought to restrict the final true-up process so that achievement of the MPS would be based on verification of measure installations,

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[6] D.07-09-043, p. 4.

[7] The Commission established the Utilities' energy savings goals in D.04-09-060. The Utilities submitted energy efficiency portfolio plans, including budgets that they proposed in order to meet their energy savings goals, which the Commission approved in D.05-09-043.

[8] *See* D.07-09-043, Conclusion of Law 7, at p. 212.

[9] D.07-09-043, p. 119.

[10] Petition for Modification of Decision 07-09-043 By Pacific Gas And Electric Company, Southern California Edison Company, San Diego Gas & Electric Company And Southern California Gas Company, filed October 31, 2007 and amended November 7, 2007 (First PFM).

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but using *ex ante* planning estimates of load impacts.[11] The Utilities requested that if final verified energy savings showed that their performance fell in the "dead band," between 65% and 85% of the Commission's adopted savings goals, they should nevertheless retain interim incentives and continue earning at the established share rate of 9%. The Utilities claimed that their requested changes were necessary in order to provide sufficient certainty to investors that energy efficiency earnings could be booked "on a regular basis for accounting purposes in a manner that can be expected and anticipated by the investment community" so that energy efficiency resources would be "on par with generation resources in the minds of investors"[12]

The Commission was persuaded that effectiveness of the incentive mechanism would be diluted if the Utilities could not book authorized earnings because of uncertainty associated with the possibility that the final true-up might require the return of incentive payments.[13] It therefore granted the Utilities' first Petition for Modification (First PFM) and modified the incentive mechanism to limit the final true-up process so that

> "if a utility meets the MPS for the interim claim based on verified measure installations and costs, and the *ex ante* savings assumptions, but falls within the 65 to 85% of energy savings goals as a result of the final *ex post* true-up of load impacts…the utility will continue to earn at the 9% shared savings rate, applied to the ex post PEB. In addition, as long as a utility continues to exceed the 65% of savings goal threshold for each individual metric on an *ex post* basis, it will not be required to pay back any interim incentives payments earned."[14]

The Commission also incorporated important changes designed to mitigate the risk of large swings in earnings and decrease the risk of overpayment, including "[u]pdating

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[11] D.08-01-042, p. 4.

[12] D.08-01-042, p. 9, quoting First PFM at p.13.

[13] D.08-01-042, p. 10.

[14] D.08-01-042, Ordering Paragraph 2, page 25.

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ex ante load impacts using the DEER database prior to payout of interim claims in 2008 and 2009"[15] and requiring that 35% of the interim payment be held back.[16] While restricting the final true-up decreased "the incentive for utility managers and staff to support the most accurate estimate of energy savings" and worked against the interest of ratepayers in "shar[ing] the net benefits with shareholders at precisely the adopted share rate,"[17] use of updated DEER numbers to calculate interim claims and increasing the hold back offered some assurance that shareholders would not retain incentives for mediocre performance. The Commission explained in response to the first PFM that "[a] combination of updated *ex ante* values combined with a larger hold-back will substantially mitigate ratepayer risk brought upon by the changes we adopt to the true-up mechanism."[18]

B. Decision 07-09-043 recognized the possibility of delay in the calculation of interim incentive claims.

Prior to establishing the procedure for the payment of interim claims in D.07-09-043, the Commission considered parties' proposals and consulted with Energy Division in order to develop an interim claims schedule that would "link claims and payments to EM&V results, produce a stream of earnings during and at the end of the program to provide ongoing incentives to the utilities" while also recognizing resource limitations and competing priorities of staff time.[19] The Commission's adopted proposal[20] provided for "two interim claims and a final true-up claim, resulting in one claim per calendar year for the 2006-2008 and each subsequent program cycle, beginning in 2008. The interim claims were tied to interim Verification Reports, with the final claim tied to the Final Verification and True-Up report. The Commission adopted an

[15] D.08-01-042, Finding of Fact 15, p. 21.

[16] D.08-01-042, Finding of Fact 13, p. 21

[17] D.08-01-042, Ordering Paragraph 2, at p. 27.

[18] D.08-01-042, Finding of Fact 11, p. 20.

[19] D.07-09-043, p. 122.

[20] The interims claim proposal was appended to D.07-09-043 as Attachment 6.

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Advice Letter process for the submittal of claims, with "approximate dates of those submittals"[21] reflected in the proposal, but explicitly recognized that the actual due dates for claims depended on the issuance date of Energy Division's reports. While D.07-09-043 observed that Energy Division staff is "fully committed to meeting the deadlines" for producing reports, the Commission acknowledged that "no one can guarantee that unforeseen circumstances will never require delay to that schedule."[22]

The Commission considered but rejected the suggestion that the Utilities be allowed to submit estimated earnings claims and receive interim payments based on estimated savings in the event of a delay in the Energy Division Reports, observing "Ratepayers' interest are best served when the payout of earnings (or imposition of penalties occurs only after the installations, program costs and (for the final claim) load impacts have been verified by our staff and its contractors."[23]

C. The evaluation, measurement and verification process encountered delays, but the initial results show that the Utilities' performance entitles only one of the four Utilities to incentives.

The EM&V process of measuring energy saved by the Utilities' 2006-2008 portfolios encountered delays related to contracts[24] and in at least one documented instance, because of the Utilities' slow responses to staff data requests.[25] Moreover, in granting the Utilities' request to restrict the final true-up of energy savings, D.08-01-042 changed the interim claim process and required the use of 2008 DEER data for the first

[21] D.07-09-043, p. 122 (emphasis added).

[22] D.07-09-043, p. 122.

[23] D.07-09-043, p. 123.

[24] See Administrative Law Judge's Ruling Revising Protocols for Process and Review of Post-2005 Evaluation, Measurement and Verification (EN&V) Activities, and Addressing Next Steps for Finalizing The Annual Reporting Requirement, January 2, 2007 (describing delays due to contracting issues).

[25] *See e.g.,* July 8, 2008 letter from Paul Clanon to Kayode Kajopaiye granting the request for extension of time to issue 2007 energy efficiency audit reports pursuant to D.05-11-011 (extension requested because of delays in getting data request responses, as well as planned time-off of assigned staff.)

interim claim. This significantly increased the complexity of preparing the first Verification Report.

On November 18, 2008, rather than in August as originally planned, the Energy Division issued its "Energy Efficiency 2006-2007 Verification Report, Review Draft" (Draft Verification Report). The Draft Verification Report showed that SoCalGas would earn a 2008 interim incentive payment of $3.6 million, PG&E and SDG&E's performance would fall in the dead band and would therefore not entitle them to interim incentive payments, and SCE's performance would require it to pay a $6.9 million penalty.[26]

The Energy Division's Draft Verification Report demonstrates that the importance of using independently verified data is not hypothetical: the report shows significant differences between the Utilities' self-reported savings and the savings calculated through the process of independent verification.[27] While the results of the Draft Verification Report may change through the comment process, the Draft Verification Report provides critical analysis that should not have been ignored in the haste to pay incentives in a "timely" manner. This is particularly true when the Draft Verification Report shows that PG&E, SCE, and SDG&E are all very close to the penalty threshold of 65% of goals.[28]

Energy Division's Final Verification Report was scheduled for release on January 15, 2009, but the release of the report was delayed at the request of the Energy Division's new director.[29]

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[26] The Draft Report shows a $17.8 million penalty for SCE, but this was corrected to $6.9 in a November 18, 2008 email from Energy Division.

[27] These differences between the Utilities' self-reported energy savings and the savings verified by the Draft Verification Report interim claims are the result of differences that include the net -to -gross metric, but also expected useful life (EUL), unit energy savings (UES), and installation rates. The Utilities and the Natural Resources Defense Council (NRDC) continue to assail the use of net-to -gross metrics in spite of the importance of this metric in guiding program implementation and in measuring real energy savings impacts. The October 5, 2007 Assigned Commissioner Ruling Addressing Net-to-Gross Ratio True-Up and Methodology for Lighting Programs in the 2006-2008 Energy Efficiency Portfolios (October 5, 2007 ACR) explained the history and importance of the net-to-gross adjustment for improving programs.

[28] Draft Verification Report, Table 26, p. 65: SCE, 64%; PG&E, 65%, SDG&E, 67%.

[29] The letter explained that "Energy Division staff have completed the completed the work to finalize the

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D. The Second PFM

In response to the delays in the process for calculating their interim incentives, the Utilities filed a Second PFM that sought the following relief:

- Immediate payment of interim incentives for 2006-2007 totaling $152.7 million, net of 35% holdback ($235 million before holdback).[30]
- Calculation of interim incentives payments based on self-reported measure savings and cost estimates in the event that Energy Division's EM&V reports are delayed; [31]
- Removal of the requirement that interim earnings claims be based on updated DEER estimates;[32] and
- The opportunity for Commission review earnings-related issues raised in evaluation, measurement, and verification reports, outside of the current advice letter process.[33]

The Utilities claimed in their Second PFM that the delay in the Verification Report would prevent the Utilities from booking incentive earnings in a timely manner. Their claim for $152 million in incentives assumed that that the Commission granted their request to calculate interim claims without using updated DEER values, in contravention of D.08-01-042's directive to use the most current metrics available.

E. Decision 08-12-059

The Decision authorized payment of interim incentives of $41.5 million to PG&E; $24.7 million to SCE, $10.8 million to SDG&E and $5.2 million of SoCalGas based on their requests in their Second PFM. While the Decision increased the holdback of

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report and resolution in time to issue it today, January 15, 2009 as required by the decision," but requested additional time for the new Energy Division Director to review and understand "the highly complex underlying analysis." January 15, 2009 letter from Julie Fitch to Paul Clanon. The Executive Director granted the request, even though it was not made at least not made at least three business days, for a delay was before the deadline, as required by Rule 16.6 of the Commission's Rules of Practice and Procedure.

[30] Second PFM, p. 6.

[31] Second PFM, pp. 3-4.

[32] Second PFM, p. 4.

interim claims payments from 35% to 65%, if the Utilities are not entitled to incentive payments, then no holdback, short of 100%, would protect ratepayers from the risk of paying non-refundable incentives. Similarly, while the Decision claimed to reinstate the dead band for purposes of conducting the *ex post* true-up for the 2006-2008 program cycle, it only provides that no "additional" incentives will be awarded.[34] Since this decision did not otherwise change the non-refundability of incentive overpayments, it did not truly reinstate the deadband as established by D.07-09-043. Thus, it remains true that "payment of awards to utility shareholders for incentive-based savings is a one-way street."[35]

III. STANDARD OF REVIEW

Rule 16.1(c) requires an applicant for rehearing to "set forth specifically the grounds on which the applicant considers the order or decision of the Commission to be unlawful or erroneous," making specific references to the record or law. Section 1705 of the Public Utilities Code requires Commission decisions to be based on "findings of fact and conclusions of law on all issues material to the order or decision." When a reviewing court examines the validity of a Commission decision pursuant to Section 1757 of the Public Utilities Code, it determines whether the decision is supported by the findings and whether the findings in the decision are supported by "substantial evidence in light of the whole record."[36] The reviewing court also examines, among other things, whether the

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[33] Second PFM, p. 4.

[34] D.07-09-043, Ordering Paragraph 4, p.28.

[35] D.08-12-059, dissent, p. DMG-2.

[36] Public Utilities Code §§ 1757(a)(3)-(4). Section 1756 of the Public Utilities Code provides that a party may petition for a writ of review in the court of appeal or the Supreme Court so that the court can determine the lawfulness of a Commission order. Section 1757(a) provides that in a complaint or enforcement proceeding, or in a ratemaking or licensing decision of specific application that is addressed to particular parties, the court's review shall is limited to determining whether, on the basis of the entire record, whether any of the following errors occurred: "(1) The commission acted without, or in excess of, its powers or jurisdiction. (2) The commission has not proceeded in the manner required by law. (3) The decision of the commission is not supported by the findings. (4) The findings in the decision of the commission are not supported by substantial evidence in light of the whole record. (5) The order or decision of the commission was procured by fraud or was an abuse of discretion. (6) The order or
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Commission has proceeded in manner required by law, and whether the decision is an abuse of discretion.

IV. DECISION 08-12-059'S AWARD OF INCENTIVES BASED ON UNVERIFIED CLAIMS RESULTS IN RATES THAT ARE NOT JUST AND REASONABLE.

Section 451 of the Public Utilities Code requires that:

> All charges demanded or received by any public utility, . . . for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.

The obligation to ensure just and reasonable rates has been characterized by one customer group as the Commission's "'oldest and most basic responsibility.'"[37] Exercising that responsibility requires that the Commission "assure the public that the prices they pay for electric and gas distribution service are in fact just and reasonable, and reasonably related to costs prudently incurred by efficient, conscientious managers to provide the quality of service we expect."[38] The Decision fails to uphold this obligation.

The Decision approves $82.2 million in incentives, in the face of a Draft Verification Report demonstrating that SoCalGas would be entitled to $3.6 million in incentives, but the other three Utilities would be entitled to nothing. The result could be an overpayment of over $78 million, most of which could never be recovered even if the Final Verification Report continues to demonstrate that the Utilities are entitled to less than $78 million. As the dissenting opinion aptly observes:

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decision of the commission violates any right of the petitioner under the Constitution of the United States or the California Constitution."

[37] D.07-12-052, Appendix C, p. 12 (summarizing intervenor positions on Utilities Long Term Procurement Plans; the California Large Energy Consumers Alliance requested that in reviewing the utility procurement plans that the Commission "to keep in mind its oldest and most basic responsibility—that embedded in Public Utilities Code Section 451—which is to assure ratepayers that they pay rates which are just and reasonable, and just and reasonable rates are those based on the cost to serve."

[38] D.04-10-034, p.6.

> "There is no justification in the record to conclude that a payout of this magnitude, which is not subject to refund upon completion of the final staff analysis, protects ratepayers from overpayment."[39]

The Decision observes that the Utilities seek relief because "there are serious questions concerning the validity of *ex ante* assumptions used to validate the [Utilities'] claims."[40] The existence of "serious questions" about the calculation of the claim weighs in favor of resolving those questions, rather than rushing to pay incentives based on disputed assumptions.

The Draft Verification Report is the subject of significant disputes. It is likely that the final results will change, although the magnitude and direction of those changes are currently unknown. Even though not yet final, the Draft Verification Report is the most comprehensive and unbiased analysis of the Utilities' claimed energy savings. Ignoring the results and paying incentives that may exceed the Utilities' actual entitlement flies in the face of the obligation to ensure that rates are just and reasonable. This is especially true when the only evidence that supports incentive payments is the Utilities' self-reported savings, and NRDC's "analysis," both of which fail to comply with the Commission's directive to use updated *ex ante* numbers for calculating the interim claims.

The Commission recognized in D.08-09-038 that including incentive payments in rates when the utility failed to meet the performance targets of the incentive mechanism at issue resulted in rates that were unjust and unreasonable.[41] Although the circumstances of that case involved the utility's knowledge that the performance targets had not been achieved, the rationale applies with equal force here: rates that include awards for goals that have not been met are not just and reasonable.

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[39] D.08-12-059, dissent, p. DMG 2.

[40] D.08-12-059, Ordering Paragraph 1, p.27.

[41] D.08-09-038, p. 98.

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V. DECISION 08-12-059 FAILS TO PROVIDE A RATIONAL BASIS FOR ITS AWARD OF $82.2 MILLION IN INCENTIVES BASED ON UNVERIFIED SELF-REPORTS.

Pursuant to Public Utilities Code Sections 1705 and 1757(a)(4), the Commission must base its decisions on findings of fact and conclusions of law on all issues material to the order or decision, and the findings must be supported by substantial evidence in light of the whole record. The substantial evidence test not only requires an agency to base its decisions on solid evidence in light of the whole record, but also to explain the basis for its decisions.[42] In *McBail & Co. v. Solano County Local Agency Formation Commission*, the Court of Appeal held that an agency's failure to provide an explanation of the basis for its decision is a "fundamental error:"

> We hold that in order for the trial court to intelligently evaluate whether substantial evidence supports the decision to deny the petition, LAFCO must first articulate the basis or reason for that decision. This is so because evidence does not relate to a decision in the abstract, but must be connected to the basis or reason for that decision. Because the court cannot apply the substantial evidence test in a vacuum, logic and reason dictate that for purposes of meaningful review the administrative agency must state its reason for a decision in order to provide the framework within which the reviewing court can apply the substantial evidence test.[43]

The court further held, "Without the benefit of an agency's reasoning, the court has nothing against which to weigh the substantiality of the evidence."[44]

This requirement goes beyond the Commission's obligations under Section 1705 of the Public Utilities Code to make findings on all material issues. The Commission must "do more than simply state ultimate factual conclusions."[45] It must explicitly weigh

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[42] Public Utilities Code Section 1757(a)(4); McBail & Co. v. Solano Co. Local Agency Formation Comm'n, 62 Cal. App. 4th 1223, 1227 (1998).

[43] *McBail*, 62 Cal. App. 4th at 1227.

[44] McBail, 62 Cal. App. 4th at 1230, citing California Hotel & Motel Ass'n v. Industrial Welfare Comm'n, 25 Cal. 3d 200, 222 (1979)(conc. op.).

[45] Stewart v. Secretary of Health, Education, and Welfare of the United States, 714 F.2d 287, 290 (3rd Cir.1983). CITE to Cal Man Association case

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the relevant evidence. A detailed evaluation of every piece of evidence or testimony is not required, but the agency "must articulate, at some minimal level, its analysis of the evidence."[46]

Prior issuance of D.08-12-059, the Commission firmly adhered to independent verification of net benefits, kW, kWh and therm achievements as a threshold feature of a "risk reward mechanism" that encourages real energy savings. Yet in the interest of "timeliness," the Decision used the Utilities' self-reported and unverified energy savings as the basis for interim incentives payments, despite the independent Draft Verification Report that showed three of the four Utilities failed to achieve the Commission's energy savings goals and were therefore not entitled to incentives. Such a fundamental change from past decisions requires findings of fact supported by the record on every material issue, with a rational explanation for the basis of the findings. Instead, some of the Decision's findings fail to support the award, while findings that would justify the Decision's radical departure from past policy are lacking.

A. Decision 08-12-059 fails to offer adequate support based on substantial evidence for its finding that "[r]egular and timely issuance of incentive payments is critical to the ability of the RRIM in creating a meaningful linkage between utility investments in energy efficiency and utility earnings."[47]

Decision 07-09-043 recognized "that an effective incentive mechanism must include provisions for earnings (or penalties) at interim points during the three-year program cycle, as opposed to waiting nearly five years after portfolio implementation for any financial feedback to utility managers and investors."[48] Decision 08-01-42 similarly

[46] *Green v. Shalala*, 51 F.3d 96, 101 (7th Cr. 1995); *see also Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, (1983) (quoting *Burlington Truck Lines, Inc. v. United States,* 371 U.S. 156, 168, (1962) (agency must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made'" to avoid making an arbitrary and capricious determination.)

[47] D.08-12-059, Finding of Fact 3, p. 25.

[48] D.08-01-042, citing D.07-09-043 Conclusion of Law 7, at p. 212.

acknowledged the importance of providing "effective feedback to utility managers and investors, a risk/reward incentive mechanism for energy efficiency" by including "provisions for earnings (or penalties) at interim points during the three-year program cycle."[49] Nevertheless, the Commission recognized the possibility of a delay in the process for verifying interim incentive claims, given the importance of verifying claims.

There is no guarantee that Energy Division's schedule for completing EM&V reports will never be delayed, based on unforeseen circumstances. However, ratepayer interests are best served if the payout of earnings (or imposition of penalties) occurs only after the installations, program costs and (for the final claim) load impacts have been verified by Commission staff and its contractors.[50]

Yet the Decision, issued less than a year after the prior decision modifying the incentive mechanism, now ascribes paramount importance to "timely" payment of incentives, even if those incentives have not been verified. This finding is not supported by substantial evidence. The Utilities claimed in their Second PFM that in order to make energy efficiency a regular part of the Utilities' business, the shareholder incentive mechanism must produce predictable, regular, and systematic earnings which can be reported to Wall Street, but presented no evidence that a delay of several months in the first interim incentive payments would harm their shareholders or their energy efficiency programs.[51] The record is therefore devoid of factual information demonstrating that a short delay in payment of the first interim earnings would significantly impact stock prices, dividends, and credit ratings. In contrast, DRA, TURN and CE Council explained that based on economic fundamentals, a one-time delay of two to three months in the

[49] D.08-10-042, Finding of Fact 1, at p. 19.

[50] D.07-09-043, Finding of Fact 118, at p. 201.

[51] Second PFM, p. 2. The Utilities claimed that they needed to book earnings with certainty by the end of 2008. Yet the Decision is subject to applications for rehearing filed no later than February 2, 2009, and then to potential judicial review. Public Utilities Code Section 1756, Thus, to the extent that the Utilities sought a decision that would allow them to book earnings in 2008 without the threat of ultimate claw back, it appears that ship has sailed.

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2008 interim claim would produce only a minor impact on the value of shareholder incentives.[52]

In fact, as DRA, TURN, and CEC pointed out in their response to the Second PFM, Wall Street was well aware of the potential for delay in the payment of incentives because the Securities Exchange Commission (SEC) filings of the four Utilities disclosed the potential for delays,[53] yet the Utilities produced no evidence that such a delay was problematic to investors. In contrast, the First PFM cited reports by CitiGroup and Lehman Brothers expressing concerns about the impact of unrestricted true-up on the effectiveness of the shareholder incentive mechanism adopted in D.07-09-043.[54]

B. Decision 08-12-059's finding that "NRDC offers an analysis that it believes shows that the interim claim amounts sought by PG&E, SCE, and SDG&E, SoCalGas are reasonably conservative and, thus, combined with the existing holdback provisions are unlikely to result in overpayment"[55] does not support the incentive award.

The Natural Resources Defense Council (NRDC) filed a Response to Utilities' Second PFM in which it supported a "timely decision" resolving the Utilities' incentive claims.[56] NRDC claimed that energy savings estimates for PG&E, SCE and SoCalGas "are based on reasonable and conservative assumptions."[57] The analytical framework for NRDC's belief that the energy savings estimates are "reasonable and conservative" was summarized in a single table on page 5 of its response. NRDC admitted that its conclusion that the Utilities' energy savings estimates represented "robust lower bounds

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[52] DRA/TURN/CE Council Response to Second PFM, p. 17, n.55.

[53] *See e.g.* DRA/TURN/CE Council Response to Second PFM at pp. 15-16 (noting for example, that SCE 10-K report dated February 27, 2008 pointed out the linkage between the timing of the reports and the timing of any interim earnings: "Timing of progress payment claims is linked to the completion of CPUC reports. Delays in CPUC reports could cause delays in recognizing earnings for these claims."

[54] First PFM, p. 2.

[55] D.08-12-059, Finding of Fact 8, p. 25.

[56] NRDC Response to The Petition for Modification of Decisions 07-09-043 And 08-01-042, filed September 15, 2008 (NRDC Response to Second PFM) p. 2.

[57] NRDC Response to Second PFM p. 3.

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for the final total incentive payment entitlement" required "setting aside" net-to-gross ratio adjustments, in direct contravention of Commission's directive in D.08-01-042 to calculate interim claims with updated *ex ante* estimates, including the net-to-gross ratio.[58] NRDC's support of the Utilities claims hinges on a change to the incentive mechanism, which it explicitly requested in their September 15, 2008 comments, yet this critical detail is not reflected in the Decision.

DRA also raised questions regarding the nature of NRDC's analysis, and to what it extent it relied on calculations provided by the Utilities, and whether it was truly an independent analysis.[59] While a series of letters was circulated to the service list debating this issue, this information in not a part of the record in this proceeding, and DRA's concern regarding NRDC's analysis was never vetted, and is not addressed in the decision.

DRA, TURN and CE Council presented their own analysis of the Utilities' energy savings claims.[60] DRA explained that because the Second PFM requested payment of $152 million dollars on a single sheet of figures with no description of methodology, illustrative formulas, or citations of data sources, it requested supporting information from the Utilities. SCE, PG&E, and SDG&E responded sufficiently in advance of the deadline for filing the response to the PFM to allow review of whether the Utilities' claimed energy achievements could be traced back to previously reported data sources and required reports; whether the claims accurately reflected the energy savings goals of D.04-09-060; and whether they accurately applied the rules adopted in D.07-09-043 and the Commission's Policy Rules v. 4.0. DRA made no attempt to verify the accuracy of data in the underlying E3 calculators, which are the basis of calculating the interim incentive claims.[61] DRA's limited review revealed inconsistencies between the Utilities'

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[58] NRDC Response to Second PFM pp. 5-6,

[59] DRA/TURN Response to PD on Second PFM, dated November 24, 2008, p. 6, footnote 17; *see also* Prehearing Conference Transcript October 2008, p.

[60] DRA/TURN/CE Council Response to Second PFM, pp. 15-17 and in Appendix A.

[61] A full verification is an enormous undertaking. "There are more than more than 220 E3 calculators,
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claims in their Second Petition and the performance presented in their fourth quarter 2007 reports, that underscored the importance of "independently verifying the accuracy of measure installation, savings assumptions, and all program costs on which incentives are based."[62]

TURN estimated what the interim claims would be if the Utilities had complied with the Commission's directive to use updated DEER numbers for calculating their interim claims. Using available data, DRA and TURN completed a rough calculation of the impact of adjusting the net-to-gross ratio, unit energy savings, and storage rates for upstream manufacturer buy-down for compact fluorescent light bulbs (CFLs).[63] Adjusting the Utilities interim claims to reflect all the updated DEER values for all measures was not feasible, but the result of the analysis is shown in Table 1 of DRA, TURN, and CE Council's response to the Second PFM. This analysis indicated that the energy savings of PG&E, SCE and SDG&E would fall in dead band, meaning that the interim incentive claims would be zero.[64] DRA, TURN and CE Council acknowledged that their analysis of the incentive claims was not intended to substitute for the Draft Verification Report, but to illustrate the potential risk of paying the Utilities unverified energy claims.

The Energy Division's Draft Verification Report further substantiated the risk of paying unverified incentive claims. The Draft Verification Report showed that while SoCalGas would earn a 2008 interim incentive payment of $3.6 million, PG&E and

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each of which has from between 1 and 1,000 measures in addition to program costs. Each measure has a user defined installation schedule, kWh savings assumptions (UES, EUL, NTG), therm savings assumptions (UES), load shapes, and other parameters. There are hundreds of thousands of data points to be verified and no automated method of doing so." DRA/TURN/CE Council Response to Second PFM, Appendix A, p. 10.

[62] DRA/TURN/CE Council Response to Second PFM, Appendix A, p. 10.

[63] DRA/TURN/CE Council Response to Second PFM, Appendix A, p. 10.

[64] DRA/TURN/CE Council Response to Second PFM, p. 18.

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SDG&E's performance were not entitled to interim incentive payments, and SCE's would be required to pay a $6.9 million penalty.[65]

The finding that "NRDC offers an analysis that it believes shows that the interim claim amounts sought by PG&E, SCE, and SDG&E, SoCalGas are reasonably conservative and, thus, combined with the existing holdback provisions are unlikely to result in overpayment" does not support the incentive award. Without more, NRDC's "belief" does not support the Commission's decision, especially in light of the Decision's failure to consider and make findings on the DRA,TURN and CE Council analysis, or to explain why the Commission found it less persuasive than the analysis offered by NRDC. After all, NRDC's analysis admittedly did not comport with D.08-01-042, which directed the Utilities to use updated DEER numbers for calculating the interim incentive claims. Similarly, the Decision should contain findings on the Draft Verification Report, and why, even though it is only a draft, is less persuasive than the NRDC analysis.

C. Decision 08-12-059's findings that "All else equal, imposing a higher holdback amount can help mitigate the risk of incentive overpayment"[66] and "All else equal, imposing a higher holdback amount can help mitigate the risk of incentive overpayment"[67] do not support the incentive award.

The Decision implemented two changes to the incentive mechanism designed to reduce the risk that ratepayers will pay incentives on self-reported, unverified claims that subsequently are found to be unjustified. First, it increased the holdback from 35% to 65%. Second, it offers a limited reinstatement of the dead band for purposes of conducting the *ex post* true-up for the 2006-2008 program cycle. Neither change will eliminate the risk that the Utilities will receive incentives for performance that falls short of the Commission's goals. The Decision does not explain why, in the face of the Draft

[65] The Draft Report shows a $17.8 million penalty for SCE, but this was corrected to $6.9 million in a November 18, 2008 email to the service list in this proceeding from the Energy Division.

[66] D.08-12-059, Finding of Fact 10, p.25.

[67] D.08-12-059, Finding of Fact 11, p.26.

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Staff Report demonstrating that three of the four Utilities are entitled to no incentives, it awards over $78 million to those Utilities, even though the payments are non-refundable. The Draft Staff Report was the second data point, subsequent to TURN's analysis, that indicated that the 65% holdback was insufficient to protect ratepayers from over payment. The Decision's Conclusion of Law 2 errs in stating that the specific 65% holdback is sufficient.

D. Decision 08-12-059 fails to recognize the critical linkage between incentives and energy efficiency achievements.

The Decision contains no finding recognizing the essential linkage between incentives and the verified energy savings that the Commission seeks to achieve. Although California has already removed many disincentives that would prevent the Utilities from pursuing all cost-effective energy efficiency, the Commission took the additional step of adopting a risk/reward incentive mechanism to encourage the Utilities to "'mine deeper' for cost-effective energy savings than ever before in California's history."[68] To date, there is little evidence that the Utilities are in fact "digging deeper" for cost effective energy savings or that they are prudently managing the forecasting risk that is inherent in managing energy efficiency portfolios.[69]

During the peer review process of the 2006-2008 portfolios, "several peer review group members, as well as Energy Division consultants, noted that [net-to-gross] values for a variety of strategies were too high."[70] Evaluation, measurement and verification of the Utilities' 2004-2005 portfolios demonstrated that savings from lighting programs was considerably lower than Utilities had estimated when planning their 2006-2008 portfolios. The prudent response to this information should have been to shift program dollars from lighting programs in which the market was transforming to other areas

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[68] D.07-09-043, p. 11.

[69] ALJ Gottstein noted that "[T]he nature of *ex post* EM&V means that there will be uncertainties facing both ratepayers and shareholders in the deployment of energy efficiency in 2006 and beyond, and managing those uncertainties is part of the energy efficiency portfolio administrator's responsibility." October 5, 2007 ACR, p. 5. (emphasis added.)

[70] October 5, 2007 ACR, p. 3.

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where significant savings still remained. There is little evidence that SDG&E, SCE or PG&E did that during 2006-2008. In fact, their pending 2009-2011 portfolio applications are largely comprised of lighting measures.

The Draft Verification Report's use of updated DEER numbers shows the result of the Utilities' continued reliance on lighting measures: all three electric Utilities fall short of the Commission's goals. While the Draft Verification Report is not yet final, it raises serious questions about whether the Utilities in fact deserve incentives. Providing "timely incentives" to the Utilities even if they have failed to meet the Commission's goals does not advance the Commission's goals of increasing energy savings.

E. Decision 08-12-059 incorrectly states that the payments it authorizes are based on the Utilities' Fourth Quarter Reports and fails to reconcile differences in the Utilities' claims.

The Decision claims that the incentive awards in authorizes are based on the Utilities' Fourth Quarter Reports.[71] As explained Appendix A of DRA/TURN and CE Council's Response to the Second PFM, the Utilities' claims in their Second PFM cannot all be reconciled with their Fourth Quarter Reports. Moreover, the Decision's reliance on the Utilities' unverified savings fails to reconcile a discrepancy in their calculation: the claims SDG&E and SoCalGas include energy savings from 2004 and 2005, while those of PG&E and SCE do not. There is no rational basis for the Commission to use a different basis for calculating rewards for different Utilities without providing a justification. Accordingly, the Decision errs in awarding payments for SCE and PG&E that are measured one way, while payments for SoCalGas and SDG&E are measured another way.

[71] D.08-12-059, Conclusion of Law 1, p.26 ("[T]he Commission should authorize interim payments to the IOUs based on their quarterly performance reports…").

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VI. THE COMMISSION COMMITTED LEGAL ERROR WHEN IT GRANTED A PETITION FOR MODIFICATION THAT FAILED TO DEMONSTRATE CHANGED CIRCUMSTANCES THAT WOULD JUSTIFY MODIFICATION OF D.07-09-043 OR D.08-01-042.

The Commission committed legal error in D.08-12-059 by granting the relief sought in a petition for modification despite that petition's failure to present evidence that would meet the appropriate "preponderance of the evidence" standard and to support the underlying factual allegations of new or changed facts with an appropriate declaration or affidavit.

Two recent Commission decisions articulated the standard of proof that must be met by a party seeking to modify a decision under Rule 16.4 under circumstances substantially similar to those present here. In D.08-04-057 (addressing the revisions AT&T proposed to its Rule 12 tariff), the Commission treated AT&T's Rule 12 Advice Letters as the equivalent of a petition to modify an earlier decision, subject to a petition's standard of proof:

> Consistent with this approach, we placed on AT&T the burden of proving that the marketing controls imposed on AT&T in the Rule 12 Decision were no longer necessary. In keeping with long-standing Commission practice, the standard of proof that AT&T must meet in order to carry its burden is a "preponderance of the evidence." In short, AT&T must show that the evidence supporting its modification of the marketing restrictions imposed in the Rule 12 Decision outweighs the evidence against maintaining all the restrictions in the Rule 12 Decision.[72]

The Commission similarly concluded in D.08-03-009 that "[T]he proponent of the petition for modification . . . bears the burden of demonstrating that our recent decision in this proceeding, D.07-12-020, should be modified."[73]

In D.08-12-059, the Commission fails to point to <u>any</u> evidence that would support granting any part of the utilities' request for relief, much less evidence that meets the

[72] D.08-04-057, p. 29 [cite omitted]; see also Conclusion of Law 1.

[73] D.08-03-009, p. 3.

"preponderance" standard or that demonstrates a need to modify the recent decision in this proceeding.

The failure to present evidence is highlighted by the petition for modification's failure to comply with Rule 16.4(b) of the Commission's Rules of Practice and Procedure. To the extent there are factual allegations that support the petition, those allegations must either be supported by citations to the record or matters that may be officially noticed, or (if a new or changed fact) by an appropriate declaration or affidavit. The Utilities' request for relief asserted that a delay in the authorization of the first interim earnings claim would undermine the effectiveness of the energy efficiency incentive mechanism. There is no citation to the existing record or matters subject to official notice, nor is there any declaration or affidavit in support of that assertion. The only material supporting the request consists of unverified pleadings from the Utilities and NRDC. D.08-12-059 simply ignores the "preponderance of evidence" standard the Commission relied upon in two recent decisions, and glosses over the failure of the Utilities to support their allegations.

A. There Is Inadequate Factual Support In The Record For A Determination That Changed Circumstances Warrant Any of the Modifications D.08-12-059 Made to D.07-09-043 and D.08-01-042.

Decision 07-09-043 adopted an incentive mechanism in which amounts paid as interim claims remained subject to full reconciliation upon the Final Verification and Performance Basis Report.[74] This approach ensured that to the extent the interim payments were, upon final review, more than the Utilities had earned, ratepayers were protected because the final true-up would adjust such overpayments. Yet even with this protection in place, the Commission rejected the proposal to permit payment of interim claims based on the Utilities' estimated savings.[75] Instead, the Commission embraced verification of even interim claims:

[74] D.07-09-043, pp. 121-124.

[75] D.07-09-043, p. 125.

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> Ratepayers' interests are best served when the payout of earnings (or imposition of penalties) occurs only after the installations, program costs and (for the final claim) load impacts have been verified by our staff and its contractors.[76]

Thus even when overpayment posed less risk to ratepayers because the final claims were ultimately subject to a full and complete reconciliation the Commission required the mechanism to pay earnings based on verified savings, not utility estimates.

In D.08-01-042, the Commission (among other things) eliminated the full and complete reconciliation in the final claim verification so long as the overall performance was not in the penalty band for the incentive mechanism. D.08-12-059 acknowledges the change's impact on ratepayer risk:

> Because this decision reduced the share of IOU incentive claims that would be subject to *ex post* review and true-up, all else equal it necessarily increased the risk of incentive overpayment.[77]

The Commission recognized that this increased risk of overpayment also increased the importance of calculating the interim payments as accurately as possible and, by extension, increased the importance of basing incentives on verified claims rather than utility estimates:

> A combination of updated *ex ante* values combined with a larger hold-back will substantially mitigate ratepayer risk brought upon by the changes we adopt to the true-up mechanism.[78]

The Commission therefore specified the *ex ante* assumptions for purposes of calculating the first and second interim claims, in light of the other modifications to D.07-09-043.[79]

In D.08-01-042, the Commission recognized that to maintain any balance of

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[76] *Id.*; repeated with slight paraphrasing in FOF 118.

[77] D.08-12-059, p. 5.

[78] D.08-01-042, Finding of Fact 11; see also Finding of Fact 13.

[79] D.08-01-042, p. 16 and Findings of Fact 15 and 16.

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ratepayer and shareholder interests, changes to the incentive mechanism that increase the risk of overpayment must be coupled with more rigorous *ex ante* evaluation of the incentive claims. Unfortunately, D.08-12-059 reversed this approach, and instead elevated payment of incentives by the end of 2008 above the goal of avoiding overpayment. It generally weakened (if not abandoned) the reliance on *ex ante* evaluation for those claims.

B. The Commission's "Belief" That Paying Interim Incentives In Early 2009 Rather Than By The End Of 2008 Undermines The Incentive Mechanism Does Not Warrant Introducing The Risk Of Overcharging Ratepayers To The Tune Of $82.2 Million.

Immediately after expressing its discomfort with making interim payments on the basis of the Utilities' estimates, the Commission observed that "we also believe that allowing the schedule for interim payments to slip undermines the effectiveness of the mechanism."[80] No matter whether this "belief" is held in good faith, the underlying assertion is a factual one, yet there is nothing in the record supporting for such an assertion. To the contrary, all of the factual evidence runs counter to the assertion.

For starters, the same conditions and circumstances were considered and addressed in D.07-09-043. The Commission acknowledged that unforeseen circumstances might cause Energy Division to miss its target dates for EM&V reports, thus potentially requiring modifications to the adopted schedule, but in the very next breath, the Commission rejected a proposal to base interim earnings on the utility estimates in the event of a delay.[81] Rarely has the Commission been so clear in its decision that a potential outcome had been anticipated, fully commented on by the parties, considered and addressed. At the time the Commission adopted D.07-09- 043, it did not "believe that allowing the schedule for interim payments to slip undermines the

[80] D.08-12-059, p. 16.

[81] D.07-09-043, p. 125, also Finding of Fact 118.

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effectiveness of the mechanism."[82] Therefore, in order for D.08-12-059 to be legally defensible, it must point to something that has changed since the issuance of that decision that would warrant the Commission's reversal regarding these elements of the shareholder incentive mechanism.

The concerns raised in the Utilities' First PFM and addressed in D.08-01-042 do not support an about-face on the question of whether interim incentives should be paid based on utility estimates. The Commission seems to suggest that the seeds for its outcome were planted there:

> [I]n D.08-01-042 the Commission accepted the notion that regularity and timeliness of interim claims is part and parcel of an effective incentive mechanism.[83]

Tellingly, the Decision cites no provision of the earlier decision that reflects the Commission's acceptance of any "notion" that would have ratepayers bear the risk of an overpayment as high as $82.2 million in order to avoid a delay of perhaps several months for an interim claim. That is because there is no way to read D.08-01-042 as supporting the outcome adopted in D.08-12-059.

In D.08-01-042, the Commission addressed circumstances that put at risk a utility's ability to book payments made based on fully verified interim claims if, at the time of the final true-up required in D.07-09-043, the utility were found to have fallen short of the threshold for earnings.[84] The result would be that the utility could receive payment for interim earnings according to the schedule established in D.07-09-043, but not be able to "book" those authorized payments until several years later, and then only to the extent that the final true-up supported the interim payment. That scenario is a far cry from the relief granted in the Decision, which permits the Utilities to recover amounts based on unverified estimates of interim claims, due to a risk of a several month delay in order to obtain the verified figures on which the mechanism is premised.. There is no

[82] D.07-09-043.

[83] D.08-12-059, p. 13.

[84] D.08-01-042, p. 4.

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suggestion that the Utilities' ability to book its interim earnings once authorized turns in any way on whether the earnings authorization issues in 2008 rather than early 2009.

Since the issuance of D.08-01-042, the only evidence regarding how delay might impact the effectiveness of the incentive mechanism are the statements the Utilities made in their SEC filings, and the lack of any apparent response from the financial community. In D.08-12-059, the Commission correctly interpreted those statements to "find that the utilities were aware of potential delays in the Energy Division review process and understood that earnings claims might not be finalized in 2008."[85] However, it attempted to dismiss the import of those SEC filings when it later stated that such "recognition is not, in [and] of itself a reasonable or logical counterargument to the concern that such delays undermine the effectiveness of the incentive mechanism."[86]

The approach adopted in D.08-12-059 is flawed in at least two important ways. First, it effectively requires intervenors to prove the negative, that is, to demonstrate that "such delays" do not undermine the effectiveness of the mechanism. But the burden is on the Utilities and, having at least implicitly embraced the claim, the Commission to demonstrate that the "concern" is valid and of such magnitude that it warrants putting ratepayers at risk of overpaying as much as $82.7 million in the first interim incentive claim.

Second, the logic embraced in D.08-12-059 ignores or misconstrues all that led up to the Utilities filing the instant petition for modification:

> • If there were any valid concern that a potential delay in the processing of interim earnings claims might undermine the mechanism, one would expect that concern to be addressed in the decision adopting the mechanism. Instead, as noted before, D.07-09-043 simultaneously acknowledged that there might be some delay to the adopted schedule, and rejected the

[85] D.08-12-059, p. 13.

[86] *Id.*, at 16.

suggestion that in the event of such delay, payments be made based on the utilities estimated savings.[87]

• If the investment community or the Utilities had any second-thoughts about the impact that such delays might have on the viability of the overall mechanism, one would expect those misgivings would be raised as part of the first petition for modification of D.07-09-043. Instead, the Utilities addressed only the elements of the mechanism that might delay their ability to "book" interim earnings awards for one or two years, even if those awards were processed according to the precise schedule set forth in the decision. The material provided by members of the investment community made no mention of the potential for delays due to the verification of interim claims.

• The Utilities' SEC filings after D.08-01-042 issued represent clear statements to the investment community that there was substantial uncertainty about whether the Commission would authorize the first interim incentive amounts before the end of 2008. Had this announcement caused any substantial concern that delays of this magnitude would undermine the effectiveness of the incentive mechanism, the investment community would have weighed in on the subject. The Utilities' failure to cite anyone other than NRDC as placing any stock in their current claims is telling.

In sum, nothing has changed since D.08-01-042 issued that justifies any modification to that decision. At the time the mechanism was first adopted in D.07-09-043, the Commission identified the risk of delay in the payout of interim earnings should Energy Division's reports not issue as scheduled, and recognized that this risk did not warrant paying interim claims based on utility estimates. At the time the mechanism was first modified D.08-01-042, the risk of delay tied to Energy Division's reports remained, while the risk of overpayment from relying on utility estimates actually grew. Even if the belief and concern expressed in the D.08-12-059 were genuine, they are not a sufficient basis for modifying the shareholder incentive mechanism. The

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[87] D.07-09-043, p. 125.

Utilities have to demonstrate that a "preponderance of the evidence" supports that belief. There is no evidence that a several month delay in the interim incentive payments will cause a real problem. Therefore, the Commission committed legal error because the findings in the decision are not supported by substantial evidence in light of the whole record, and the Commission did not have a sufficient basis for modifying the decision.

C. Decision 08-12-059 is an abuse of discretion.

An abuse of discretion is established if: (1) an agency does not proceed in the manner required by law**;** (2) an order or decision is not supported by the findings; or (3) the findings are not supported by the record.[88] Because the Decision contravenes the Commission's obligation pursuant to Section 451 of the Public Utilities Code to ensure that rates are just and reasonable, because the Decision in not supported by the findings necessary to support the incentives award, and because Finding of Fact 3 is not supported by substantial evidence, the Decision awarding incentives based on self-reported energy savings amounts to an abuse of discretion.

VII. CONCLUSION

This Decision allows the timing of incentive claims to trump the accuracy of their calculation. It dismisses the significant risk of overpayment that ratepayers face when they are required to pay incentives based on the Utilities' self-reported achievements, buttressed only by NRDC's analysis that admittedly contravenes the Commission's directive in D.08-01-042 to use updated metrics for calculating interim claims. It does so without evidence that a short delay in approving an incentives award will harm utility shareholders.

Providing "timely incentives" to the Utilities even if they have failed to meet the Commission's goals (unless self-reported savings based on outdated metrics are used) and have not effectively managed the forecasting uncertainties that are part and parcel of energy efficiency will not advance energy efficiency in California. Independent

[88] *Davis v. Civil Service Commission,* 55 Cal.App.4th 677, 686-687 (1997); *Sierra Club v. State Board of Forestry*, 7 Cal.4th 1215, 1236-1237 (1994); see also Code of Civ. Proc., §1094.5.

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verification of utility energy savings claims has been an integral component of the incentive mechanism from the onset. The Commission has authorized spending $163 million on independent verification for the 2006-2008 energy efficiency programs. It is unconscionable for the Commission to ignore the independent verification results that it set in place as part of the incentive mechanism in the absence of substantial evidence that such a significant step is warranted.

Rather than sacrificing the integrity of the shareholder incentive mechanism in the interest of "timeliness," the Commission should grant rehearing and award incentives based on the Energy Division's Final Verification Report.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of "APPLICATION FOR REHEARING OF DECISION 08-11-057," in **R.06-04-010**. by using the following service:

[**X**] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

[ ] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on February 2, 2009 at San Francisco, California.

/s/ ROSCELLA GONZALEZ

Roscella Gonzalez

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.