**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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

REPLY COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL (NRDC) ON THE PROPOSED DECISION REGARDING RISK/REWARD INCENTIVE MECHANISM REFORMS

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I. Introduction and Summary

Pursuant to Rules 1.9, 1.10 and 14.3 of the California Public Utilities Commission's (CPUC or Commission) Rules of Practice and Procedure, the Natural Resources Defense Council (NRDC) respectfully submits these reply comments on the Proposed "Decision Regarding Risk/Reward Incentive Mechanism Reforms," (PD) issued November 15, 2010. NRDC is a non-profit membership organization, with more than 250,000 California members and activists with interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption. The risk-reward incentive mechanism (RRIM) for energy efficiency is a critical part of the Commission's policy package to ensure that cost-effective energy efficiency is truly the utilities' top priority resource. In summary, NRDC provides the following reply comments on the PD:

- The CPUC should ensure that its financial signals to the utilities match the state's policy that energy efficiency is the top priority energy resource.
- The PD would send mixed messages regarding efficiency: utilities would be able to earn more than twice as much money if they invest in costlier supply-side resources instead of efficiency, and they would face no penalties if their efficiency programs do not deliver savings for customers.
- NRDC urges the Commission to provide an earnings opportunity for efficiency that approaches a conservative risk-adjusted estimate of supply-side equivalent earnings at superior levels of performance.
- NRDC urges the CPUC to retain the "cost-effectiveness guarantee" penalty to ensure that customers will at least break even on their investments in efficiency.
- NRDC urges the Commission to define which "non-resource" programs will be excluded from the incentive mechanism. Programs that have quantifiable savings,

SB_GT&S_0031674

including codes and standards advocacy and behavior-changing programs, should continue to be considered "resource" programs and included in the incentive mechanism.

II. The CPUC should ensure that its financial signals to the utilities match the state's policy that energy efficiency is the top priority energy resource. NRDC urges the Commission to provide an earnings opportunity for efficiency that approaches a conservative risk-adjusted estimate of supply-side equivalent earnings at superior levels of performance, and to require the utilities to guarantee that customers will at least break even on their investments in efficiency.

State policy recognizes that energy efficiency is the cleanest and cheapest resource available to meet customers' needs by making it the top priority energy resource. However, the PD would send mixed messages regarding efficiency: utilities would be able to earn more than twice as much money if they invest in costlier supply-side resources instead of efficiency, and they would face no penalties if they do not make efficiency their top priority. The Commission should align its financial signals to utilities with the state's policy that energy efficiency is the top priority resource. An incentive mechanism that approaches a conservative risk-adjusted estimate of supply-side earnings at superior levels of performance, and requires the utilities to guarantee the cost-effectiveness of the efficiency portfolios, will align the Commission's policy objectives with its regulatory incentives.

1. NRDC urges the Commission to adopt a cap that provides a meaningful earnings opportunity for utilities if they do a good job of saving customers money through energy efficiency and also balances the reduced risk of the new mechanism.

In NRDC's opening comments, we proposed a methodology to ensure that the cap on earnings appropriately "levels the playing field" with supply-side resources: the cap should be set by estimating a conservative level of comparable supply-side earnings, and then reduced to account for the reduced risk of the new incentive mechanism. We estimate that the cap for 2010-12 should be about $300 million. (NRDC pp. 8-11) The utilities proposed a cap of $350 million, which they derived by reducing the 2006-2008 cap of $450 million by approximately 22% to account for the reduced risk of the mechanism. (SCE p. 6, PG&E p. 10) However, the $450 million cap for 2006-08 represented a conservative estimate of supply-side earnings for the forecasted energy savings levels *in 2006-2008*, and the utilities' proposed cap for 2010-12 fails to reduce the cap to account for the lower forecasted energy savings in 2010-12. Since comparable supply-side earnings are based on the amount of energy the utilities would have had

SB_GT&S_0031675

to procure if they did not achieve the energy savings, the cap should be lowered both for the reduced risk and for the moderately lower projected energy savings in 2010-12. Therefore, the utilities' proposed cap is too high.

In contrast, TURN's proposed cap would fail to provide a meaningful incentive to "level the playing field" with supply-side investments. TURN supports the PD's illustrative cap of $189 million and proposes a cap of $200 million on all potential efficiency incentives (including any potential earnings for custom and non-resource programs excluded from the PD's mechanism). (TURN p. 2) These caps are far lower than is warranted by the moderately lower energy savings in 2010-12 and the reductions in risk associated with the new mechanism. These caps would provide approximately *half* of the earnings opportunity that utilities would have if they procured the energy from supply-side sources instead ($390 million). (NRDC p. 9) The CPUC should not send such mixed messages about the priority of efficiency as a procurement resource. NRDC urges the Commission to reject the caps proposed by both TURN and the utilities. The Commission should adopt NRDC's proposal, which accounts for the reduced energy savings as well as the reduced risk of the new mechanism, while still providing a meaningful earning opportunity.

2. NRDC urges the Commission to adopt a shared savings rate that is derived from an *earnings opportunity* that would provide a meaningful incentive but also balances the reduced risk of the new mechanism.

Parties presented varying views on the best approach to determine the shared savings rate, ranging from TURN's support for the PD's illustrative 5.4% shared savings rate to PG&E and SCE's support for continuing the 12% rate. (TURN p. 2, PG&E p. 11, SCE p. 7) In order to meet the principles established in D.07-09-043 and to ensure that potential earnings approach a conservative risk-adjusted level of comparable supply-side earnings at superior levels of performance, the shared savings rate should be derived from the *earnings opportunity* the CPUC seeks to create. Ultimately, it is the magnitude of the potential earnings that determines whether or not the utilities' incentives for efficiency are on an even footing with supply-side investments. Therefore, the Commission should adopt a shared savings rate that is derived from a targeted level of earnings, as NRDC proposed in opening comments. (NRDC pp. 11-13)

TURN supports the PD's shared savings rate (TURN p. 2), but as NRDC discussed in detail in opening comments, the PD's methodology to determine the shared savings rate is flawed and should be corrected. (NRDC pp. 11-13) The PD's illustrative shared savings rate of

5.4% does not provide an appropriate level of potential earnings; if the utilities achieve 100% of their goals, we estimate that they would earn less than 20% of what the CPUC intended in the 2006-08 mechanism: $38 million versus $323 million, respectively.[1] This reduction in potential earnings is wholly disproportionate to the moderate reductions in energy savings in 2010-12 and the reductions in risk in the new incentive mechanism. Moreover, this shared savings rate is so low that earnings would be very unlikely to ever reach the cap TURN proposes of $189 million to $200 million, even at superior levels of performance.[2] The Commission should correct the PD's methodology as NRDC proposed in opening comments to provide an earnings opportunity of approximately $172 million at 100% of goals, and ensure that the shared savings rate will provide such an opportunity. (NRDC pp. 12-13)

3. NRDC urges the CPUC to retain the "cost-effectiveness guarantee" penalty.

NRDC urges the CPUC to ensure that the incentive mechanism includes both potential rewards and risks. In particular, the utilities should face penalties if they do a poor job delivering savings to customers through energy efficiency. Therefore, NRDC agrees with TURN and SCE that the new incentive mechanism should retain the "cost-effectiveness guarantee," which requires the utilities to reimburse customers for any negative net benefits. (TURN p. 5, SCE p. 8)

III. NRDC urges the Commission to define which "non-resource" programs will be excluded from the RRIM. Programs that have quantifiable savings associated with them, such as codes and standards advocacy and behavior changing programs, should continue to be considered "resource" programs.

In NRDC's opening comments on the PD, we urged the Commission to clearly define which "non-resource" programs will be excluded from the new incentive mechanism's calculation of the Performance Earnings Basis. (NRDC p. 15) PG&E and OPower urged the CPUC to clarify that certain programs, including codes and standards advocacy and behavior-based programs, will continue to be considered "resource" programs and included in the RRIM. (PG&E p. 7, OPower pp. 3-5) We agree that programs that are currently considered to be "resource" programs and have quantifiable savings associated with them should continue to be considered "resource" programs and included in the RRIM.

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[1] 5.4% of the net benefits NRDC modeled at 100% of goal achievement are $38 million; under the 2006-08 mechanism, the utilities were projected to earn $323 million at 100% of goals. ($323 million - $38 million)/$323 million = 88% reduction. For a detailed explanation of NRDC's methodology, s*ee* NRDC Opening Comments at 6.

[2] We estimate that at 150% of goal achievement, utilities would only earn $77 million, far below the proposed cap.

SB_GT&S_0031677

In NRDC's August 7, 2009 post-workshop comments in this proceeding, we recommended that the CPUC adopt the following definition of "non-resource" programs:

" 'Non-resource programs' are programs that

- do not, will not, and are not intended to have measurable savings evaluated by Energy Division and counted towards the utilities' goal and threshold achievement for the current or following portfolio cycle (with the exception of pilots),
- do not drive savings to other resource programs, and
- do not include portfolio administration costs."[3]

NRDC also provided an Appendix with our recommendations on which 2009-11 programs under consideration at that time should be considered "non-resource" programs. While these definitions need to be updated for the 2010-12 program cycle and the new RRIM design, we urge the CPUC to clearly define which programs will be considered "non-resource" using this as a starting point for purposes of the final incentive mechanism.

IV. Conclusion

NRDC urges the Commission to revise the PD by incorporating the recommendations above and presented in NRDC's opening comments. We urge the CPUC to adopt an improved RRIM that ensures that the financial incentives that the CPUC provides to the utilities are aligned with the state's policy that energy efficiency is the top priority resource.

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Respectfully submitted,

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[3] Post-Workshop Comments of the Natural Resources Defense Council (NRDC) in the Matter of R.09-01-019, August 7, 2009, p. 15.

SB_GT&S_0031678

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"Reply Comments of the Natural Resources Defense Council (NRDC) on The Proposed Decision Regarding Risk/Reward Incentive Mechanism Reforms"** to all known parties of record in proceeding R.09-01-019 by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on December 13, 2010 at San Francisco, California.

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