Item 52 and 52b Statement Regarding the 2006-2008 True-Up Proposed Decision and Alternate Proposed Decision

- Colleagues, before introducing this agenda item, I remind you that that Item 52a has been withdrawn by Commissioner Bohn. This leaves Item 52, the ALJ's Proposed Decision, and 52b, my Alternate Proposed Decision, for your consideration.
- These decisions seek to resolve the true up of energy efficiency incentives for the 2006-2008 energy efficiency program cycle.
- Three years ago, this Commission adopted a Risk Reward Incentive Mechanism designed to provide incentives to motivate the utilities to embrace energy efficiency as a core part of their business activities.
- Combined with revenue decoupling, incentives for the utilities to effectively manage and implement energy efficiency programs can, I believe, help transform the utility industry from one that has historically been fixated on supply side solutions, to one that considers energy services more holistically to include demand side solutions in general, and energy efficiency in particular.
- First, let me note that the 2006-2008 Energy Efficiency portfolios managed by the utilities were vast, representing approximately $2 billion dollars worth of ratepayer investment.
- However this large investment also paid huge dividends.

- All told, the measures deployed under these programs provided gross energy savings worth an estimated $4.6 billion.

- Despite these tremendous benefits, the two decisions before you offer a very different picture of the performance of our utilities and their efforts over the three year period to promote energy efficiency.
- For those of you who have not been following this, let me apologize in advance for the minutia that you are about to be dragged through.
- The ALJ's decision would find that over the course of the past three years, the utilities efforts to pursue energy efficiency do not merit any incentive rewards.
  - This means not only that the IOUs should receive no additional incentives in this true-up phase of the program cycle, it also finds that, in retrospect, the utilities should not have received the $143 million they received in interim incentives thus far.
- In contrast, my APD would find that for their efforts over the 2006-2008 period, the utilities should receive a total of $211 million in incentive rewards.
  - Because they have already received $143 million in interim payments, my APD would authorize an additional $68 million in incentive payments to make up the difference.
- The very disparate outcomes of the ALJ's Decision and my Alternate is driven by the proposed decision's relatively strict

adherence to an incentive framework adopted in 2007 that in my view has simply proven unworkable.

- For an incentive mechanism to be effective, it must offer rewards or mete out punishment on the basis of those factors within the control of the entity whose behavior the incentive framework is attempting to influence.
- In the case of the incentive mechanism we adopted in 2007, the utilities' achievements against the goals we set for them were to be assessed, and their progress against those goals serving as the basis for determining whether incentive rewards or penalties are owed.
- While this seems relatively straightforward, the challenge with the approach under the mechanism we adopted in 2007, is that measuring utility performance when it comes to energy efficiency is, at it turns out, a bit of a fuzzy exercise, particularly because of the dynamic nature of the environment in which these programs are being implemented.
- I am going to focus on one element that has factored prominently in driving the differences between my Alternate and the ALJ's Proposed Decision, the so-called "net to gross" ratio, or NTG.
- The NTG is an estimate of the percent of savings from a given energy efficiency measure, like CFLs, that would have happened irrespective of a utility program.

- When the NTG is high, it means that a greater amount of the savings from a given measure or activity are attributable to the utility program.
  - In other words, rebates provided by a utility caused customers to buy and install CFLs.
- If the NTG is low, it means more of those savings would have happened anyway.
  - That is, customers would have bought and installed CFLs even without getting a rebate.
- Notably, in the case of this particular parameter, it has nothing to do with the total amount of energy savings a given measure actually provides, rather it determines whether or not the utility and its programs get credit for catalyzing those savings.
- When we initially approved the 2006-2008 portfolios in 2005, there were a number of assumptions, including the NTG, which served as the basis for our determination that those portfolios were cost effective and would yield energy savings commensurate with the goals we had established.
- Based on this, the utilities went forward and implemented the energy efficiency programs this Commission approved.
- However, when it came to assessing the utility incentives, pursuant the 2007 incentive mechanism and as modified by subsequent decisions, the assumptions that were used in evaluating the

portfolios for purposes of determining incentives were updated to reflect more current market conditions.

- In making these updates, many of the parameters were found by our Energy Division to have changed dramatically.
- One of those variables was the NTG, but there were others as well.
- Applying these updates resulted in a substantial reduction in the estimated energy savings attributed to the utilities' programs.
- Based on these evaluations and parameter updates, the utility portfolios, which this Commission had approved as cost effective only a few years before, were found to be woefully lacking.
- Rather than getting close to realizing the goals we had established, these evaluations found the utilities' should get no incentives and in several cases, should be penalized.
- Now, to be fair, under the mechanism we adopted, the expectation was the utilities would actively monitor the market and adjust their portfolios accordingly.
  - For example, the Commission was very clear when it adopted the portfolios for the 2006-2008 program cycle that we had concerns with various parameters used in developing those portfolios, most notably expressing the position that the NTG ratios were too high particularly for lighting programs.
  - Yet when the utilities implemented their portfolios over the 2006-2008 period, with the notable exception of SCE, they did not

make any adjustments to their portfolios to be responsive to this concern.

- However, even in the case of Edison, which did make some adjustments, the dramatic changes in the updates to these parameters, as required under the mechanism we adopted, would still have found that their portfolio achieved less than 85 percent of the goals we had established for them.
- To me, the central question before us in this decision is whether or not the utilities effectively managed the energy efficiency programs given what they knew and could reasonably respond to.
- To this question, I find that the answer is, on balance, yes and to that end, believe it is appropriate to provide them incentives accordingly, again, keeping in mind that the purpose of the mechanism is to put energy efficiency on equal footing, from a business model and profitability standpoint, with supply side resources.
- I do not come to this conclusion lightly.
- Certainly there were things the utilities could have done better.
  - They could have been more proactive in their management of their portfolios.
- However, in my view, to find that the utility programs were a failure, as the findings based on the application of the existing incentive framework would all but have us do, is grossly unfair.

- Even had the utilities been more proactive, I do not think there is any way they could have anticipated the truly massive swings Energy Division finds in its evaluation reports to assess program performance.
  - The timing and ongoing controversy regarding the empirical basis for the changes identified by Energy Division, in my view, created an environment and circumstances that were insufficiently clear to allow the utilities to modify their portfolios effectively.
- Furthermore, and equally important, even had they predicted these huge swings, it is not clear to me if it is mathematically possible for them to modify their portfolios in a way to avoid finding themselves in the dead band or subject to penalties given the budget constraints of the portfolios we adopted.
- Again, the net-to-gross ratio provides a telling example.
- The NTG for upstream CFL lighting programs dropped, according to Energy Division's evaluation report, by over 30%.
  - This means, by definition, that program supporting these measures will yield 30% less savings that the utilities will get credit for.
- Because a large share of these savings would happen anyway, they are no longer on the table for the utilities to claim.
- Now one would think that this would also result in a commensurate decrease in the goals themselves, since these goals are based, or,

at any rate, should be based, on those savings that the utilities can impact.

- If we find that a substantial portion of these savings are simply going to happen on their own, then we should not hold the utilities accountable for capturing these since we've already said they are going to happen anyway.
- Unfortunately this is not how the program worked.
- Instead, the utilities were told that the tools they had to achieve the energy savings were not nearly as effective as was once thought, not because the measures themselves are necessarily less impactful, but because customers don't need incentives to deploy these measures.
- One way to address this issue would be to change the goals to reflect these updated assumptions.
- Another way, and the approach I believe is most reasonable for the 2006-2008 period, is to assess utility performance on the basis of the ex ante assumptions in place at the time this Commission approved the utility portfolios.
    - These assumptions reflect what this Commission adopted as the basis for approving the portfolios and also the assumptions that were embedded in the goals against which the utilities were being assessed.

- In making this change to the incentive mechanism as it applies to the 2006-2008 period, I recognize that it changes the risk balance of the mechanism.
- As adopted, the mechanism was predicated on updated assumptions on the premise that the utilities should be held accountable for making changes to their portfolios based on changing market dynamics.
  - As I've described, this premise has proven profoundly flawed, given the magnitude of changes to various assumptions and controversy around the legitimacy of those updates.
- However, because shifting to an approach that assesses utility performance on the basis of ex ante assumptions does remove a key element of uncertainty, it necessarily reduces the risk to the utilities of being found to have underperformed.
- Conversely, this increases the risk to ratepayers that incentives will be provided for savings that based on updated assumptions are found to have been less than what had been expected.
- Recognizing this change in the mechanism's overall risk profile I believe it is reasonable to modify the share of estimated net benefits the utilities earn in incentives from 9 and 12 percent to a flat 7%.
- With these changes my APD finds that the utilities are eligible for a total of $211 million in incentives over the 2006-2008 cycle.

- Because the utilities have already received interim awards of $143 million, for purposes of the true-up, the utilities would receive, under my APD, $68 million in additional incentives.
- While this sounds like a lot of money, some perspective is in order: as I mentioned earlier, energy efficiency measures deployed under the utility programs over the 2006-2008 program cycle provided about $4.6 billion in gross benefits.
- These are the benefits efficiency measures provided before getting into the thorny issue of what share of those savings would have happened anyway and what share should be credited to the utilities' programs.
- Relative to these gross benefits, the $211 million in incentive payments in my APD represents only about 5% of that gross amount.
- Even after subtracting out the approximate ratepayer costs of $2 billion associated with deploying these measures, the incentives account for only 8% of the remaining $2.6 billion in gross benefits that flow to ratepayers.

- The APD would also apply the adopted methodology to the 2009 Energy Efficiency program year.
- 2009 is somewhat of an orphan year in the energy efficiency program context, as owing to the timing of the issuance of the most recent portfolio decision, which covers 2010-2012, in 2008 we

issued a decision directing the utilities to simply continue their existing program in 2006-2008 to 2009.

- In my view, it would be consistent with this decision where 2009 was essentially a bridge year, to simply apply the mechanism we adopt here for the 2006-2008 period to 2009.
- To that end, the utilities are directed to file applications applying the mechanism adopted in my APD to their 2009 efforts, no later than June 30, 2011.
- Energy Division will assess these filings for accuracy and consistency and a PD will be issued timely to allow the Commission to act on these applications by end-of-year 2011.
- Before moving this item, let me say that I recognize the challenges and frustration I think all parties feel with regard to the incentive mechanism.
- Some sense of contrition from the Commission is perhaps in order, given that I think, frankly, we adopted a mechanism that proved too complex and engendered far more controversy than it should have had we been more practical in our consideration of such matters.
- I believe my APD offers a practical means to resolve the issues for the 2006-2008 period and will allow us to focus on reforms to the incentive mechanism going forward.
- While I think the challenges we have seen with utility incentives so far cannot be denied, this is not in my view, an indictment of utility

incentives, per se, rather it is evidence that the mechanism is in need of significant reform.

- The fundamental case for utility incentives remains unchanged.
- By offering incentives, we can leverage the utilities' profit motive to align their financial and business interests with the overarching resource priorities and objectives of the state to provide safe and reliable energy service, at reasonable cost, both to our citizens, and to the environment.
- I know that all of my fellow Commissioners probably have something to say on this issue. Before doing so, I do want to thank ALJ Pulsifer for his thoughtfulness throughout this proceeding.
  - While I did not, ultimately, agree with everything he did in arriving at his proposed decision, his grasp of the complexities of the issues and ability to distill this material into something comprehensible has been invaluable throughout.
- I also want to thank Commissioner Bohn, his advisor Robert Kinosian, Emy Youngsmith in Legal Divison, and last, but certainly not least, Jeorge Tagnipes and Zeny Tapawan-Conway in Energy Division for their patience and resilience through what can only be described as a highly contentious issue for this Commission.