

**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)

**COMMENTS OF THE UTILITY REFORM NETWORK ON PROPOSED
DECISION OF ALJ PULSIFER REGARDING RRIM REFORMS**

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December 6, 2010

COMMENTS OF THE UTILITY REFORM NETWORK ON PROPOSED DECISION OF ALJ PULSIFER REGARDING RRIM REFORMS

Pursuant to Rule 14.3 the Utility Reform Network (“TURN”) submits these comments on the Proposed Decision of ALJ Pulsifer (“PD”) issued on November 15, 2010 concerning modifications to the Risk/Reward Incentive Mechanism (RRIM) for 2010-2012 energy efficiency activities.

TURN applauds ALJ Pulsifer for delving through the morass of opinions and conflicting advice in order to craft a fairly sensible solution for an incentive mechanism for energy efficiency activities in 2010-2012. TURN provides a few policy recommendations to ensure better understanding of the total potential risks and rewards due to the gamut of utility efficiency activities.

While we appreciate the positive changes to the RRIM as compared to the mechanism for 2006-2008, TURN must emphasize that we do not at all agree that a “shared earnings model” which attempts to provide profits for energy efficiency that in some way mimic profits for supply-side activities (after adjusting for risk profiles) is at all necessary or sufficient to reduce or eliminate the inherent utility bias towards supply-side capital investments. An incentive mechanism for DSM simply rewards the utility for a particular activity. It will in no way reduce the *utility incentive* to continue to earn profits from its traditional supply-side investments. Admittedly, the hope is that in the long run the size of those investments may decrease due to the EE activities. However, the utility will undoubtedly seek to maximize all profits, and the huge increases in capital

spending by the utilities in the past five years certainly provide no evidence of a decline in incentives for supply-side investments. TURN cannot understand how any incentive mechanism could force a company to act in a way that would reduce or eliminate growth, which is the engine that drives value and shareholder interest.

Having said that, TURN believes that within the context of a “shared savings model,” the balance struck by the PD is reasonable. Specifically, TURN believes that the huge reduction in utility risk due to the 1) elimination of any true-up using *ex post* parameters, 2) elimination of a dead band and penalty range is appropriately balanced by a reduction in the total cap on earnings and in the sharing rate. TURN supports the methodology, proposed by the DRA, adopted in the PD which results in an illustrative sharing rate of 5.4% and an illustrative cap of \$189 million.

However, our support is predicated on the accuracy of those illustrative numbers, which we believe also provide the proper absolute level of earnings. Due to the inherent uncertainties associated with 1) a separate incentive mechanism for non-resource/custom programs, and 2) the ultimate *ex ante* numbers and avoided cost methods adopted in other proceedings, we strongly recommend that the PD also adopt a *total absolute incentive* cap of \$200 million for all energy efficiency incentives for 2010-2012.

1. Resource and Custom Programs

The PD states that a separate incentive mechanism for non-resource and custom programs will be adopted in another rulemaking. This incentive would likely be tied to program performance metrics rather than net avoided cost benefits. Moreover, in order to reduce the bias against long-term strategic initiatives, the PD directs that the costs of non-resource programs be removed from the PEB calculation.

There are three potential problems with this approach. The first is that removing the costs of non-resource programs provides the utility an incentive to disproportionately allocate administrative costs to the non-resource programs in order to inflate the PEB for the incentive mechanism. The PD should rectify this problem by either requiring that the same percentage of A&G costs be allocated to each category or by assigning all A&G costs to resource programs.

The second problem is the unknown amount of potential shareholder profits from all EE activities. The PD notes that non-resource programs account for about 15% of the proposed budgets. There is not comparable data for custom programs. TURN is extremely concerned that total incentives are unbounded. We suggest that the PD be revised to adopt an absolute total cap, for example of \$200 million, for all utility incentives for 2010-2012. An alternative approach is to adopt a separate cap for the non-resource/custom programs in the range of \$10-20 million, corresponding to the size of these programs.

The third problem is the fact that removing non-resource costs will provide an inaccurate picture of the cost-effectiveness of the energy efficiency

portfolio. The Commission is legally obligated to promote *cost-effective energy efficiency* activities. Historically, the Commission has interpreted these statutory requirements based on a total portfolio cost-effectiveness analysis. The Commission must continue to provide a portfolio-level analysis of cost-effectiveness for the entire portfolio, irrespective of the calculation of the PEB. However, it would be more appropriate to include all costs in the PEB calculation, especially if a separate incentive mechanism is designed to promote non-resource programs.

2. Uncertainty in Inputs and Methodology

The second major difficulty with the PD is that it relies on numbers that are yet to be adopted in A.08-07-021. The PD notes that the *ex ante* parameter values required to calculate savings estimates for various measures will be determined in A.08-07-021. TURN has argued extensively in that proceeding for the adoption of the most accurate *ex ante* numbers.

Another potential uncertainty is with the actual method of calculating the avoided cost benefits of energy efficiency programs. The PD calls for the freezing of certain parameter values which are presently included in the DEER database. However, the PD says nothing about the method of calculating the PEB itself. It is TURN's understanding that certain changes proposed in R.09-11-014 could impact the way avoided energy and capacity costs and environmental benefits are calculated in the future, mostly in the direction of increasing the benefits

attributed to energy efficiency. Such changes might increase the PEB calculation and thus increase potential earnings for the same level of EE activity.

Again, to address this potential ratepayer risk TURN recommends that the Commission adopt in this PD an absolute cap on total utility incentives for energy efficiency in 2010-2012. TURN recommends the figure of \$200 million, although we acknowledge that there is little information on the record to quantify the uncertainty in risk exposure.

3. Cost Effectiveness Guarantee

The current RRIM mechanism “guarantees” cost-effectiveness by mandating that utilities pay back to ratepayers any “negative net benefits.”¹ The PD does not mention what happens if utility net benefits are negative. TURN recommends that the PD be modified to require the payback of negative net benefits, thus providing a cost-effectiveness guarantee on a portfolio-level.

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Respectfully submitted,

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¹ Though this portion of the mechanism is apparently being ignored, given that at least one utility (SoCalGas) appears to have b/c ratio of less than 1.0 for 2006-2008.