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)

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 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, and that capturing all cost-effective savings becomes a core part of the utilities' business model. In summary, NRDC provides the following comments on the PD:

- NRDC strongly supports continuation of a "shared savings" incentive mechanism and many elements of the PD that simplify the mechanism.
- NRDC urges the CPUC to revise the PD to retain customized projects and the "cost-effectiveness guarantee" in the incentive mechanism.
- The considerations adopted in D.07-09-043 should be used to determine the magnitude of potential earnings and penalties under the incentive mechanism. Earnings should continue to approach comparable supply-side earnings (adjusted for the reduced risk of the mechanism) at superior levels of performance.
- The PD would provide earnings much lower than risk-adjusted comparable supply-side earnings (even at superior levels of performance). In addition, the PD would provide much lower earnings (approximately 80% lower[1]) than the 2006-

[1] At 100% of goals, NRDC estimates that the utilities would earn about \$38 to \$52 million under the PD's mechanism, whereas in 2006-2008, utilities were expected to earn \$323 million at 100% goal achievement. *Infra*, note 9.

08 mechanism, which is considerably lower than what is warranted by the reductions in risk.

- NRDC strongly urges the CPUC to revise the PD's methodology for determining the shared savings rate and cap to reflect the principles adopted by the CPUC in D.07-09-043 (and endorsed in the PD). NRDC's proposed revisions to the PD's methodology would result in an estimated cap of approximately $300 million and an earnings opportunity at 100% of goals approximately 50% lower than in 2006-08[2] (to account for the reduced risk and moderately lower energy savings in 2010-12). This earnings opportunity could be provided by a shared savings rate in the range of 12% to 15%.
- NRDC urges the Commission to extend the RRIM framework it adopts for the final true-up for 2006-08 to the 2009 program year, rather than eliminating the incentive mechanism for that year altogether.
- The Commission should define certain elements of the new incentive mechanism in more detail in order to ensure a smooth implementation process.

II. NRDC strongly supports continuation of a "shared savings" incentive mechanism, which aligns shareholder and customer interests by allowing the utilities to share in a small portion of the benefits the efficiency programs provide for customers.

The PD proposes to continue the "shared savings" structure of the incentive mechanism, which NRDC strongly supports. A shared savings mechanism is the only type of incentive mechanism that aligns shareholder and customer interests. The shared savings mechanism bases the utilities' earnings on a portion of the net benefits (i.e. total bill savings) the efficiency programs provide to customers. This appropriately encourages utilities to both maximize energy savings and minimize costs. Further, the shared savings mechanism is fair to customers. Unlike incentive mechanisms for other resources that reward utilities for *spending* money, the shared savings mechanism only rewards utilities for *saving* customers money. Moreover, customers would retain the vast majority of the economic savings.

III. NRDC supports many elements of the PD that simplify the incentive mechanism.

The PD proposes many changes to the existing incentive mechanism in order to simplify and streamline the mechanism. (PD, pp. 2-3) Although many of these modifications to the RRIM differ from what NRDC proposed in comments in this proceeding over a year ago, we now believe many of these changes are reasonable. (NRDC's view on how to best improve the incentive mechanism has continued to evolve over the last year as we have observed the final implementation of the 2006-08 mechanism.) NRDC now supports the following changes proposed in the PD for the 2010-12 mechanism:

[2] NRDC's proposal would provide $172 million at 100% goal achievement, which is about 50% less than the $323 million in D.07-09-043 for 2006-2008.

- Changing from assessing performance primarily based on ex-post evaluation, measurement and verification (EM&V) results to ex-ante values (while explicitly emphasizing the Commission's ongoing commitment to conducting ex-post evaluations to inform future ex-ante values);
- Eliminating the Minimum Performance Standard (MPS) tied to goals for both earnings and penalties;
- Establishing a single flat shared savings rate;
- Excluding non-resource costs from the Performance Earnings Basis (PEB) and examining incentive mechanisms for non-resource programs further; and
- Submission of annual utility applications to assess annual performance.

IV. NRDC urges the CPUC to include savings and costs from customized projects in the incentive mechanism, rather than excluding them as the PD proposes.

The PD would exclude savings and costs associated with customized projects from the shared savings incentive mechanism, and defer consideration of whether, and if so how, these programs should be incentivized to a later process. This represents a very large change to the shared savings mechanism, since the utilities estimate that approximately 35% of the overall net benefits from their portfolios will come from custom projects.[3] However, the PD provides only minimal discussion of the rationale for this significant change. (PD, p. 38) Although we agree with the PD that customized projects require "project-by-project calculations" of savings, we disagree that these projects "do not lend themselves to the RRIM formula." (PD, p. 8) The methods for analyzing customized project savings are generally well-established and those projects provide significant savings for customers and should be encouraged through the RRIM.

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

The 2006-08 RRIM had two penalty provisions: (i) per-unit penalties if energy or demand savings fell below thresholds, and (ii) a cost-effectiveness guarantee. The PD provides a detailed discussion on the first type of penalty and concludes that the 2010-12 mechanism should eliminate the per-unit penalties. (PD, p. 31 and Ordering Paragraph (OP) 5) However, the PD provides no discussion of whether or not the cost-effectiveness guarantee should be continued. Further, it is unclear whether the OP's statement that "no penalty provision shall apply" just refers to the per-unit penalties (that are related to the MPS discussed in the rest of the OP) or

[3] Customized measures are expected to provide approximately $723 million of PEB net benefits, while total PEB net benefits (after excluding non-resource program costs) are estimated to be $1.9 billion. IOU 2010-2012 Compliance Filings, A.08-07-021 et al, November 23, 2009 (PG&E Advice Letter 3065-G and 3562-G, SCE Advice Letter 2410-E, SDG&E Advice Letter 2127-E/1903-G, SoCal Gas Advice Letter 4041). Data on customized measures from IOU responses to NRDC data request, November 23 and 30, 2010.

whether it would eliminate all penalties including the cost-effectiveness guarantee. NRDC urges the CPUC to explicitly retain the cost-effectiveness guarantee, which will ensure that utilities reimburse customers for any excess costs and that the portfolio remains cost-effective.

VI. NRDC strongly urges the CPUC to revise the PD's methodology for determining the shared savings rate and cap to reflect the principles adopted by the Commission in D.07-09-043 (and endorsed in the PD) for establishing the magnitude of potential earnings and penalties under the incentive mechanism. NRDC's proposed revisions to the PD's methodology based on those principles would result in an estimated cap of $300 million and an earnings opportunity at 100% of goals approximately 50% lower than in 2006-08 (to account for the reduced risk and moderately lower energy savings in 2010-12). This earnings opportunity could be provided by a shared savings rate in the range of 12% to 15%.

1. The considerations adopted in D.07-09-043 should be used to determine the magnitude of potential earnings and penalties under the incentive mechanism, as the PD proposes.

In adopting the 2006-08 RRIM, the Commission considered the factors below in setting the magnitude of the earnings and penalty opportunity. (D.07-09-043, Finding of Fact 92) NRDC strongly supports the PD's recommendation that the Commission should continue to use these considerations to determine the potential earnings in the 2010-12 incentive mechanism:

> "(a) The level of earnings that balances potential penalties and offsets existing financial and regulatory biases in favor of supply-side procurement.
> (b) The level of earnings potential that will provide a clear signal to utility investors and shareholders that achieving and exceeding the Commission's savings goals (and maximizing ratepayer net benefits in the process) will create meaningful and sustainable shareholder value.
> (c) Differences in the risk/reward profiles of utility resource choices in applying the comparable earnings benchmark to the incentive mechanism.
> (d) The level of performance expected in return for higher and higher earnings potential.
> (e) What is "fair" to ratepayers in terms of the return on their investment in energy efficiency." (PD, pp. 41, 45)

Based on those considerations, the CPUC set the cap on earnings to be the lower end of the range of comparable earnings for supply-side resources ($450 million) (D.07-09-043, pp. 107-108), and structured the mechanism so that the cap was expected to be reached at a level of superior performance (125% of goals). (D.07-09-043, Table 1, p. 9; PD, p. 41)

2. The PD would provide earnings much lower than comparable supply-side earnings (even at superior levels of performance). In addition, the PD would

provide much lower earnings than the 2006-08 mechanism, beyond what is warranted by the reductions in risk.

Although the PD endorses the same considerations adopted in D.07-09-043, its proposed mechanism fails to meet them. If the utilities were to procure power instead of achieving the energy savings expected from the 2010-12 portfolios, they would earn approximately $390 million or more.[4] The PD would cap earnings for efficiency at an illustrative value of $189 million, or less than half the comparable supply-side earnings. The 2006-08 RRIM's $450 million cap created potential earnings of up to about 4% of the utilities' total pre-tax earnings, whereas the PD's estimated cap would only create potential earnings of about 1.5% of the utilities' pre-tax earnings.[5] To put it another way, the PD's cap would amount to 6% of the efficiency budget, whereas the CPUC routinely provides utilities with profits of anywhere from 30% to 60% of the amount they spend to procure power (on a net present value basis).[6] Of course, all parties agree that the potential earnings under the incentive mechanism should be reduced to account for the lower risk profile of the new incentive mechanism, but the PD's methodology to significantly reduce the cap does not include a risk analysis.

Figure 1, below, illustrates the relative reward/penalty balance of the incentive mechanism the CPUC adopted in D.07-09-043 for 2006-08, compared to the earnings proposed in the PD. The CPUC's energy saving goals for 2006-08 and 2010-12 are comparably aggressive, if not more aggressive,[7] but the PD would provide earnings of approximately $38 million to $52 million at 100% of goals,[8] whereas the CPUC expected to provide earnings of $323 million at 100% of goals in D.07-09-043. The PD's 80% reduction in potential earnings is

[4] *Infra*, note 12.

[5] The 2006-08 RRIM's cap of $450 million in pre-tax profits represented about 4% of the utilities' total pre-tax profits. PG&E, SCE, SDG&E, and SoCal Gas had $11.5 billion in income before taxes, combined, for 2006 through 2008. Sources: Consolidated Statements of Income (2006-2008) from each utility's annual report. Average annual earnings before taxes over the last 4 years (for all 4 utilities) was $3.95 billion per year. Conservatively assuming that profits do not increase over the following years, total pre-tax profits for 2010-12 would be approximately $11.8 billion for all utilities, so the PD's estimated cap of $189 million would be about 1.5% of pre-tax profits.

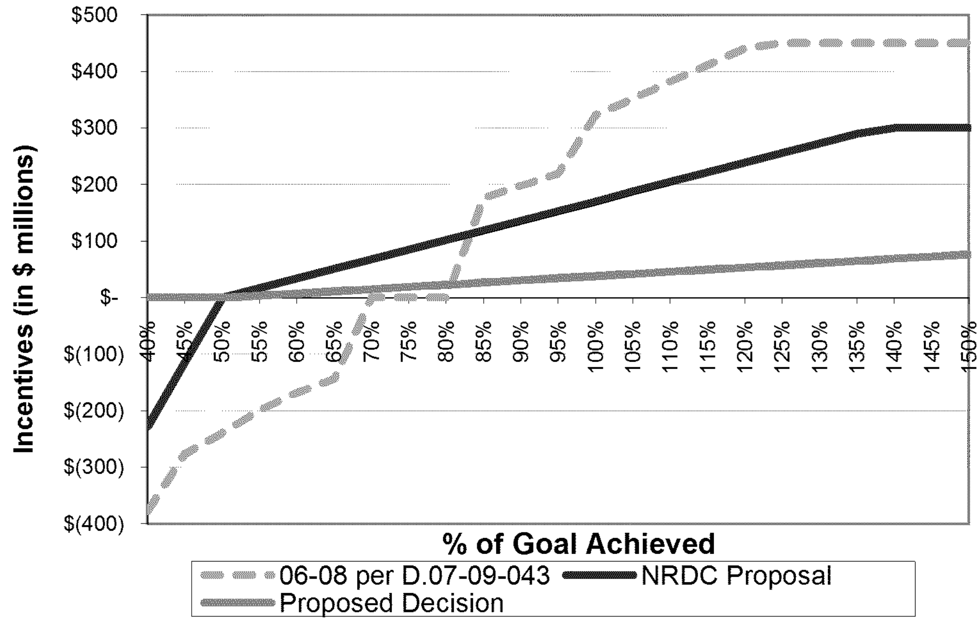
[6] D.07-09-043 found that supply-side earnings were roughly 37% of costs, assuming a 50-50 split between utility rate-based projects and procurement of power from other plant owners, a 12-year period for depreciation, and calculation of the net present value. A rate-based asset alone could earn more than 60% of costs on a net present value basis. For example, an asset that costs $100, has a 25 year life over which it is depreciated, and earns an 11.35% return on equity (PG&E's current authorized return), would earn $147 over 25 years, or 147% of the investment on a nominal basis, and $67, or 67%, on a net present value basis (discounting at the same 11.35% rate).

[7] NRDC presented an in-depth analysis in reply comments on June 12, 2009 based on the best available information that found that the 2009-11 goals were as aggressive, if not more aggressive, than the 2006-08 goals. The 2010-12 goals are nearly the same as the 200-11 goals, so this conclusion still holds. (The 2009-11 three year total annual electricity savings goal is 6,946 GWh, and the 2010-12 goal is 6,966 Gwh or 0.3% higher. The natural gas savings goal is 5% higher for 2010-12 than for 2009-11. CPUC D.09-09-047, pp. 45-46 (September 24, 2009).)

[8] *Infra*, note 9.

out of proportion to the relatively moderate reduction in risk associated with the 2010-12 mechanism.

Figure 1: Estimated Earnings and Penalties in Efficiency Incentive Mechanisms[9]



3. Significant portions of the PD's proposed methodologies to determine the cap and shared savings rate are inconsistent with the considerations adopted in D.07-09-043 (and endorsed in the PD) and should be revised.

Although the PD endorses the same considerations for determining the earnings opportunity that the CPUC outlined in D.07-09-043 (including that earnings should approach the

[9] The 2006-2008 RRIM potential earnings and penalties are from D.07-09-043, Table 1, p.9. To model the PD's incentive mechanism and NRDC's proposal, we used the savings and PEB projections in the IOU 2010-2012 Compliance Filings, A.08-07-021 et al, November 23, 2009 (PG&E Advice Letter 3065-G and 3562-G, SCE Advice Letter 2410-E, SDG&E Advice Letter 2127-E/1903-G, SoCal Gas Advice Letter 4041). The projected PEB, after removing non-resource costs, is $1.94 billion. The PD also removes customized measures ($723 million), which results in a PEB of $1.21 billion at projected levels (at 134% of goal achievement). (Data on customized measures from IOU responses to NRDC data request, November 23 and 30, 2010.) NRDC scaled the PEB linearly down to $0 at 50% of goal achievement, and scaled up above 134% at the same rate, based on the assumptions used in D.07-09-043, Table 1. NRDC then applied the PD's shared savings rate of 5.37% to derive potential earning levels at every stage of goal achievement. (We use the PD's lower illustrative shared savings rate because the projected PEB without non-resource costs of $1.94 billion is closest to the $1.86 billion PEB used in that illustration.) The PD's proposal never drops below $0 because the PD proposes no penalties. Under NRDC's proposal, the forecast PEB is $1.94 billion since we propose to retain customized measures in the mechanism. NRDC's revisions to the PD's methodology to determine the earnings opportunity yields $172 million at 100% goal achievement. NRDC scaled the forecast PEB linearly down to $0 at 50% of goal achievement, based on the assumptions used in D.07-09-043, Table 1. The PEB at 100% of goal, under NRDC's proposal, is $1.1 billion, yielding a shared savings rate of 15%. If the PEB were scaled down to reach $0 at 0% of goal instead, the PEB would be $1.42 billion at 100% of goal, yielding a shared savings rate of 12%. While this graph depicts a 15% shared savings rate, if PEB scales differently, then NRDC's proposed methodology would yield a different shared savings rate. NRDC's proposal shows penalties below 50% of goals because NRDC proposes to retain the cost-effectiveness guarantee. NRDC's proposal hits the proposed cap of $300 million at 140% goal achievement and remains flat thereafter.

lower end of the range of comparable earnings for supply-side resources at a level of superior performance), it fails to apply them in its proposed methodologies for determining the cap and shared savings rate for 2010-12.

First, the PD appears to *intend* to adjust the 2006-08 cap so that it will be the lower end of the range of comparable earnings for supply-side resources for the 2010-12 portfolio, and to do so based on "differences in expected energy efficiency savings applicable to the 2010-2012 portfolio relative to the 2006-2008 portfolio." (PD, p. 45) But instead, the PD arbitrarily lowers the $450 million cap based on the ratio of expected net benefits for the 2010-12 cycle compared to the expected net benefits when the 2006-08 RRIM when adopted. Since comparable supply-side earnings are dependent on the *energy savings* (GWh, MW and MMTherms) achieved by the programs (i.e. the energy savings determine how much power would have been procured in its place), the cap should be adjusted by *energy savings* not *net benefits*.[10] The PD recognizes this in stating that "the revised shared savings percentages and cap recommendations must incorporate differences in expected energy efficiency savings applicable to the 2010-2012 portfolio relative to the 2006-2008 portfolio;" (PD, p. 45) however, the PD fails to use the relative energy savings in adjusting the cap.

The PD's proposed methodology to establish the shared savings rate is largely consistent with the CPUC's principles in D.07-09-043, except for the first step which suffers from the same methodological problems as the cap. The PD would derive the shared savings rate based on a desired earnings opportunity as a fraction of the forecast PEB (PD, pp. 47-49); however, the PD's first step in adjusting the earnings opportunity relative to the 2006-08 level has the same significant flaw as the PD's adjustment of the cap discussed above: the PD would lower the earnings opportunity based on the relative *net benefits* of the two cycles instead of the relative *energy savings*. (PD, p. 47) This is contrary to the PD's own discussion that "incentive earnings levels must be reduced as a result of lower energy efficiency savings levels expected from the 2010-2012 portfolio relative to the prior cycle." (PD, p. 41)

The PD's proposal to adjust the cap and earnings opportunity used to derive the shared savings rate based on the ratio of net benefits between the two program cycles would send the wrong message to the utilities, and would create a mechanism that neither creates "meaningful and sustainable shareholder value" nor "offsets existing financial and regulatory biases in favor

[10] The PD's note that the "cap amount should be reduced by the budgeted amount for 2010-2012 non-resource programs" (PD, p. 46) appears to be similarly misguided, since the magnitude of the energy savings should determine the comparable supply-side earnings, and these are unaffected by the budget for non-resource programs.

of supply-side procurement." (PD, p. 41) The utilities are required to capture all cost-effective energy savings and the CPUC is pushing them to get more and deeper energy savings. The Commission's energy saving goals for 2010-12 are as aggressive, if not more aggressive, than the goals for the 2006-08 program cycle.[11] The 2010-12 cycle is estimated to have lower net benefits than the 2006-08 cycle for numerous reasons (as the PD notes on page 46), including the emphasis on more comprehensive savings, the more limited savings that are available relative to increasing codes and standards and "business as usual" market practices, and EM&V results that are lowering saving estimates. So, the energy savings now cost more to achieve.

But the PD's methodology would essentially send a message that as savings get harder to achieve and more costly (decreasing net benefits), the Commission will continuously lower the cap and potential earnings. This is counterproductive, since it would indicate that as the utilities have to work harder to get more energy savings, the incentive mechanism will offer lower and lower potential shareholder value. Reducing the shared savings rate because net benefits are expected to be lower essentially provides a "double penalty" (since earnings are reduced both by the lower shared savings rate and by the lower net benefits). Taken to the extreme, the PD's methodology would eventually result in a near-zero earnings *opportunity* even as the utilities have to work harder to capture energy savings and net benefits. The utilities would then be in a situation in which investments in supply-side resources would yield significant earnings but the energy savings would have almost no possible earnings (even if they could achieve them more cost-effectively). This would clearly be counter to the CPUC's goal to offset existing biases in favor of supply-side procurement. The Commission should correct these errors in the PD's methodology, and determine an appropriate shared savings rate for 2010-12 based on a level of risk-adjusted earnings opportunity that meets the considerations provided in D.07-09-043.

4. **The Commission should set the <u>cap</u> at a level approaching comparable supply-side earnings for superior performance, adjusted for the reduced risk of this incentive mechanism. NRDC estimates the cap would be approximately $300 million for all four utilities over the three year cycle.**

NRDC supports the PD's proposal to base the earnings opportunity in the 2010-12 incentive mechanism on the considerations the CPUC adopted in D.07-09-043 discussed above. To be consistent with those considerations, NRDC recommends that the Commission set the cap using the following methodology:

[11] *Supra*, note 7.

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Step 1: Estimate the comparable supply-side earnings for the 2010-12 portfolio, that should be reached at a level of superior performance. (Unadjusted for risk.)

In D.07-09-043, the CPUC found that $450 million represented the lower end of the range of comparable earnings for supply-side resources for the 2006-08 energy savings. To estimate the comparable supply-side earnings for the 2010-12 portfolio, the CPUC should adjust the $450 million based on the ratio of energy savings in the 2010-12 portfolio compared to the 2006-08 portfolio, which yields comparable supply-side earnings for 2010-12 of approximately $390 million.[12]

Step 2: Reduce the cap to account for the reduced risk in the proposed 2010-12 incentive mechanism.

All parties in the proceeding agreed that the earnings opportunity should be reduced if the new mechanism reduces risks. The PD embraces DRA's approach to reduce earnings by 5% for each discrete change that reduces risks. NRDC agrees that this is a reasonable approach, recognizing the difficulty of more precisely calculating the risk reduction associated with each change in the incentive mechanism. However, we do not agree with the list of changes that DRA asserts would warrant such a risk adjustment factor (PD, p. 44). NRDC proposes that the CPUC lower the cap based on the following four reductions in risk, which yields a total risk adjustment factor of 20%: (1) Use of ex-ante values instead of ex-post values for most metrics; (2) MPS limited to portfolio being cost-effective; (3) interim earnings not subject to refund; and (4) no per-unit penalties. If the CPUC eliminates the cost-effectiveness guarantee, contrary to NRDC's recommendation, then the risk adjustment factor would be 25%.

Applying these risk adjustment factors to the comparable supply-side earnings estimated above ($390 million) yields a range for the risk-adjusted cap of $292 million to $312 million, before taxes.[13] Therefore, the cap based on NRDC's revisions to the PD's methodology (for all four utilities over all three years) would yield, for illustrative purposes, a cap of approximately $300 million. This cap is 33% lower than the cap in 2006-08 and more than 20% lower than the

[12] When the 2006-08 RRIM was adopted, the portfolios were forecasted to provide 7,371 GWh of net savings; the 2010-12 portfolios are forecasted to provide approximately 6,381 GWh of net savings. 2006-08 forecasted savings are from D.05-09-043, Attachment Table 2. 2010-12 forecasted gross savings are from IOU 2010-2012 Compliance Filings, Tables 1.1, and the net savings are conservatively estimated using the 0.63 portfolio-average net-to-gross ratio from the Energy Division's *2006-2008 Energy Efficiency Evaluation Report*, July 2010, Table 1. ($390 million = $450 million x 6,381 GWh / 7,371 GWh)

[13] $390 million x 0.75 = $292 million. $390 million x 0.8 = $312 million.

estimated comparable supply-side earnings for the 2010-12 cycle, reflecting the reduced risk in the incentive mechanism.

Step 3: Qualitatively evaluate the considerations adopted in D.07-09-043 to determine how to adjust the 2006-08 cap to set the cap for 2010-12.

As discussed above, the Commission established five criteria to consider in establishing the potential earnings opportunity in D.07-09-043, and the PD endorses those. In this section, we evaluate each of those considerations to determine how they would change the cap for the 2010-12 proposed incentive mechanism. (The criteria in italics are from the PD, page 41.)

(a) The level of earnings that balances potential penalties and offsets existing financial and regulatory biases in favor of supply-side procurement.

- The Proposed Decision reduces risk in the 2010-12 mechanism compared to the 2006-08 mechanism by eliminating all penalties. This should reduce the earnings opportunity in the 2010-12 mechanism. NRDC's proposed revision to the PD would only eliminate the per-energy unit penalties but retain the cost-effectiveness guarantee, which would moderately reduce the penalties and should moderately reduce the earnings opportunity in 2010-12.
- Existing financial and regulatory biases have not changed since the Commission adopted the 2006-08 RRIM, so the earnings opportunity should approach a conservative estimate of supply-side earnings at superior levels of performance.

(b) The level of earnings potential that will provide a clear signal to utility investors and shareholders that achieving and exceeding the Commission's savings goals (and maximizing ratepayer net benefits in the process) will create meaningful and sustainable shareholder value.

- Creating meaningful shareholder value would indicate that the earnings opportunity in 2010-12 should be comparable in magnitude to that in the 2006-08 RRIM.
- Creating sustainable shareholder value would indicate the earnings opportunity should approach a conservative estimate of supply-side earnings for superior performance.

(c) Differences in the risk/reward profiles of utility resource choices in applying the comparable earnings benchmark to the incentive mechanism.

- The PD's proposed use of ex-ante values instead of ex-post values to evaluate the energy savings from the programs reduces the risk to utilities relative to supply-side investments, which should reduce the earnings opportunity in the 2010-12 mechanism.

(d) The level of performance expected in return for higher and higher earnings potential.

- The PD's proposal to change the MPS to be based on the portfolio's cost-effectiveness instead of the percent of CPUC goals achieved reduces the threshold at which utilities could earn rewards, which should moderately reduce the earnings opportunity.
- As discussed above, the 2010-12 goals are as aggressive, if not more aggressive, than the 2006-08 goals. This would indicate that similar or greater earnings opportunities should be available at the same level of performance relative to the 2006-08 RRIM.

(e) What is "fair" to ratepayers in terms of the return on their investment in energy efficiency.

- The shared savings rate should continue to be a modest portion of net benefits, to ensure that customers retain the vast majority of net benefits from the efficiency investments.
- The cap should ensure that utility earnings will not be disproportionate to their earnings on other resources, while recognizing that efficiency is the state's top priority resource. This would indicate that the cap should provide the utilities no more of a reward as a portion of their total profits than in the 2006-08 RRIM.

On balance, weighing all these considerations would indicate that the 2010-12 cap should be *moderately lower* than the 2006-08 cap. NRDC's proposed methodology, which yields a cap of approximately $300 million, is 33% lower than the 2006-08 cap, consistent with this analysis.

5. The Commission should establish the appropriate level of risk-adjusted earnings opportunity for 2010-12 by adjusting the earnings opportunity adopted in D.07-09-043 to account for the reduced risk and moderately lower energy savings in 2010-12, and then set the shared savings rate at a level that will provide that earnings opportunity. NRDC estimates that the appropriate earnings opportunity at 100% of goals should be about 50% lower than in 2006-08, and that the shared savings rate should be approximately 12% to 15% in order to provide that earnings opportunity.

NRDC agrees with the PD that "there is a trade-off between reductions in risk and the associated magnitude of earnings" (PD, p. 47) and we urge the Commission to lower the *magnitude* of potential earnings at 100% of goals to account for the reduced risks in the 2010-12 mechanism. However, the PD confuses the *shared savings rate* with the *magnitude of earnings* when it states "we shall reduce the applicable shared savings percentage to recognize reduced risks relative to the RRIM that applied during the 2006-2008 cycle." (PD, p. 46) The magnitude of earnings is the product of the shared savings rate and the net benefits, therefore

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we urge the Commission to first determine the appropriate level of risk-adjusted earnings opportunity that it seeks to create, and then set the shared savings rate at a level that will provide that opportunity. (Of course, the magnitude of the shared savings rate itself is something that the CPUC should consider; however, it is only one of many factors that the Commission should look at in deciding on the appropriate earnings opportunity based on the CPUC's principles discussed above.)

The PD uses a similar approach, deriving the shared savings rate based on a desired earnings opportunity as a fraction of the forecast PEB (PD, pp. 47-49); however, the PD's first step in adjusting the earnings opportunity relative to the level the CPUC adopted for 2006-08 has the same significant flaw: the PD would lower the earnings opportunity based on the relative *net benefits* of the two cycles instead of the relative *energy savings*. (PD, p. 47) This adjustment contravenes the considerations in D.07-09-043 and the PD's own discussion that "incentive earnings levels must be reduced as a result of lower energy efficiency savings levels expected from the 2010-2012 portfolio relative to the prior cycle" (PD, p. 41).

To correct these deficiencies, NRDC recommends the following approach:

Step 1: Lower the earnings opportunity the CPUC adopted for 2006-08 to reflect the "lower energy efficiency savings levels expected from the 2010-2012 portfolio relative to the prior cycle" (PD, p. 41) using the correct metric of *energy savings* rather than *net benefits*.

In D.07-09-043, the CPUC planned to provide an earnings opportunity of $323 million for savings at 100% of the utilities' goal of 6,599 GWh (net). The utilities' goal for 2010-12 is 6,966 GWh (gross), which we conservatively estimate is about 4,393 GWh (net).[14] Therefore, adjusting the $323 million earnings opportunity based on the relative savings of the two cycles, the comparable earnings opportunity at 100% of goals for 2010-12 would be $215 million.[15]

Step 2: Further lower the earnings opportunity to account for the reduced risks in the 2010-12 incentive mechanism.

Consistent with the PD's adoption of DRA's 5% risk reduction factor, this $215 million earnings opportunity should be reduced by 20% to account for the four reductions in risk discussed above. (If the CPUC eliminates the cost-effectiveness guarantee contrary to NRDC's recommendation, then this would be a 25% reduction.) This yields an earnings

[14] This assumes a 0.63 portfolio-average net-to-gross ratio from the Energy Division's *2006-2008 Energy Efficiency Evaluation Report*, July 2010, Table 1, although NRDC's analysis has shown that this is extremely conservative.
[15] $215 million = $323 million x (4,393 GWh / 6,599 GWh)

opportunity of $172 million at 100% of goals, which is nearly 50% lower than the $323 million earnings opportunity the CPUC put forth in D.07-09-043.

Step 3: Calculate the shared savings rate that will provide the magnitude of earnings derived above.

The shared savings rate that will provide $172 million in potential earnings at 100% of goals is a function of the expected net benefits. In the utilities' compliance filings on the 2010-12 cycle,[16] they project a PEB of $1.94 billion (excluding non-resource program costs) at 134% of goals. There are two simple ways to estimate the net benefits at 100% of goals:

i. Assume the PEB varies linearly with percent of goals, starting at zero PEB at 50% of goals consistent with D.07-09-043 Table 1. In this scenario, the PEB at 100% of goals is $1.14 billion. To provide $172 million in earnings from a PEB of $1.14 billion, the shared savings rate would be <u>15%</u>.

ii. Assume the PEB varies linearly with percent of goals, starting at zero PEB at zero savings. In this scenario, the PEB at 100% of goals is $1.44 billion. To provide $172 million in earnings from a PEB of $1.44 billion, the shared savings rate would be <u>12%</u>.

Alternatively, the CPUC could look at the shared savings rate necessary to reach the cap on earnings at a level of superior performance. The utilities project a PEB of $1.94 billion (excluding non-resource program costs) at 134% of goals. To reach the cap of approximately $300 million discussed above would require a shared savings rate of <u>15%</u>.

This analysis indicates that the CPUC should consider a shared savings rate in the range of 12% to 15% in order to provide an earnings opportunity that meets the considerations established in D.07-09-043. Figure 1, above, illustrates the difference in the potential earnings between the 2006-08 RRIM the CPUC adopted in D.07-09-043, the PD, and NRDC's proposal. It shows that NRDC's proposed 12% to 15% shared savings rate appropriately produces a lower level of potential earnings than the 2006-08 RRIM (to account for the reduced risks and somewhat lower energy savings), while still meeting the CPUC's principles, including to "offset existing financial and regulatory biases in favor of supply-side procurement," and to "create meaningful and sustainable shareholder value." In contrast, the PD would significantly reduce potential earnings such that it does not meet these objectives.

[16] IOU 2010-2012 Compliance Filings, A.08-07-021 et al, Nov. 23, 2009, Tables 1.7 & 1.8 (PG&E Advice Letter 3065-G/3562-G, SCE 2410-E, SDG&E 2127-E/1903-G, SoCal Gas 4041).

VII. NRDC urges the Commission to extend the RRIM framework it adopts for the final true-up for 2006-08 to the 2009 program year, rather than eliminating the incentive mechanism for that year altogether.

When the CPUC adopted the existing RRIM in D.07-09-043, it ruled that the mechanism would continue "until further Commission notice." (Ordering Paragraph 1) In the Order Instituting Rulemaking in this proceeding, issued in February 2009, the CPUC stated its intent to develop a new incentive mechanism for 2009-11. (p. 5) This proceeding had a relatively intensive commenting period on a new mechanism for 2009-11 during the spring and summer of 2009. It was clear that all parties expected some incentive mechanism to apply to the 2009 program year. However, the CPUC did not take further action for more than a year after parties filed their last comments in August 2009. While we recognize the difficult position that the CPUC now finds itself in – determining the structure of an incentive mechanism for a past year – we believe that on balance it is preferable for the CPUC to maintain the credibility of its commitment to treating energy efficiency as the top priority resource (including by providing an incentive mechanism), rather than eliminating the RRIM after the fact. Since the CPUC extended the 2006-08 efficiency programs to 2009 in D.08-10-027, one simple way to resolve this is to extend the RRIM framework the CPUC adopts for the final 2006-08 true-up to 2009.

VIII. The Commission should define certain elements of the new incentive mechanism in more detail in order to ensure a smooth implementation process.

NRDC is concerned that significant portions of the PD are unclear or open to interpretation, which may result in controversy over implementation of the mechanism. We strongly urge the Commission to clarify the following issues in the PD:

- The PD does not specify the earnings cap or shared savings rate for the new mechanism, and instead provides a relatively high-level description of a methodology for calculating a new earnings cap and shared savings rate. However, this methodology could be interpreted in different ways. Further detail and clarification is needed to avoid future controversies.
- The ex-post verification for the final true-up should include an audit of program implementation costs *not* incremental measure costs (IMC).[17] Parties are in consensus that actual expenditures to implement the programs should be trued-up ex-post, but updating IMC

[17] OP 4 of the PD states that assessment of performance will rely on ex-ante values for all measures except actual efficiency measure installations and "actual incremental measure costs." However, throughout the PD these costs are referred to using different terms that have very different meanings (see, e.g., pp. 5, 23, 24, 31, 55).

on an ex-post basis is not straightforward (and would be inconsistent with the PD's direction to use mostly ex-ante values), we urge the CPUC to clarify throughout the PD that program implementation costs will be verified ex-post, instead of incremental measure costs.

- The PD directs that non-resource costs would be excluded from the PEB, but does not provide a definition for which programs should be included in that category. These costs should be clearly defined to ensure smooth implementation of this directive.
- If customized projects are excluded from the RRIM, contrary to NRDC's recommendation, then the Commission should clearly define which costs and savings fall into that category.
- In R.09-11-014, the Assigned Commissioner issued a ruling asking parties to comment on lengthening the current efficiency program cycle based on CPUC staff's recommendation to extend it by a year. The Commission should revise the PD so that the adopted incentive mechanism will be in place for the entire program cycle, if the CPUC decides to extend it.

IX. Conclusion

NRDC urges the Commission to revise the PD by incorporating the recommendations above and the specific recommendations to the Findings of Facts, Conclusions of Law and Ordering Paragraphs in Attachment A. We urge the CPUC to adopt an improved RRIM that ensures that energy efficiency is truly the state's top priority resource and to ensure that the financial incentives that the CPUC provides to the utilities are aligned with the state's policies.

Dated: December 6, 2010

Respectfully submitted,

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Attachment A: Recommended Revisions to the PD's Findings of Facts, Conclusions of Law and Ordering Paragraphs

Findings of Fact

1. The Commission determined in previous decisions that shareholder incentives for energy efficiency should be provided so that energy efficiency programs are pursued vigorously by utility management as a core business strategy.

2. A "shared savings" incentive mechanism encourages utilities to maximize the net benefits customers receive as a result of the energy efficiency programs, by allowing the utilities to share in a portion of those net benefits. This type of mechanism creates a "win-win" alignment of shareholder and customer interests.

2. Awards or penalties under the incentive mechanism for energy efficiency programs adopted in D.07-09-043 was originally expected to be subject to ministerial action, without litigation, protracted controversy or delay regarding performance metrics.

3. Based on experiences encountered with RRIM implementation during the 2006-2008 program cycle, the process for submission, review, and approval of incentive earnings claims has not functioned as intended, but has proven highly contentious, consuming excessive time and resources.

4. Evaluated ex post updates have been controversial particularly because they impact the magnitude of incentive earnings so significantly. At the same, the ex post updates often involve metrics whose measurement require considerable subjective judgment and debates as to the meaning and use of raw data.

5. Ex post measures are often largely determined by factors outside of a program administrator and implementer's control. Awarding or penalizing for factors outside of management control fails to achieve the objective of linking incentive award levels with management behavior.

6. A significant measure of dispute over 2010-2012 RRIM earnings or penalty determinations could be neutralized by modifying the process for measuring net benefit performance metrics used to determine incentive awards based upon ex ante values.

7. The RRIM adopted in D.07-09-043 places the utility at risk for no incentive earnings (or penalties) if measured performance is below the threshold MPS, even if customers still may be receiving benefits.

8. To be eligible for earnings, the RRIM currently required the utility to meet specified minimum performance standards (MPS) for the energy efficiency portfolio as a whole:

i. Achieve a minimum of 85% of the Commission-adopted savings goals, based on a simple average of the percentage of each individual gigawatt-hour (GWh), megawatt (MW) and, as applicable, million therm (MTherm) goal they achieve; *and also*

ii. Meet a minimum of 80% of the goal for each individual savings metric.

9. Basing incentives on a tiered MPS structure creates a potential "cliff" effect whereby a single kilowatt hour could result in a difference of tens of millions of dollars in rewards or penalties.

10. The MPS, as currently applied in the incentive calculations, has fostered excessive controversy, and is unduly complex.

11. By de-linking the savings rate from a minimum performance standard would eliminate potential controversies relating to the "cliff" effect whereby relative small differences in evaluated savings could have a large effect on whether, or how much incentive earnings accrue.

12. In D.09-09-047, the Commission concluded that both 2008 DEER and non-DEER ex ante measure values should remain frozen through the 2010-2012 cycle for purposes of establishing savings goals and portfolio performance over the 2010-2012 program cycle.

13. The determination of ex ante values for 2010-2012 savings measures currently remains unresolved, but is pending the disposition of certain clarifying issues in the IOUs' Petition for Modification of D.09-09-057.

14. The incentive mechanism measurement process can be effectively modified by calculating the PEB utilizing frozen DEER and non-DEER ex ante values, subject to Commission determinations pending in A.08-07-021 et al., ~~without~~ and only applying ex post updates to verified installations and program expenditures to compute net benefits.

15. In D.07-09-043, the Commission adopted the following considerations to determine the magnitude of potential earnings and penalties in an energy efficiency incentive mechanism:

(a) What level of earnings will balance the level of potential penalties under the mechanism and offset existing financial and regulatory biases in favor of supply-side procurement.

(b) What level of earnings potential will provide a clear signal to utility investors and shareholders that achieving and exceeding the Commission's savings goals (and maximizing ratepayer net benefits in the process) will create meaningful and sustainable shareholder value.

(c) Differences in the risk/reward profiles of utility resource choices in applying the comparable earnings benchmark to the incentive mechanism.

(d) The level of performance expected in return for higher and higher earnings potential.

(e) What is "fair" to ratepayers in terms of the return on their investment in energy efficiency.

16. Based on these considerations, the Commission adopted the current RRIM to provide earnings approaching the lower end of the range of comparable supply-side earnings at a superior level of performance.

15. The purpose of a comparable earnings analysis is to provide a numerical benchmark for addressing these biases that favor supply-side resources, and not to prove or disprove the tautology of zero foregone shareholder earnings posed by DRA and TURN in this proceeding.

16. A comparable earnings benchmark recognizes that utilities as decision makers make day-to-day decisions on how to direct their resources and personnel that regulators cannot directly control or mandate.

17. Without an energy efficiency incentive, given the focus of investors and utility management on increasing shareholder value, utilities will on balance be more inclined to devote scarce resources to procurements on which they will earn a return, and not on meeting or exceeding the Commission's energy efficiency goals, or maximizing ratepayer net benefits in the process.

18. Knowing how much investors would have earned on supply-side procurements, if not for energy efficiency, is useful information: It helps the Commission to consider, among other factors, what level of earnings potential will be sufficient to overcome the biases in favor of supply-side resource procurement and achieve the policy objectives for energy efficiency.

19. Comparisons of the risk/reward profile for demand-side and supply-side resources are difficult to make, given the differing performance, earnings and investment characteristics of these resources. In addition to who funds the initial investment, there are multiple dimensions to the relative risk between supply- and demand-side resources (and that are changing over time), including (1) how shareholder earnings vary with project performance and (2) who bears the risk of non-cost effective investments.

20. The RRIM earnings rates of 9% and 12%, and the cap of $450 million, as adopted in D.07-09-043, were based upon assumed energy efficiency savings attributable to the 2006-2008 portfolio of measures in comparison to earnings on supply-side "steel-in-the-ground" resources otherwise foregone by pursuing energy efficiency programs. This cap was set at the lower end of the range of comparable earnings for supply-side resources, and the mechanism was structured so that the cap would be reached at a superior level of performance.

21. There is a trade-off between reductions in risk and the associated magnitude of earnings to provide a reasonable incentive for the IOU to pursue energy efficiency investments as a core business activity. The precise quantification cannot be reduced to a precise mechanical formula, but requires a reasoned judgment as to an appropriate adjustment to the potential RRIM award amount to recognize this reduced risk.

22. DRA's methodology to apply a 5% reduction for each discrete reduction in risk relative to the 2006-08 RRIM represents a reasonable approach to approximate the risk-reducing effects on the appropriate earnings potential from the incentive mechanism. A total risk-reduction factor of 20% is reasonable to apply based on the following four reductions of risk in the incentive mechanism adopted herein, relative to the mechanism adopted in D.07-09-043: (i) the change

from ex-post to ex-ante metrics for most values used to calculate the PEB, (ii) eliminating the MPS tied to goals, (iii) eliminating the potential for refunds of interim earning awards, and (iv) eliminating per-unit penalties tied to an MPS.

22. A reasonable approach to revising the RRIM earnings cap for 2010-2012 is to compare the ratio of energy savings ~~net benefit~~ estimates from the 2006-2008 cycle relative to corresponding estimates for the 2010-2012 cycle to determine the lower end of the range of comparable earnings for supply-side resources. This value should then be further reduced by 5% for each reduction in risk in the 2010-2012 incentive mechanism relative to the mechanism the Commission adopted in D.07-09-043. Although the 2010-2012 energy savings ~~net benefit~~ estimates have not been determined by the Commission an illustrative calculation can be made using IOU estimates. The resulting ratio of 0.87~~0.42~~ (= 6,381 GWh / 7,371 GWh~~$1.642/$3.919~~) yields a revised estimate of comparable supply-side earnings ~~cap value~~ of $390 ~~189~~ million on an illustrative basis derived as a function of the ratio of the net energy savings ~~benefits~~ for the 2010-2012 period divided by the net energy savings ~~benefits~~ for the 2006-2008 period, applied to the previous cap of $450 million. Reducing that value approximately 20% further to account for the reduction in risk in the 2010-2012 incentive mechanism yields an illustrative cap of approximately $300 million.

23. A reasonable approach to determine the shared savings rate is to first establish a reasonable earnings opportunity and then determine the shared savings rate as the ratio of the earnings opportunity to the forecast net benefits. A reasonable earnings opportunity can be determined by starting with the earnings the Commission expected to provide at 100% of goals in D.07-09-043 ($323 million), adjusting that value by the ratio of the energy savings (at 100% of goals) in 2010-2012 relative to 2006-2008, and reducing that value further to account for the reduced risks in the 2010-2012 incentive mechanism. This approach yields an earnings opportunity at 100% of goals of approximately $172 million (=$323 million * 4,393 GWh / 6,599 GWh * 0.8), or approximately half the magnitude of potential earnings as the mechanism adopted in D.07-09-043. The shared savings rate to provide this earnings opportunity is in the range of 12% to 15%.

~~23. The DRA calculation of a revised RRIM shared savings rate of 5.4% results from adjusting for the reduced level of DRA-estimated net benefits for the 2010-2012 cycle, and further adjusting for DRA's assessment of reduced investor risk associated with prospective changes in the design of the RRIM formula.~~

24. This ~~The DRA~~ methodology provides a reasonable approach to calculating a risk-adjusted earnings opportunity~~reduced shared savings percentage~~, subject to further adjustment by applying the Commission's subsequent determination of 2010-2012 ex ante values in A.08-07-021 et al.

~~25. A reasonable approach to adjusting the 2010-2012 RRIM earnings cap is to apply the ratio of net benefits from the 2006-2008 cycle to the ratio of net benefits from the 2010-2012 cycle, multiplied by the earnings cap that applied for the 2006-2008 cycle. Based upon the transfer of non-resource programs and customized measures to a separate incentive mechanism, it is reasonable to exclude non-resource programs and customized programs in calculating the revised RRIM earnings cap.~~

26. Since the ex-post updates will be much more limited, it is not necessary to change ~~As a means of mitigating the risk of overcompensation of RRIM earnings, it is reasonable to increase~~ the hold-back percentage of RRIM earnings. ~~to 50% calculated for the first and second interim years, subject to a~~A third-year true up will be based on Energy Division's evaluations of installations and actual program ~~incremental measure~~ costs.

27. An annual application filing is a reasonable procedural vehicle whereby each of the IOUs may request recovery of their RRIM earnings claims pursuant to the modified protocols adopted in this decision.

Conclusions of Law

1. The protocols and processes for administering and implementing the RRIM should be modified in order to correct identified deficiencies, and to better align the mechanism with the Commission's goals and objectives relating to the achievement of energy efficiency in a manner that is cost effective to ratepayers.

2. The adopted revisions as set forth in the order below should be adopted to take effect immediately for purposes of determining incentive awards for the 2010-2012 program cycle, and any further program years if the Commission decides to extend the program cycle, in accordance with the processing schedule adopted below.

3. In the interests of moving forward with a new mechanism in a timely manner, ~~no~~ RRIM awards or penalties ~~should be pursued~~ for calendar year 2009 bridge funding programs will be assessed in the same manner that the Commission resolves the 2006-2008 RRIM.

4. A separate incentive mechanism for non-resource programs should be pursued through a new rulemaking. The prospective RRIM for the 2010-2012 cycle should accordingly be limited to resource programs only.

5. Metrics adopted through the PPMs advice letter process, pursuant to D.09-09-047, shall not prejudge the Commission's consideration of specific metrics that should apply to an incentive mechanism for non-resource programs.

6. Any further revisions in the RRIM that may be appropriate to implement beyond the 2010-2012 cycle, or beyond the final date of the program cycle, if extended, should be taken up in a new rulemaking.

7. In order to recognize the reduced level of expected ~~resource~~ energy savings relative to the 2006-2008 cycle, and to recognize the reduced risks associated with the revised RRIM design measures adopted herein, the earnings cap and expected earnings opportunity ~~shared savings rate~~ should be reduced accordingly. The shared savings rate should be set to provide that earnings opportunity. Potential earnings of $172 million at 100% of goals (approximately 50% lower than the expected earnings opportunity in D.07-09-043), provided by a shared savings rate in the range of 12% to 15% ~~The DRA calculation of a shared savings rate of 5.4%~~ provides an illustrative calculation of a reasonable methodology for revising the shared savings rate.

8. A three-year earnings cap of approximately $300 ~~$189~~ million reasonably illustrates an appropriate adjustment to the $450 million cap for the difference in estimated energy savings ~~net benefits~~ between the 2006-2008 and 2010-2012 cycles, and the reduced risks associated with the revised RRIM design measures adopted herein ~~subject to exclusion of customized projects~~.

ORDER

IT IS ORDERED that:

1. The Risk/Reward Incentive Mechanism is hereby amended to incorporate the following revisions to take effect for purposes of determining incentives for the 2010-2012 performance cycle. Except as explicitly noted below, the previously adopted Risk/Reward Incentive Mechanism provisions remain effective for the 2010-2012 cycle.

2. ~~No p~~Penalties or incentive earnings shall be assessed for calendar year 2009 energy efficiency bridge funding program activities in the same manner that the Commission resolves the 2006-2008 RRIM.

3. The revisions to the mechanism adopted in this decision shall become effective for program activities for the 2010-2012 program cycle and any further program years if, in a subsequent decision, the Commission extends the current program cycle. Incentive claims for calendar year 2010 activities shall be processed in accordance with schedule adopted below.

4. For purposes of computing the Performance Earnings Basis used to derive 2010-2012 RRIM earnings, the Database of Energy Efficiency Resources and non- Database of Energy Efficiency Resources ex ante assumptions of per-measure efficiency savings underlying the savings goals yet to be adopted in A.08-07-021 et al. shall subsequently remain frozen for the duration of the 2010-2012 cycle. The Performance Earnings Basis shall be trued-up only to recognize actual energy efficiency measures installed and to reflect actual program ~~incremental measure~~ costs incurred at the end of the cycle.

5. The shared-savings percentage rate applied to derive incentive earnings shall no longer be linked to a specific minimum performance standard. Incentive earnings shall accrue as a uniform flat rate percentage of the Performance Earnings Basis. No penalty provision linked to specific minimum performance standards shall apply. However, the "cost-effectiveness guarantee" penalty will continue to apply.

6. The Performance Earnings Basis shall exclude the budgeted costs of non-resource energy efficiency programs ~~and customized projects adopted for the 2010-2012 cycle~~. Subsequent inquiry shall be conducted to determine an appropriate ~~allocation of~~ incentive mechanism ~~earnings~~ for non-resource programs ~~and customized projects~~ through a separate rulemaking.

7. The incentive earnings potential for the 2010-2012 cycle shall be adjusted to recognize the reduced investor risks relating to the redesigned elements adopted in this decision, and also to recognize the reduced levels of energy ~~efficiency avoided cost~~ savings in comparison to corresponding levels for the 2006-2008 cycle utilizing the following methodology: ~~proposed by Division of Ratepayer Advocates.~~

a. The $323 million earning opportunity the Commission adopted in D.07-09-043 at 100% of goals shall be multiplied by the ratio of net energy savings at 100% of goals in 2010-2012 to the net energy savings at 100% of goals expected in 2006-2008;

b. That value will be multiplied by 0.8 to account for the reduced risk of the incentive mechanism adopted herein;

c. That value will be divided by the expected net benefits at 100% of goals for 2010-2012 to determine the shared savings rate.

8. The incentive earnings cap for the 2010-2012 cycle shall be reduced ~~by~~ from the level that applied for the 2006-2008 cycle to reflect the lower level of energy ~~resource~~ savings relative to the prior cycle, and the reduced risk associated with the mechanism adopted herein utilizing the following methodology:

a. The $450 million cap the Commission adopted in D.07-09-043 shall be multiplied by the ratio of forecast net energy savings from the 2006-2008 cycle relative to the forecasted net energy savings for the 2010-2012 cycle;

b. That value will be multiplied by 0.8 to account for the reduced risk of the incentive mechanism adopted herein to determine the cap.

~~This cap amount shall exclude the budgeted amounts for 2010-2012 non-resource. An allocation of 1/3 of the cap shall apply to each year of the 2010-2012 cycle.~~

~~9. The IOUs shall apply a reduced shared savings percentage to reflect the reduced investor risks and lower potential resource savings for the 2010-2012 cycle relative to the 2006-2008 cycle. The methodology proposed by DRA is adopted for purposes of quantifying the reduction in shared-savings earnings adjusted for risk.~~

10. In accordance with the schedule in Attachment 6 of D.07-09-043, each investor-owned utility shall submit its Measure and Cost Report covering calendar year 2010 to Energy Division by February 29, 2011. The IOUs will submit formal applications as the vehicle to request recovery of their 2010 RRIM earnings claims by September 15, 2011.

11. As part of their applications for interim RRIM awards to be filed in 2011, each of the IOUs shall provide a calculation of the revised shared savings rate and cap, utilizing the 2010-2012 energy savings ~~net benefits~~ values to be adopted in A.08-07-021 et al., using the methodology set forth ~~in DRA's proposal, as illustrated~~ above. Based upon the shared savings rates and cap so derived, the IOUs shall calculate the amount of RRIM earnings or penalties they are due or owe for calendar year 2010 programs.

12. The Energy Division will not be required to review the first and second year RRIM interim claims of installations and costs, but shall be required to evaluate and verify installations and costs as part of the third-year true-up.

13. This decision provides final resolution of issues pending in this rulemaking. Any subsequent changes in the incentive mechanism or separate implementation of an incentive mechanism for non-resource programs shall be addressed through a separate rulemaking.

14. Any further issues necessary to design and implement a separate mechanism for incentives to promote the development of non-resource program ~~and customized project incentive~~ goals shall be addressed in a new rulemaking.

15. Rulemaking 09-01-019 is closed.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"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 6, 2010 at San Francisco, California.

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