BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Reform the Commission's Energy Efficiency Risk/Reward Incentive Mechanism.	**Rulemaking 12-01-005 (Filed January 12, 2012)**

COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U39M) ON ADMINISTRATIVE LAW JUDGE'S RULING CALLING FOR COMMENTS ON INCENTIVE REFORM

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Pacific Gas and Electric Company (PG&E) responds to the *Administrative Law Judge's Ruling Calling for Comments on Incentive Reform Issues*, dated June 15, 2012 (ALJ Ruling). The ALJ Ruling allows parties to file comments by July 16, 2012.

I. INTRODUCTION

PG&E supports the Commission's direction to align a fair and efficient risk/reward incentive mechanism (RRIM) with long-term energy efficiency goals. As noted by the Commission in its *Decision Providing Guidance on 2013-2014 Energy Efficiency Portfolios and 2012 Marketing, Education and Outreach* (D.12-05-015 or the "Guidance Decision"): "The unifying objective of the Strategic Plan was to compel sustained market transformation to move California towards long-term, deeper savings achievable only through high-impact programs."[1/] PG&E firmly supports this objective.

On July 2, 2012, PG&E filed its *Application for Approval of 2013-2014 Energy Efficiency Programs and Budget* (A.12-07-001) (Application) which proposes a cost-effective portfolio with a greater emphasis on deeper, lasting savings programs and market transformation to meet the Commission's energy savings goals and support State Energy Policy.

1/ D. 12-05-015, p. 6.

In these comments, PG&E proposes additional incremental changes to the methodology used to calculate the RRIM to help further achieve the Commission's goal to encourage and reward the utilities for achieving deeper energy savings. PG&E also supports a separate performance-based mechanism for non-resource programs. These incremental changes to the most recent RRIM will reward deeper energy savings and achievement of both energy savings and market transformation goals without the need to have a separate incentive mechanism for short-term and long-term energy savings.

II. THE RRIM SHOULD SUPPORT THE PRINCIPLES IN THE ALJ RULING

PG&E supports the criteria for an effective incentive mechanism described in Energy Division's 2009 White Paper[2/] (White Paper), which was summarized in the ALJ Ruling. A RRIM should be, "simple, transparent, meaningful and timely."[3/] PG&E proposes incremental changes to the most recently applied RRIM to embody the criteria described in the White Paper. A summary of PG&E's complete proposal is included in Attachment A and the proposed incremental changes are discussed below.

A. The RRIM Should Reward The IOUs For Achieving Cost-Effective Energy Savings.

Two primary benefits of an energy efficiency portfolio are: (1) reduced procurement costs; and (2) environmental benefits. A well-designed RRIM should, as its main objective, provide a meaningful earnings opportunity for achievement of cost-effective energy savings. PG&E agrees with the Commission that "[b]y aligning shareholder and consumer interests through todays adopted incentive mechanism we create a "win-win" regulatory framework for energy efficiency."[4/] An effective RRIM

2/ April 2009, "White Paper: *Proposed Energy Efficiency Risk-Reward Incentive Mechanism and Evaluation Measurement & Verification (EM&V) Activities.*"

3/ PG&E Opening Comments in R.12-01-005 (February 2, 2012).

4/ D. 07-09-043, p. 2.

will provide an incentive for the utility to deliver cost-effective energy savings benefits that are shared among customers and the utility. Most savings benefits should be enjoyed by customers, while a fair and meaningful share should be provided to shareholders to promote superior program administration and performance by the utility.

B. PG&E's 2013-2014 Application, Consistent with the Guidance Decision, Promotes Deeper Energy Savings.

The ALJ Ruling asks parties to address whether the RRIM should be revised to provide a greater incentive for achieving measures with deeper energy savings.[5/] A RRIM that is largely based on a shared-savings mechanism, coupled with a properly-designed portfolio, would reward PG&E for achieving longer-lasting energy savings without creating separate incentive mechanisms for short-term and long-term energy savings measures. Designing the RRIM to include separate savings rates for long-term versus short-term measures would also create an unduly complicated process and thus would not achieve the goal of a simplified RRIM identified in the White Paper.

The Guidance Decision includes substantial directions for the preparation of the utilities' 2013-2014 energy efficiency portfolios.[6/] The Commission instructed the utilities to increase energy savings through long-term, deeper savings achievable only through high-impact programs.[7/] PG&E designed its 2013-2014 portfolio to achieve deeper energy savings than were achieved in prior years. Specifically, PG&E proposed to expand deep retrofit strategies with increased support for programs that promote deeper residential and non-residential retrofits.[8/] PG&E's Application, if approved, will encourage customers to achieve deeper energy savings by bundling measures and

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5/ ALJ Ruling, p. 3.

6/ *Decision Providing Guidance On 2013-2014 Energy Efficiency Portfolios And 2012 Marketing, Education, And Outreach*, D. 12-01-015.

7/ *Id.*, p. 6.

8/ See PG&E's Prepared Testimony, pp. 2-7, 4-2.

encouraging continuous energy improvements, innovative auditing, and a comprehensive whole building approach to commercial building energy efficiency. In support of these efforts, PG&E proposed budget increases for both the Whole Home Upgrade Program (WHUP) (formerly known as Energy Upgrade California) and non-residential calculated subprograms.

The Guidance Decision includes a significant change to energy calculations to reward the utilities for achieving longer- lasting savings. The Guidance Decision adjusts the discount rate to more appropriately value longer-lasting measures and encourage the utilities to pursue these measures.[9/] This change also encourages the utilities to pursue measures with deeper energy savings.

III. PG&E PROPOSES INCREMENTAL CHANGES TO THE RRIM TO BETTER ACHIEVE COMMISSION GOALS

While various shared-savings mechanisms proposed by parties have differed slightly, the mechanisms are aligned in that they each propose to value achievement of energy savings and share the benefits among customers and shareholders.[10/] Most proposed mechanisms also support a separation between resource and non-resource programs, and recommend separately rewarding performance for goal achievement in each area.[11/] PG&E continues to propose a RRIM for the 2013-2014 portfolios based on a shared-savings model for resource programs, and incorporates improvements that reward achievement of a wide range of portfolio goals for non-resource program elements. PG&E's proposal is summarized in Attachment A.

9/ D. 12-05-015, OP 2 "Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company shall use the new avoided cost calculator (which includes the recommended data inputs) and the after-tax Weighted Average Cost of Capital as the discount rate."

10/ PG&E, NRDC, TURN, SDG&E and SCG Opening Comments dated February 2, 2012 propose shared-savings mechanisms and a separate mechanism for non-resource program achievements.

11/ *Id.*

A. The Shared-Savings Mechanism Supports Superior Achievement of Cost-Effective Energy Efficiency Savings.

A RRIM should support superior program performance by creating a "win-win" scenario that shares cost savings from the programs among customers and shareholders, with customers garnering most of the benefits. As the Commission has recognized, a shared-savings mechanism is key to achieving this goal.[12/] A shared-savings mechanism is an important component of a broader mechanism that rewards energy savings as well as non-energy savings achievements. To this extent, PG&E proposes continued use of a shared-savings mechanism at a rate of 7% based on *ex-ante* values.[13/] After a thorough analysis in D. 07-09-043, the Commission determined that "Establishing the level of earnings for a shareholder risk/reward incentive mechanism is ultimately a judgment call that the Commission must make, and not a precise science."[14/] PG&E agrees and notes that there are many variables in an equation to establish a supply-side equivalent rate that provides a fair return. This approach is largely aligned with all previously proposed shared-savings mechanisms and promotes the achievement of the Commission's energy efficiency goals for 2013 and beyond. The Commission should continue to use a prescriptive process similar to that in D. 10-12-049 as it significantly simplified the claim review process.[15/]

12/ "Ensuring sustained and successful commitment to energy efficiency is best accomplished by moving away from a cost-of-service compliance regulatory framework, to one that will create a "win-win" alignment of shareholder and ratepayer interests. Today's decision creates incentives of sufficient level to ensure that utility investors and managers view energy efficiency as a core part of the utility's regulated operations that can generate meaningful earnings for its shareholders." D. 07-09-043, p. 4.

13/ A shared-savings rate of 7% is substantially less than the supply-side equivalent number. The Commission approved the 7% shared-savings rate in D. 10-12-049 and PG&E proposes to retain this amount to expedite approval of a RRIM.

14/ D. 07-09-043, FoF 92, p. 198.

15/ D. 10-12-049, p. 63.

B. Incremental Changes to the RRIM Will Support Deeper Savings And Market Transformation

PG&E proposes three areas for improvement to the most recent RRIM, including the method for valuing energy savings and rewarding achievement of programs that are not measured in kW, kWh or Therm savings to encourage deeper energy savings. PG&E continues to support the current mechanism with the following recommended improvements to achieve a mechanism more aligned with Commission policy: (1) exclusive use of Program Administrator Cost (PAC) test; (2) removal of the existing useful life (EUL) cap of 20 years to align the mechanism with deeper savings goals; and (3) creation of separate resource and non-resource program mechanisms with a non-resource program performance adder.

1. The Commission Should Solely Use the Program Administrator Cost Test to Calculate The Performance Earnings Basis.

To appropriately align the mechanism with deeper savings goals, the Commission should use the PAC test exclusively, instead of using both the PAC and total resource costs (TRC) tests to calculate the Performance Earnings Basis (PEB). The exclusive use of a PAC test removes incremental measure costs from the PEB calculation. This would make long-lasting measures, which typically have high incremental measure costs, more attractive under the PAC test. Further, the non-energy benefits, like the incremental measure costs, are often difficult to measure or incorrectly captured in the cost calculations. Finally, using only the PAC, rather than a combined PAC/TRC test simplifies the mechanism.[16/]

16/ "The alternative to the two options for fixing the TRC is to replace it with a different test, specifically the PACT. This approach has a number of advantages. First, it is much simpler. There is no need to quantify non-energy benefits, which means much less complexity and controversy. Second, it is much less expensive. Not only do we not need to add potentially enormous new evaluation costs, we can even modestly reduce some existing expenditures because we no longer need to routinely estimate the full cost of efficiency measures since the PACT is concerned only with program spending. Third, this approach would create some symmetry with how supply-side investments are assessed. Finally, while one should not underestimate the difficulties in persuading regulators to change the test that they use, for all of the reasons noted above we expect this approach could be adopted more easily, more comprehensively and more quickly than the

2. The Commission Should Remove The Cap on the Existing Useful Life (EUL).

PG&E also proposes to remove the EUL cap of twenty years to support achievement of deeper energy savings. Removing this cap will more appropriately value measures with EULs exceeding twenty years. Many of these long-life measures are in programs that will be promoted in the 2013-2014 portfolio, including WHUP measures. Removing the artificial EUL cap of twenty years is essential to encourage measures that support the State's energy efficiency goals, including zero-net energy goals.

3. The Commission Should Approve A Performance Adder For Non-Resource Programs.

A shared-savings mechanism, or a resource program-based incentive, should be separated from a non-resource incentive to create an incentive mechanism framework that rewards achievement in both areas without having one negatively affect the other. The mechanism should evaluate resource benefits from a resource program perspective, and non-resource benefits from a non-resource program perspective. To do this, the mechanism must separate out costs associated with the non-resource programs from the resource program calculation. This change would eliminate any motivation to spend less on non-resource programs to achieve greater resource program benefits.

PG&E agrees with other parties and the Commission that it is reasonable to consider a separate incentive mechanism for non-resource programs as these activities are an important part of the energy efficiency portfolio, provide long-term market transformation benefits, and require significant efforts.[17/] Specific metrics can be identified for these non-resource programs, and included in an incentive mechanism design. Achievement of these metrics should be rewarded to align performance incentives with broader portfolio goals. This change was previously recommended by

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other options discussed above." 2010 ACEEE Summer Study on Energy Efficiency in Buildings, *Is it Time to Ditch the TRC? Examining Concerns with Current Practice in Benefit-Cost Analysis*, p. 5-308.

17/ ALJ Ruling, p. 4.

NRDC, SDG&E, and SoCalGas.[18/] PG&E also supports having workshops as proposed by NRDC, SCE, and SDG&E/So Cal Gas, to develop the non-resource portion of the incentive mechanism. PG&E proposes the parties work collectively to create guidelines for non-resource market transformation program metrics.

PG&E recommends the parties determine the number of metrics, the appropriate incentive level, and the specific metrics for the non-resource programs incentive. PG&E recommends between five and ten easily measurable and verifiable metrics related to market transformation programs. This number of metrics ensures the mechanism is feasible, timely, simple and transparent – all qualities of an effective mechanism identified in the White Paper. These metrics should encourage market transformation, including emerging technology, zero net energy, increased contractor and program participant outreach and other market transforming areas. An appropriate and reasonable incentive level for these metrics is 3% of the budget, which is modest compared to administrative incentive adders in other states.[19/]

Incorporation of these incremental changes to the current RRIM mechanism best positions the mechanism to support deeper savings, market transformation program goals and cost-effective energy savings in a "win-win" approach for customers and shareholders. Additionally, the proposed changes simplify the mechanism calculations and more closely align the mechanism with the criteria in the White Paper.

18/ SDG&E/ SoCalGas Opening Comments (Feb 2, 2012), p. 6; NRDC Opening Comments (Feb. 2, 2012), p. 2.

19/ 2011 ACEEE, *Carrots for Utilities: Providing Financial Returns for Utility Investments in Energy Efficiency*, p. 12 shows program cost mechanisms up to 15%.

IV. RESPONSE TO QUESTIONS IN ALJ RULING

A. *What alternative approaches, performance metrics, and related formulas could be utilized to derive incentive earnings in a more transparent, streamlined, and less controversial manner while promoting energy policy goals?*

The Commission recognized the simplicity and transparency achieved through the use of *ex ante* values. Similarly, PG&E recommends moving to a 100% PAC calculation as this reduces evaluation, measurement and verification (EM&V) needs, simplifies the overall equation and more closely aligns the mechanism with policy goals for deeper savings. Additionally, PG&E recommends removing the EUL cap of 20 years as this will increase cost-effectiveness of longer-lasting deeper savings measures. EM&V would continue to play an essential role but would be forward looking to design programs to meet the needs of energy policies and of customers. PG&E also recommends separating resource and non-resource programs to reward achieving both energy savings and market transformation benefits. Last, PG&E recommends a limited number of performance metrics be developed in workshops with all parties to ensure goals are strategically designed, feasible, timely to implement, simple and transparent.

B. *Based on the performance metrics and formulas identified in the preceding question, what level of (and limits on) incentive earnings should be established for such metrics, both individually and collectively? What governing principles and empirical data should be applied to determine relevant performance metrics and formulas?*

A shared-savings rate of 7% and a performance adder of 3% for non-resource programs would reward the utilities for aggressive achievement of energy efficiency goals while providing most of the savings to customers. The empirical data and relevant performance metrics and formula would be separated between resource programs – a shared-savings rate – and non-resource programs – a performance adder for achievement of non-resource program metrics. The resource program mechanism would be a 7% shared-savings rate applied to a PAC-based PEB for resource programs, including only resource program costs to remove the counter-intuitive aspect of the previous mechanism.

The non-resource mechanism would be a 3% performance adder for non-resource programs where 3% of non-resource program spend would be paid as an incentive for achievement of pre-determined non-resource program metrics. These non-resource program metrics would be limited in number, easily verifiable and notable towards achieving long-term energy efficiency goals in California.

C. *What threshold level of earnings is necessary to motivate IOU management to maintain a commitment to EE as a core part of regulated operations? What relevant metrics or financial measures identify the appropriate limits on RRIM earnings to meet this threshold? (e.g., parity with earnings from supply-side resources, percentage of operating earnings or earnings per share, etc.)*

PG&E's RRIM earnings for the 2006-2008 portfolio cycle were $104 million. While it is difficult to determine an appropriate minimum threshold level of incentive earnings, PG&E recommends the RRIM continue to be based on a supply-side equivalent investment to place investment in energy efficiency on equal footing with supply-side investments from a business perspective. Equally important, earnings under an incentive mechanism should be predictable, the methodology used to calculate the earnings should be transparent, and earnings should be calculated on a regular annual basis to maximize their impact on the utilities' core regulated operations.

D. *What limits or caps on earnings are appropriate to ensure that customers are protected in terms of just and reasonable rates and that they receive appropriate benefits to justify payment of incentives?*

PG&E supports an earnings cap that rewards achievement while providing protection for customers. The shared-savings mechanism provides the majority of benefits to customers and a small portion to IOU shareholders. The previous mechanism provided customers with 93% of the benefits and shareholders 7% of the benefits. PG&E supports a cap for resource programs of 1.5 times the filed PEB and a cap on the non-resource programs equal to 3% of the approved budget for non-resource programs.

E. ***Is supply-side equivalent earnings an appropriate proxy for the magnitude of incentive earnings levels, considering both peak load and energy consumption load impacts separately and the anticipated medium-term need for generation to integrate renewable resources and replace once-through-cooling plants in load pockets, rather than generation to meet system-wide peak? Do other measures better represent the avoided costs and net benefits of energy efficiency to customers?***

The supply-side comparability is an important aspect of the RRIM. "From a business perspective, the ability to earn a return for successful energy programs helps place energy efficiency programs on an equal footing with other supply side and capital investments, which do offer the opportunity for such returns."[20/] The Commission recognized this in D.07-09-043, stating that a shared-savings based mechanism will "produce a 'win-win' alignment of customer and shareholder interests in achieving least-cost, integrated resource planning objectives."[21/] A mechanism with comparable earnings to the avoided supply-side earnings creates an appropriate incentive for utilities to make economically rational decisions to pursue energy efficiency measures rather than generation assets. As the Commission discussed, the shared-savings ". . . represents the substantial cost savings created by displacing more expensive supply-side alternatives with energy efficiency, resulting in lower utility revenue requirements and lower customer bills."[22/] The supply-side comparability is an important and appropriate comparison as it incorporates the economically rationale decision making process of management from an earnings perspective with the customer energy savings resulting from the energy efficiency programs.

20/ PG&E Comments in R.09-01-019 (September 23, 2011), p. 4.

21/ D. 07-09-043, p. 60.

22/ *Id.,* p. 3.

F. ***What degree of ex post independent evaluation and verification is warranted as the basis for the Commission to determine the amount of, or timing of, payment of incentives under a revised mechanism? Should metrics be limited to verifying the actual number of installations and total costs?***

Ex-post verification should be limited to verifying the actual number of installations and total costs. The ability of a utility to execute achievement towards its goals should be based on the *ex-ante* values used to set the portfolio. The Commission has established the foundation for a mechanism based on the following principles "Timely, Fair and Cost-Efficient, and Simple and Transparent."[23/] Using *ex-ante* values would ensure timely review as significant delays are often associated with *ex-post* values. It is a fair approach as it measures the utilities' performance against established goals, and it is the simplest and most transparent measurement tool as all parties know and have agreed to the values in advance. This is consistent with Commission direction in Decision 10-04-029 to use *ex-ante* values to develop a "more transparent, more streamlined and less controversial RRIM program."[24/]

V. CALCULATION OF THE RRIM

In the *Order Instituting Rulemaking To Reform The Commission's Energy Efficiency Risk/Reward Incentive Mechanism*, issued January 19, 2012 (OIR), the Commission requested the utilities to calculate an equivalent supply-side earnings. The ALJ Ruling requests an update on these values.

PG&E's calculations below use the same supply-side assumptions as were used in its February 2, 2012 comments and are based on the RRIM as most recently applied by the Commission to the 2009 incentives claims. PG&E has updated the calculations consistent with its forecast savings, budget and PEB in its Application.

23/ *Order Instituting Rulemaking*, R.09-01-019, pp. 4-5 (February 4, 2009), cited by the Commission with approval in D.10-12-049, p. 5 (December 27, 2010).

24/ *Id.*

1. *Identify the energy savings associated with the 2013-2014 portfolio:*

In PG&E's Application, the total benefits associated with the portfolio are:[25/]

Table 1 Forecast Energy Savings Associated with PG&E's Proposed 2013-2014 Portfolio			
	MW	GWh	Therm
2013	126	818	17
2014	132	823	18
Total	258	1,641	35

2. *Provide the 2013-2014 PEB based on expected benefits and budget*

The filed PEB for 2013-2014 is $426.8M, based on the energy savings from Appendix D to PG&E's July 2, 2012 testimony in support of its Application and the benefits from the E3 calculator based on the forecasted energy savings from step 1.

Table 2 Calculation of Performance Earnings Basis Associated With 2013-2014 Portfolio				
	Benefits ($)	TRC Costs ($)	PAC Costs ($)	PEB ($)
2013-2014 Total	1,467,455,342	1,164,214,131	793,674,554	426,754,401

3. *Calculate the equivalent supply-side resources:*

PG&E used its previous supply-side equivalence calculation model[26/] with updated assumptions as discussed previously to calculate 2013-2014 earnings avoided by energy-efficiency programs.[27/] The table below represents the avoided earnings.

25/ See PG&E's Prepared Testimony, Appendix D.

26/ *See* PG&E's foregone earnings model filed on September 8, 2006: PG&E's Post-Workshop Comments and Updated Proposal on Energy Efficiency Shareholder Risk/Reward Incentive Mechanisms, Attachment A – Analysis of Foregone Supply-Side Earnings, revised as described for Version C in Chapter 2 of PG&E's May 17, 2007 filing in R.06-04-010.

Table 3 Forecast of Incentive Revenue of Supply Earnings ($ Millions)	
Supply-side generation (utility owned)	$76
Supply-side generation from PPAs	$16
T&D	$56
2013 – 2014 Supply-side Incentive Revenue Requirement	$148

4. *Calculate the RRIM shared-savings percentage rate required to yield the supply-side equivalent earnings:*

The RRIM shared-savings percentage rate is then calculated by dividing the supply-side equivalence of the 2013-2014 portfolio ($148 million as derived in step 3) by the 2013-2014 PEB of $426 million derived in step 2. The result is 34.8%.

The same calculation using PG&E's proposed mechanism, including a split resource/non-resource mechanism and PAC only test, produces a PEB of $804M and a supply-side equivalent shared-savings rate of 18.4%.

VI. NEXT STEPS

PG&E requests that the Commission issue a final decision on the 2013-2014 RRIM before December 2012 so that the 2013-2014 cycle can commence with certainty about the new RRIM. This will reduce potential future controversy, and allow the mechanism to function as it should to motivate increased savings. The Commission should immediately schedule a workshop to determine the non-resource program metrics for inclusion in the RRIM before year end. In addition, the Commission should issue a decision clarifying the applicability of the 2009 RRIM for 2010-2012, so the utilities can timely file incentive calculations for the 2010-2012 program cycle.

27/ PG&E's Comments in R. 12-01-005 (February 2, 2012), pp. 16-18.

VII. CONCLUSION

PG&E appreciates this opportunity to provide comments on the 2013-2014 energy efficiency incentive mechanism.

Respectfully submitted,

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Attachment A

PG&E Proposed 2013-2014 RRIM Mechanism

Split Mechanism:

- Resource Program portion, 7% shared savings rate
- Non-Resource Program portion, Program Metrics with 3% Spend Adder

Overarching:

- Cost-effectiveness guarantee
  - IOU incentives occur only after portfolio is cost-effective on a Program Administrator Cost (PAC) basis
  - IOU incentive is included in in cost-effectiveness calculation, but not in determining Performance Earnings Base (PEB)
- No penalty
  - cost-effectiveness guarantee ensures no reward unless portfolio is cost-effective
- Earnings Cap 1.5x filed PEB plus 3% non-resource program spend
  - Earnings cap rewards superior program performance while retaining customer protection against rate pressure

Resource Portion:

- Shared-savings mechanism of 7%
  - 7% multiplied by filed PEB
  - PEB = resource program benefits – resource program PAC costs
  - Commission litigated 7% in D. 10-12-049
- PAC cost-effectiveness test exclusively
  - Removes combined TRC and PAC calculation and aligns policy of pursuing deeper savings programs with appropriate incentive signal
- No Minimum Performance Standard
  - Incentives occur when portfolio is cost-effective simplifying the mechanism
- Use *ex ante* values with verified installations and costs

Non-Resource Portion:

- 5-10 measurable metrics
  - Metrics must be easily measurable and aligned with principles as recommended in Energy Division's White Paper
  - Metrics determined through workshop
- 3% of non-resource spend paid in incentive if metrics achieved

Change from PG&E's proposed 2013-2014 incentive mechanism (Reply Comments Filed February 16, 2012)

- Removes proposal to measure savings on a gross basis
  - Creates further alignment between PG&E's and other parties' proposed mechanisms