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 SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) AND SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) ON ADMINISTRATIVE LAW JUDGE'S RULING CALLING FOR COMMENTS ON INCENTIVE REFORM ISSUES

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I.
INTRODUCTION

Pursuant to direction provided in the June 15, 2012 Administrative Law Judge's Ruling Calling for Comments on Incentive Reform Issues ("Ruling"), San Diego Gas & Electric Company ("SDG&E") and Southern California Gas Company ("SoCalGas") (also referred to as the "Joint Utilities") respectfully provide their comments and modified proposal regarding the Risk/Reward Incentive Mechanism ("RRIM").

II.
GENERAL OVERVIEW

The hallmarks of Commission approved incentive mechanisms that have worked well are: 1) an agreed-upon goal; 2) an agreed-upon benchmark of performance; 3) clear measurement and ease of calculation of results; and 4) a level of incentives that the Commission has determined is in proportion to the benefits accruing to ratepayers. The Gas Cost Incentive Mechanism ("GCIM") approved for SoCalGas and in continuous operation since 1994 is an example of such a mechanism. There was a clear goal – reducing the cost of procuring gas for customers; a clear market benchmark in monthly and daily gas price indexes; clear measurement of results in the average price of gas purchased; a level of incentives proportional to the benefits accruing to customers, which are easily calculated. Other policy considerations entered into consideration also during the energy crisis, namely protecting customers from market price spikes. Consequently, SoCalGas undertook hedging to successfully protect its customers which led to larger than usual shareholder incentive amounts during that unique period of California energy history. As a result, the GCIM mechanism was modified to cap the shareholder incentive

amounts and to exclude certain specified hedging costs incurred on behalf of customers and the resulting hedging benefits, but the GCIM nevertheless retains the four attributes described above.

A RRIM based on *ex ante* assumptions then, can serve its intended purpose in terms of motivating superior performance in the utility acquisition of energy efficiency savings. But in order to do so there has to be: (1) the clear goal - achieving energy savings; (2) a clear benchmark for energy savings - *ex ante* savings assumptions established prior to the planning and the execution of the energy efficiency program; (3) measurement of results, i.e. clear, simple accounting standards for measurement of program energy savings based on the verified installations; and (4) a level of incentives that the Commission determines is proportional to the ratepayer benefits. Clearly, the consumption of parties' resources used in and the unnecessary distractions caused by the Quixotic, pursuit of perfect Evaluation, Measurement & Verification ("EM&V") for its own sake must be avoided in the future by firmly establishing *ex ante* values for all measures including custom measures.[1] And a more limited cap compared to the 2006-2008 RRIM may be needed to avoid the sideshow of wrangling over uncertain savings amounts and unreliable net-to-gross ratios. Best estimates are more likely to occur where regulators and other stakeholders are not so preoccupied with the magnitude of potential rewards in the face of the uncertainty of measured benefits.

Further, a long-term shared savings approach with *ex ante* assumptions is compatible with "learning-by-doing" market transformation. Initially, the cost effectiveness of such a measure or program may be marginal, but as that EE measure becomes more widely adopted due to utility EE program support, the cost effectiveness improves as the cost drops. Evidence of market transformation can be measured by increased gross savings per dollar expense for a measure combined with a changing net-to-gross ratio over time. Using ex ante assumptions for savings and the net-to-gross ratio allows the utility to be rewarded for successful market transformation. In the current cycle, the adoption of the measure increases as "learning-by-doing" occurs and the price drops. In the next cycle, the cost effectiveness increases as the price of the technology or measure drops, but this is partially or fully offset by the decreased net-to-gross ratio that lowers the earnings basis. As the Commission stated in D.01-01-060 Conclusions of Law 12 and 13:

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[1] EM&V results should be used to update and inform the future program cycle.

12. "It is reasonable to adopt the utilities' proposed overall milestone structure and the weighting of awards 80% for energy savings, 10% for market effects, and 10% as a performance adder for information programs, to require that the weighting be standardized for all utilities, and to require that incentives total 100% and not 110% of the previously adopted 7% performance award cap."

And 13. "It is reasonable to set the energy and demand savings portion of the milestones to absolute savings targets to ensure that each utility has a clear goal and clear metrics for earning shareholder incentives and so that the incentives will be based on an appropriate balance of 'risk and reward'."

Other types of market transformation are not amenable to an incentive mechanism. Education programs aimed at influencing customer preferences, reducing market barriers such as facilitation of financing, etc. fail to provide a clear benchmark. True market transformation is a function of the "entire" market participating in creating changes. The utilities' programs seed the beginnings of market transformation, but true and permanent changes in the market result from changes in manufacturing, distribution, retail and customer acceptance, which are not controlled by the utilities.

At best a market transformation mechanism would be based on market indicator-type milestones that would relate to specific utility program activities. However, the problems with the milestone approach used for market transformation programs in the late 1990s should not be repeated.

Therefore, EE market transformation programs that the Commission wants utilities to pursue should have no utility incentives unless an agreed-upon benchmark can be established. For these non-resource programs, no further discussion is provided based on the assumption they will be addressed later in the proceeding (Ruling, page 5).

III.
PROPOSED RRIM STRUCTURE

For the Program Cycle 2013--2014 and succeeding future program cycles, SDG&E and SoCalGas propose to divide the RRIM structure into two parts: (1) the magnitude of the cap; and (2) the reward structure for performance. The size of the RRIM cap draws from the significant amount of thinking that has already taken place in this proceeding in prior decisions, proposed decisions, workshops, and parties' comments.

A. RRIM CAP

The RRIM cap should have the following characteristics:

- The incentive earnings cap would equal an earnings rate multiplied by 1.25 times the program expected performance earning basis ("PEB").
- The earnings rate would equal 7 percent as approved in D.10-12-049. SDG&E and SoCalGas provided a justification for this percentage in prior comments, incorporated by reference that will not be repeated here.[2] The initial 9 to 12 percent figure was based on a comparison to supply-side earnings, but was then reduced to 7 percent to recognize the lower risk of using ex ante values rather than ex post; this put the incentive amount in a range with which the Commission was more comfortable due to the lack of certainty of measured ratepayer benefit.
- The expected PEB would equal 2/3 of the Total Resource Cost ("TRC") net expected benefits and 1/3 the Program Administrator Cost ("PAC") net expected benefits.
- Non-resource programs, including market transformation programs, would be excluded from this calculation of the shared savings cap.
- Ex ante data frozen before the earnings period would be used to determine the program expected PEB used for the RRIM cap.

B. RRIM REWARD STRUCTURE

The Ruling requested parties to address how a 2013-2014 incentive mechanism should be calibrated to the different types of programs in the portfolio, specifically: (1) "how to avoid encouraging undue emphasis on short-lived savings programs"; and (2) how to place greater emphasis on programs offering "deeper savings" with longer design lives. (Ruling, page 3). To accomplish this goal, SDG&E and SoCalGas propose a reward structure with the following structure:

- The payment would be based strictly on 2013-2014 cumulative undiscounted kWh and therms savings.

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[2] "San Diego Gas & Electric Company (U 902 M) and Southern California Gas Company (U 904 G) Comments on Order Instituting Rulemaking R.12-01-005 and Assigned Commissioner's Ruling Soliciting Further Comments and Production of Data Regarding Energy Efficiency Incentive Reforms," February 2, 2012, page 17.

- Programs with peak demand emphasis, such as air conditioning programs, would multiply the kWh savings by 1.5 to account for the higher value of on-peak energy savings.
- The payment per kWh or per therm is calculated by dividing the RRIM cap by 125 percent of expected cumulative savings.
- A utility's RRIM earnings would be the number of installations of each measure times the ex ante expected cumulative savings from the measure.

Using this structure, the RRIM would provide an emphasis on longer-term measures by using undiscounted cumulative savings and longer lived measures would have proportionally more savings. This approach is quite comparable to one that would be based on greenhouse gas emissions reductions since, for gas, all therms have the same GHG emissions and for electricity, assuming natural gas is on the margin, most hours have the same GHG emissions based on a combined cycle gas turbine, but peak summer hours have higher emissions as less efficient combustion turbines are on the margin.

The overall proposed structure thus provides the necessary link to supply-side alternatives through the cap and the calculated $ per kWh or therm, while meeting the objective of rewarding superior long-term energy savings.

IV.
CALCULATIONS OF SHARED SAVINGS RATES FOR 2013-2014

Ordering Paragraph 3 states,

> "Each of the Investor-owned Utilities (i.e., Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company and Southern California Gas Company) shall provide updated calculations of shared savings rates for 2013-2014. The updated calculations shall be provided in comments due on July 16, 2012, and shall incorporate the relevant net benefits impacts of the 2013 - 2014 portfolios as reflected in the filings due on July 2, 2012, in Rulemaking 09-11-014. Parties should include supporting rationale and calculations for assertions and conclusions, as appropriate."

Response:

SDG&E:

Cost Effectiveness (Lifecycle Present Value Dollars)						
	Cost	Benefits		Benefit - Cost		
		Electric	Gas	Incentives	NPV	B/C Ratio
Program TRC ($)	$ 279,102,538	$ 353,043,331	$ 38,122,261	NA	$ 112,063,055	1.40
Program PAC ($)	$ 206,813,078	$ 353,043,331	$ 38,122,261	NA	$ 184,352,514	1.89

Calculation of PEB
PEB = 2/3 x TRC Net Benefits + 1/3 x PAC Net Benefits
PEB = 2/3 x 112,063,055 + 1/3 x 184,352,514
PEB = $136,159,541

SoCalGas:

Cost Effectiveness(Lifecycle Present Value Dollars)						
		Benefits				
	Cost	Electric	Gas	Incentives	NPV	B/C Ratio
Program TRC ($)	$ 250,977,141	$ 5,974,762	$ 302,630,173	NA	$ 57,627,794	1.23
Program PAC ($)	$ 171,411,191	$ 5,974,762	$ 302,630,173	NA	$ 137,193,744	1.80

Calculation of PEB
PEB = 2/3 x TRC Net Benefits + 1/3 x PAC Net Benefits
PEB = 2/3 x 57,627,794 + 1/3 x 137,193,744
PEB = $84,149,777

Under SDG&E and SoCalGas' RRIM Proposal the forecasted earnings using the data from the 2013-2014 EE applications would be:

	TRC	PAC	PEB	Earnings Rate	Cap	Annual Earnings	Annual EarningsCap
SDG&E	$ 112,063,055	$ 184,352,514	$ 136,159,541	7%	125%	$ 4,765,583.95	$ 5,956,980
SoCalGas	$ 57,627,794	$ 137,193,744	$ 84,149,777	7%	125%	$ 2,945,242.20	$ 3,681,553

Dated July 16, 2012.

Respectfully submitted

By *_/s/ Steven D. Patrick_*

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