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)

SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) AND SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) POST-WORKSHOP COMMENTS AND PROPOSAL FOR THE DESIGN AND IMPLEMENTATION OF AN INCENTIVE MECHANISM FOR ENERGY EFFICIENCY RESOURCE PROGRAMS FOR THE 2013-2014 CYCLE

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I. INTRODUCTION

Pursuant to direction provided in the September 5, 2012 Administrative Law Judge's Ruling Setting Schedule for Post-Workshop Comments("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") based on discussions with other workshop participants. In addition, the Joint Utilities provide the relevant calculations and supporting assumptions applicable to the calculation of their RRIM proposal for the2013-2014 cycle based on the data provided in A.12-07-002 et al, the 2013-2014 Energy Efficiency ("EE") proceeding.

The Commission held the RRIM workshop on August 20, 2012 to provide an opportunity for interested parties to discuss ideas and methods for a new RRIM for the 2013-2014 program cycle. The workshop was moderated by Energy Division with the following parties in attendance: Division of Ratepayer Advocates ("DRA"), Natural Resource Defense Council ("NRDC"), The Utility Reform Network ("TURN"), Southern California Edison Company ("SCE"), Pacific Gas and Electric Company ("PG&E") and the Joint Utilities. At the workshop, the parties discussed overarching elements required for a RRIM to be effective, transparent and simple to execute. Parties generally supported reforms to the incentive mechanism that promotes the Commission's goals to develop a RRIM that would further encourage the IOUs to promote a

comprehensive portfolio for meeting the Commission's objectives for deeper, longer-lasting savings as called out in D. 12-05-015[1] and the California Long Term Strategic plan.

At the conclusion of the one day workshop, all parties agreed that focus should be on the "resource" portion of the incentive mechanism. Parties identified sufficient common ground in the workshop, and agreed to continue discussions with the goal of reaching a possible settlement for Commission consideration. Interested parties included TURN, DRA, NRDC, and the IOUs. Since then, parties have worked together towards creating an innovative mechanism based on goals discussed in the workshop, and while this post-workshop discussions did not result in a common RRIM, there was sufficient agreement such that many of the features of the proposed RRIM are consistent between the IOUs and NRDC, i.e., the general structure of the mechanism and cost effectiveness guarantee. Lastly, this mechanism incorporates an aspect of TURN's proposal in its comments dated July 16, 2012 by including a management fee mechanism for non-resource programs to encourage the IOUs to focus on specific market transformation activities.

The Joint Utilities provide high level considerations for the 2013-2014 RRIM and propose that the following principles continue to guide the development of the next generation for RRIM:

- The RRIM must send clear unambiguous signals to the utilities on CPUC expectations.
- The RRIM must promote the delivery of aggressive deeper and longer lasting energy efficiency savings for California.
- The RRIM must drive towards the achievement of the Greenhouse Gas ("GHG") goals of the state through the delivery of aggressive deeper and longer lasting energy efficiency savings for California.
- The RRIM must drive the utilities to deliver a more cost effective portfolio for ratepayers.
- The RRIM process must be simple and transparent.

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[1] Decision Providing Guidance on 2013 – 2014 Energy Efficiency Portfolios and 2012 Marketing, Education and Outreach, issued May 18, 2012.

II.
GENERAL OVERVIEW

A. PROPOSED OVERALL PORTFOLIO RRIM CAP

An incentive mechanism for energy efficiency should be designed to align the goals of utility management and shareholders, with those of customers and regulators by providing an opportunity to earn a return on the net benefits that accrue from implementing successful energy efficiency programs. In order to facilitate the most cost effective and successful energy efficiency programs, incentives should be of sufficient size and structured in such a manner to encourage utility management to devote high performing resources to the programs.

The value of the return to shareholders on supply-side resource investments was a logical starting point to consider in determining the magnitude of incentives associated with energy efficiency activities. The US Department of Energy ("DOE") recognized that performance-based incentive mechanisms can provide a useful means to achieve energy efficiency targets in their report on *State and Regional Policies that Promote Energy Efficiency Programs Carried Out by Electric and Gas Utilities*. In this report, DOE recommends that, "Regulators should consider allowing utilities' returns at least as great from prudent investments in energy efficiency as from supply-side investments."[2] Amory Lovins also noted in his book, *Reinventing Fire*, "Allowing utilities to make money on energy efficiency (rewarding independently measured savings, not expenditures or activities) is critical."[3] In addition, California's Energy Action Plan calls for several specific actions to optimize energy conservation and resource efficiency. One of those actions is directed specifically at utility incentives and called for action to provide utilities with demand response and energy efficiency investment rewards comparable to supply-side resources.[4]

A survey of earnings cap levels provides a useful comparison of previous Commission-adopted earnings mechanisms and other proposals.

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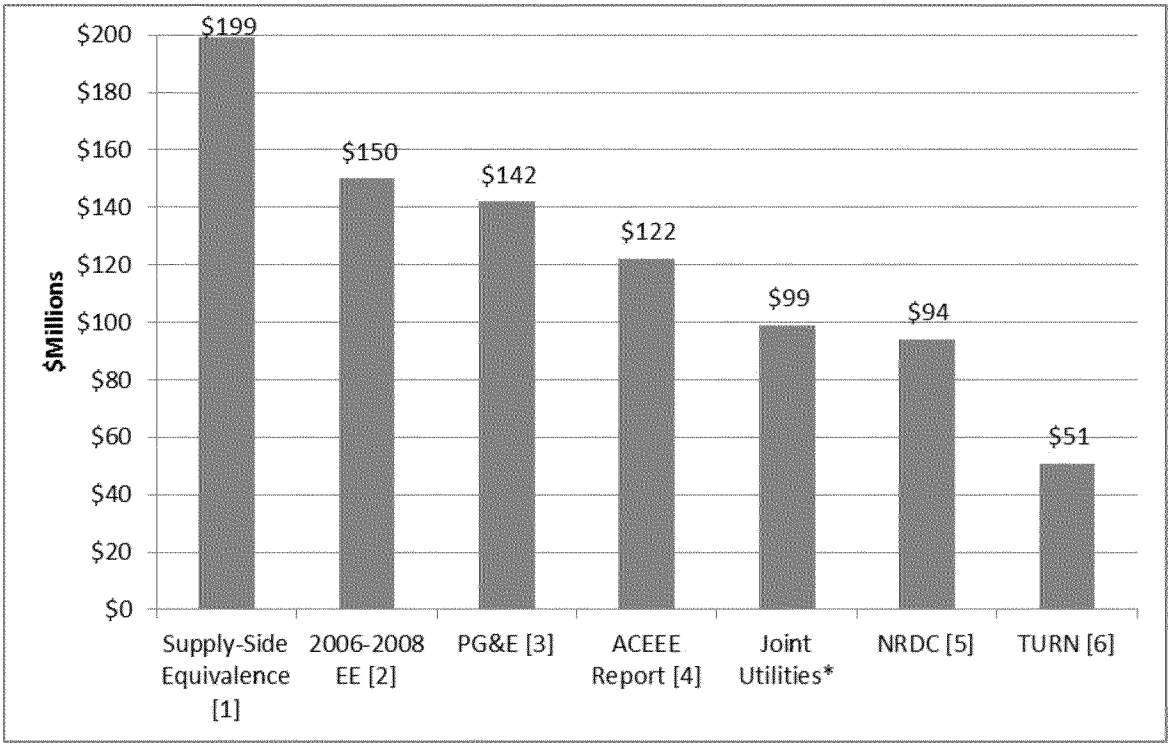
2 State and Regional Policies that Promote Energy Efficiency Programs Carried Out by Electric and Gas Utilities, A Report to the United States Congress Pursuant to Section 139 of the Energy Policy Act of 2005, March 2007, U.S. Department of Energy, pages 57-58.

3 Amory B. Lovins and the Rocky Mountain Institute, Reinventing Fire: Bold Business Solutions for the New Energy Era, (White River Junction, VT: Chelsea Green Publishing Co., 2011), 2.

4 Energy Action Plan 1, p. 5.



[1] IOU July 16, 2012 R.12-01-005 RRIM comments.
[2] D.07-09-043
[3] PG&E July 16, 2012 R.12-01-005 RRIM comments.
[4] ACEE Report, "Carrots for Utilities: Providing Financial Returns for Utility Investments in Energy Efficiency". The report states, "Caps generally range from 5% to 20% of energy efficiency spending. The average cap on incentives was approximately 12-13% of total program spending." This analysis used 12% of the statewide proposed program budget.
[5] NRDC July 16, 2012 R.12-01-005 RRIM comments, page 28.
[6] TURN July 16, 2012 R.12-01-005 RRIM comments, page 21.
* Joint Utilities proposed cap in these comments.

The Joint Utilities therefore propose a revised annual statewide cap of less than $100 million, a 33 percent statewide reduction from the D.07-09-043 RRIM cap of $150 million, and less than 50% of the supply-side equivalent. The Joint Utilities believe that their proposal provides a reasonable balance between sharing the net benefits with its customers and adequately recognizing management's efforts in aggressively pursuing long-term cost effective savings. This cap would be cumulative less than $200 million over the 2013-2014 cycle so that if an IOU earns less than the full cap in a single year, it would be authorized to "catch up" the subsequent year to reflect any ramp up period resulting from program delays and cycle start-up.

B. PROPOSED SUB-CAPS WITHIN THE PORTFOLIO CAP

1. Codes & Standards Sub-cap

The Joint Utilities recognize that Codes and Standards ("C&S") savings contribute significantly to the overall portfolio goals, with the remaining goals attributed to the installation of actual measures and incentives through various programs. Therefore to account for the contribution of C&S savings, the Joint Utilities also propose a statewide sub-cap of $16 million annually to ensure a balance of earnings between C&S and other resource acquisition programs. This represents approximately 16 percent of the total cap.

2. Management Fee for Non-Resource Programs

The Joint Utilities also propose an annual non-resource cap based on 3% of approved non-resource budgets which amounts to $8.3 million annually on a statewide level based on the IOU's on the IOUs' 2013-2014 applications. A management fee for non-resource programs would encourage greater focus on achievement of non-resource program goals while removing the disincentive from the previous mechanism to shift funds and resources away from non-resource programs.

Table 1
IOU Management Fee for Non-resource Programs

IOU	Annual Earnings
PG&E	$ 2.19
SCE	$ 2.31
SDG&E	$ 1.05
SoCalGas	$ 1.66

C. SUMMARY OF CAP COMPONENTS

The Joint Utilities RRIM cap proposal is as follows:

Proposed Total Annual Statewide Cap:	**$**	**99,000,000**
Resource Programs	**$**	**90,700,000**
Subcap for Codes & Standards (within Resource Programs)	**$**	**15,840,000**
Management Fee for Non-Resource Programs	**$**	**8,300,000**

Step 1: Establish 2013 - 2014 Target Earnings For Resource Progams

Annual earnings target is:	**$90,700,000**
The 2013 - 2014 target is:	$181,400,000

D. REPORTING AND APPROVAL OF RRIM

The IOUs' earning claims would be based on the annual Energy Efficiency reports filed in May for the prior year's savings and would be resolved in the year the annual report is issued. The Joint Utilities propose to file concurrently with the May 1 Annual Report, a Tier 2 Advice Letter regarding their earnings claims based on the report. For example, the 2013 claim would use the 2013 annual report submitted May 1, 2014 and the 2013 earnings would be verified and approved before the end of the fourth quarter 2014. Any such claims should be associated with the final cost effectiveness calculators approved in A.12-07-002 et al. to ensure consistency with the eventual decision for the 2013 – 2014 program cycle.

III.
PROPOSED RRIM STRUCTURE

The Joint Utilities, working together with PG&E and SCE, propose the Commission adopt a lifecycle gross energy savings approach, similar to NRDC's anticipated monetization proposal[5], to reward the IOUs for delivering energy savings from resource programs and a separate management fee for non-resource programs. The Joint Utilities' proposed incentive mechanism incorporates the following elements: (1) Incentives per unit of energy savings (KWH, Therms) and demand reduction (KW); (2) a cost-effectiveness guarantee; (3) a cap on incentive payments; and (4) a management fee for non-resource programs.

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[5] The Joint Utilities were provided an understanding of the NRDC preferred RRIM framework through collaborative discussions as noted in Section I.

The proposed mechanism for resource programs would reward the IOUs based on lifecycle energy savings as opposed to rewarding the IOUs based on net benefits as in the 2009 RRIM. By doing so, this would emphasize long term energy savings, not just short term savings, which is in line with CPUC policy direction. This proposed mechanism would also thus recognize energy savings achievement while also simplifying the equation by only using ex ante lifecycle savings, calculated as the annual savings[6] of a measure multiplied by its effective useful life ("EUL"). As an illustrative example, a measure that saves 5 KWH/year and lasts for 7 years creates 35 KWH of lifecycle savings – 5 KWH multiplied by 7 years. A mechanism that incentivizes lifecycle savings provides a clear signal to focus on measures with longer EULs.

The RRIM proposal includes a management fee of 3% of the non-resource program expenditures for the non-resource programs. The proposed management fee would encourage the IOUs to successfully execute programs that are designed to achieve the Commission's non-resource program goals as outlined in the California Long Term Energy Efficiency Strategic Plan.

This proposed mechanism with these two components: ex ante lifecycle savings and a management fee, is the most simple, clear and reasonable method to reward IOUs for aggressive efforts to achieve energy efficiency goals for both resource and non-resource programs. The metrics and earnings rate per unit are predetermined and the savings are based on ex ante approved data (refer to footnote 6). The earnings review process will be thus only need to involve the verification of installed measures and a reasonableness review of program expenditures. These efforts would require significantly less staff time allowing more time to be dedicated to EM&V activities that will lead to improvements in the next generation of programs.

The mechanism includes a cost-effectiveness guarantee to ensure the IOUs will not earn an incentive unless the portfolio Program Administrator Cost ("PAC") test exceeds 1.0. The IOU would not be entitled to any shareholder earnings in an amount that would reduce the PAC test result below 1.0. However, the IOUs would not be penalized.

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6 The measure savings are determined using DEER, deemed non-DEER savings or the custom project process.

The Joint Utilities provide the detailed technical analysis in this filing to illustrate how the mechanism would work using the data submitted in the IOUs 2013-2014 EE applications. The technical details are provided in the Attachment.

The mechanism should be finalized using the final approved portfolio values once the Commission issues its final decision for the 2013-2014 program cycle to determine the parameters for calculating the earnings.

A. INCENTIVE PER UNIT OF SAVINGS FOR RESOURCE PROGRAMS

The mechanism uses a "lifecycle savings" monetization methodology. The method for determining a $ / unit valuation is to:

a) Set a target for earnings at 100% of Commission-established goals

b) Allocate target earnings among the metrics (KWH, KW, Therms)

c) Determine the lifecycle savings of each metric

d) Divide the target earnings for each metric (b) by the lifecycle savings of each metric (c)

This type of mechanism has multiple benefits. First, it calculates the lifecycle energy savings, removes hard to determine cost issues such as incremental measure costs, which are outside of the utility's control and negatively affect larger, longer lasting installations. The proposal includes a cost-effectiveness guarantee, so the IOUs are not rewarded unless the portfolio is cost effective. Second, this methodology would incorporate the Commission's gross goals for resource acquisition programs and net goals for C&S.[7] Third, the methodology would utilize approved *ex ante* lock-down values for resource programs and C&S.[8] The proposed

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[7] This is consistent with the Commission adopted goals in D. 12-05-015, at page 89-90.

[8] This includes:

a. 2011 DEER database – version 4.01 dated May 16, 2012
b. Net To Gross tables dated May 23, 2012
c. HVAC interactive effects tables dated May 23, 2012
d. Load shapes tables dated May 16, 2012
e. READI tool version 0.99.7 dated May 25, 2012

RRIM's resource incentive component is based on this simplified approach to reward savings on an incentive per unit (kW, kWh, Therm) basis as shown in Table 2 below:

Table 2
Incentive per metric for resource programs

$/KW	$/KWH	$/Therm
5.06775	0.00276	0.01999

The proposed allocation of the resource incentive mechanisms to the IOUs is in Table 3 below. The proposed allocation reflects an 85% electric, 15% gas split of net benefits. This 85/15 split is based on a comparison of the statewide total net benefits (benefits – cost) of gas and electric programs from the IOUs' 2013-2014 applications. The statewide electric split is a 75% energy, 25% capacity split of electric benefits. This electric split is an estimation of the avoided costs from energy and capacity based on discussion in R. 09-11-014, the 2011 Avoided Costs Update.

Table 3
IOU Incentive Split

IOU	% of Resource Mechanism
PG&E	42%
SCE	40%
SDG&E	10%
SoCalGas	8%

The key assumptions of the resource incentive calculation are included in the Attachment.

B. COST EFFECTIVENESS GUARANTEE

A cost-effectiveness guarantee using the PAC test ensures that the IOUs are rewarded only if there are positive net benefits for customers.

- Use of the PAC test for cost-effectiveness. A PAC test is the appropriate cost-effectiveness calculation for portfolios targeting deeper, lasting savings because it appropriately excludes the high incremental measure costs typically associated with

longer lasting measures. A PAC test also values energy efficiency measure costs on level footing with other supply-side investments from a customer perspective.

- This proposal would only result in an incentive award if individual IOU portfolios exceed a 1.0 PAC.

- Shareholder incentives, up to the earned amount, are paid to IOUs if the PAC test result is above 1.0, including the incentive award. If earnings reduce the PAC to below 1.0, the award would be reduced to an amount that allows a result equal to 1.0.

C. OTHER INCENTIVE MECHANISM PROPOSALS

The Joint Utilities do not believe additional performance metrics should be required for a comprehensive and reasonable incentive proposal, however if the Commission wishes to incorporate TURN's proposed performance metrics, the Joint Utilities recommend certain modifications.

1. TURN's Proposed Metric For the Whole Home Upgrade Program.[9]

TURN's proposed metric for the Energy Upgrade California ("EUC") program targets a 10% annual increase over 2010-2012 participation levels in hotter climate zones, and paying the IOUs 1.25% of their spend if this increased participation is achieved.[10] If the Commission ultimately chooses to adopt an incentive for customer participation in the Whole Home Upgrade Program (WHUP), the incentive amount should be consistent with the overall program expenditure level and projected goals for 2013-2014. This would ensure that the mechanism reasonably values benefits from programs in the portfolio. The final targets should be commensurate with the actual, authorized budget.

While it may appear reasonable to target this metric to installations in hotter climate zones, as TURN proposes, targeting participation in hotter climate zones was only one of many criteria used in designing the program. Successful implementation of this program should not be focused on only targeting participation in hotter climate zones, and it would be inappropriate to redirect program funding solely based on a single customer criteria. Economic conditions and energy usage, as well as other factors indicating the likelihood that a customer will participate in

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9 TURN July 16, 2012 R.12-01-005 Comments, page 27.

10 Ibid., page 27.

a residential upgrade program should also be considered. Customer research indicates that change of life events, such as moving into a new home are important opportunities to leverage in optimizing outreach and program engagement. The Joint Utilities plan to continue to target whole house programs to geographic areas and markets where customer data and segmentation indicates a higher likelihood of customer participation using climate as one, but not the sole, consideration.

2. TURN's Proposed Metric for Spending on Rebates and Financing.

If the Commission adopts a specific metric for spending on rebates, the Joint Utilities suggest a percentage consistent with the spending levels the Commission finally approves for the 2013-2014 program cycle.

TURN's proposal to base a metric on the IOUs' spending of at least 50% of their authorized budgets on rebates and financing is too high for a mature market, as California and should be reduced to 40%.[11] TURN's 50% rebate/financing spend metric was based on nationwide energy efficiency programs, many of which are in their infancy and have more cost-effective measures than the more mature California energy efficiency programs. The IOUs' applications propose over 40% of their budgets for customer rebates and financing. The 40% figure is more reasonable, and consistent with the IOUs' overall budget proposals as it balances resource and non-resource program goals. This 40% includes all rebates, direct install rebates and labor costs, loan proceeds, and loan support financed through the IOUs' applications, and represents the upper limit of spending on those elements in the IOU applications. Also, California has a statewide mandate to implement non-resource programs to encourage the implementation of programs with long lasting savings. This results in an overall portfolio that shifts focus away from rebate programs. For this reason, it is inappropriate to compare California's energy efficiency programs with those operating in other states. Lastly, if the Commission determines this is an appropriate metric the final determined percentage of spend should be tied to the IOUs' approved final portfolio.

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[11] *Id.*, page 22.

In addition to the two metrics above, TURN also proposed a specific metric for a residential HVAC rebate program.[12] As part of the effort to promote market transformation of the HVAC market, the HVAC programs have shifted their focus to quality maintenance and quality installation ("QM/QI"). Therefore TURN's HVAC performance metric is not appropriate.

IV.
CONCLUSION

The Joint Utilities proposed RRIM provides a balance between customers, State and utility management goals, rewards superior performance for achieving aggressive long term lifecycle energy savings through an increased focus on deeper and longer-lasting energy savings measures. The Joint Utilities appreciate the Commission, Energy Division staff, DRA, TURN, NRDC, PG&E and SCE in this continued discussion to forward the objective of developing an appropriate RRIM for the coming 2013-2014 program cycle.

Respectfully submitted,

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[12] *Id.*, page. 25.

ATTACHMENT
San Diego Gas & Electric Company and Southern California Gas Company
Calculation of Incentive Per Metric

Proposed Total Annual Statewide Cap:	**$**	**99,000,000**
Resource Programs	**$**	**90,700,000**
Subcap for Codes & Standards (within Resource Programs)	**$**	**15,840,000**
Management Fee for Non-Resource Programs	**$**	**8,300,000**

Step 1: Establish 2013 - 2014 Target Earnings For Resource Progams

Annual earnings target is:	**$90,700,000**
The 2013 - 2014 target is:	$181,400,000

Step 2: Allocate target earnings by electric and gas split based on benefits net.

Source: IOUs 2013 - 2014 EE Application Filings

	Benefit Net (Million $)		
	Electric	Gas	Total
PG&E	1,231	236	1,467
SCE	1,678	0	1,678
SDG&E	353	38	391
SoCalGas	0	303	303
Total	**3,262**	**577**	**3,839**

Electric %:	85%
Gas %:	15%

	Electric	Gas
Target Allocatio	$154,190,000	$27,210,000

Step 3: Allocate electric target earnings by energy and demand.

Source: Historical estimate and NRDC analysis.

Demand %:	**25%**
Energy %:	**75%**

	Demand	Energy
Electric Allocatio	$38,547,500	$115,642,500

Step 4: Determine 2013 - 2014 Commission Goals

EE Programs
Source: Guidance on 2013 - 2014 Energy Efficiency Portfolios
Decision 12-05-015, May 10, 2012, Page 96

C&S Advocacy
Source: Updated Codes and Standards Forecasted Savings Estimates
Navigant, September 4, 2012, Pages 4 - 6

	2013 - 2014 Commission Goals								
	MW			GWH			MMTherms		
	2013	2014	Total	2013	2014	Total	2013	2014	Total
PG&E									
EE Program	**114**	**100**	214	**599**	**593**	1,192	**21.0**	20.3	41.3
C&S	**31**	**32**	63	**254**	**239**	493	**0.1**	0.6	0.6
Total	145	132	277	853	832	1,685	21.1	20.9	41.9
SCE									
EE Program	**149**	**144**	293	**660**	**678**	1,338	**0.0**	0.0	0.0
C&S	**32**	**33**	65	**262**	**246**	508	**0.0**	0.0	0.0
Total	181	177	358	922	924	1,846	0.0	0.0	0.0
SDG&E									
EE Program	**36**	**33**	69	**162**	**156**	318	**2.2**	2.1	4.3
C&S	**7**	**8**	15	**59**	**56**	115	**0.0**	0.1	0.1
Total	43	41	84	221	212	433	2.2	2.2	4.4
SoCalGas									
EE Program	**0**	**0**	0	**0**	**0**	0	**24.0**	22.3	46.3
C&S	**0**	**0**	0	**0**	**0**	0	**0.1**	0.9	1.0
Total	0	0	0	0	0	0	24.1	23.2	47.3

ATTACHMENT
San Diego Gas & Electric Company and Southern California Gas Company
Calculation of Incentive Per Metric

Step 5: Weighted Average Measure Life

Source: IOUs Weighted Average Measure Life From 2013 - 2014 Energy Efficiency Application Filings

	Average Measure Life	
	Electric (Years)	Gas (Years)
PG&E	**9.4**	**11.0**
SCE	**11**	-
SDG&E	**11.3**	**17.6**
SoCalGas	-	**15**
IOU Simple Aver	10.6	14.5

Step 6: Determine 2013 - 2014 Lifecycle Goals

Source: 2013 - 2014 IOU Goals in Step 4 x Weighted Average EUL in Step 5

	2013 - 2014 Lifecycle Goals		
	MW	GWH	MMTherms
PG&E	2,930	17,826	609
SCE	3,787	19,529	-
SDG&E	889	4,581	64
SoCalGas	-	-	688
Total	7,606	41,936	1,361

Step 7: Determine incentive per metric for resource programs

Source: Divide the allocated target earnings in Steps 2 & 3 by the lifecycle goals in Step 6.

Allocated target earnings from Steps 2 & 3.

	Demand	Energy	Gas
Allocated Earnir	$38,547,500	$115,642,500	$27,210,000

Incentive per metric for resource programs

$/kW	$/kWh	$/Therm
5.06775	0.00276	0.01999

Step 8: 2013 - 2014 Incentive Payments For Resource Programs

	At Target	At Cap
PG&E	$76,193,879	$95,242,349
SCE	$73,047,028	$91,308,785
SDG&E	$18,405,833	$23,007,291
SoCalGas	$13,753,260	$17,191,575
Total	$181,400,000	$226,750,000

Table 2
IOU Incentive Split

IOU	% of Resource Mechanism
PG&E	42%
SCE	40%
SDG&E	10%
SoCalGas	8%