

**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)

**OPENING COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 M)
ON ADMINISTRATIVE LAW JUDGE'S RULING SOLICITING COMMENTS
ON MODIFIED METHODOLOGY AND USE OF DATA TO DERIVE
INCENTIVE EARNINGS AMOUNTS**

ANN H. KIM
MARY A. GANDESBERY

Law Department
Pacific Gas and Electric Company
P.O. Box 7442
77 Beale Street, MSB30A
San Francisco, CA 94120
Telephone: (415) 973-0675
Facsimile: (415) 973-5520
E-Mail: MAGq@pge.com

Attorneys for
PACIFIC GAS AND ELECTRIC COMPANY

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Pacific Gas and Electric Company (PG&E) submits these opening comments on the *Administrative Law Judge's Ruling Soliciting Comments on Modified Methodology and Use of Data To Derive Incentive Earnings Amounts*, dated September 25, 2012 (ALJ Ruling) applicable to the 2010-2012 Energy Efficiency Portfolio. The ALJ Ruling allows the parties to file "one round of concurrent opening comments" no later than October 5, 2012. (ALJ Ruling, p. 23.) The ALJ Ruling proposes to replace the most recent energy savings-based incentive mechanism with a mechanism that is comprised of: (1) a management fee of 2% of each IOU's annual portfolio expenditures; and (2) a "performance bonus payment" of up to 3% of annual portfolio expenditures. (ALJ Ruling, p. 2.)

I. INTRODUCTION AND SUMMARY

PG&E does not support the proposed "performance bonus" component described in the ALJ Ruling for the 2010-2012 portfolio because it is not based on achievement of energy savings or customer benefits. The Commission has previously stated: "The purpose of the RRIM is to offer incentives to the IOUs in a manner that will encourage and compel them to meet and exceed Commission goals for energy efficiency savings, and to extend California's commitment to making energy efficiency the highest energy resource priority."^{1/} The proposed performance

^{1/} D.10-12-049, p. 10.

bonus component, by contrast: (a) is not directly connected to California's energy efficiency policy goals and does not directly promote delivering energy savings benefits to customers, (b) is completely new but would be applied retroactively although the IOUs have been operating under the existing shared energy savings mechanism, and (c) could discourage the IOUs' staff from raising valid concerns to Energy Division regarding the workpaper processes and other portfolio management issues about which the IOUs and Energy Division staff regularly communicate.

Instead of using the approach described in the ALJ Ruling, the Commission should continue to use the 2009 risk reward incentive mechanism (RRIM) for the 2010-2012 portfolio in order to award incentives to the IOUs based on their significant energy savings achievements and to reflect the IOUs' reasonable reliance on the prior RRIM mechanism when planning and successfully executing their energy efficiency portfolios. The Commission should use the data already available in the 2010-2011 Energy Efficiency Annual Progress Evaluation report presented to the Legislature to calculate the 2010-2011 earnings claim, which was developed in close collaboration between the investor-owned utilities (IOUs) and Energy Division's Reporting Group. This report includes all the information necessary to calculate both 2010 *and* 2011 earnings claims, and the Commission should do so.

PG&E opposes the proposed methodology in the ALJ Ruling because it does not directly link the incentive a utility could earn and the overall objectives of delivering energy savings for customer benefit. For example, a utility could earn a full incentive award simply by spending its annual authorized budget and submitting timely and accurate workpapers and custom project submittals, and *achieve little energy savings*. On the other hand, a utility could exceed its savings goals, and receive lower scores for its *ex-ante* workpapers or custom project submittals, and earn a lower incentive. The proposal would elevate the workpaper review process to an importance and focus that is not merited and would not put sufficient weight on activities that promote the fundamental objectives of energy efficiency, such as achieving the state's aggressive energy savings goals, helping customers reduce their energy bills, and meeting AB 32 carbon reduction goals.

The late adoption of the performance bonus payment metrics and lack of interim scoring during the portfolio period is also prejudicial to the IOUs given their reliance on the prior shared savings mechanism. Changes to the incentive mechanism should be “available in a manner that would have allowed the utilities to react in a timely manner.”^{2/} The IOUs had no prior notice that the incentive mechanism would be tied to the *ex-ante* review process. These newly proposed metrics for the performance bonus payment would be approved in the last quarter of the three-year portfolio period, which is far too late for the IOUs to adjust any behavior to achieve higher scores. Further, most of the processes for which the IOUs received a 2010 score were under development and were not even established until well into the 2010-2012 portfolio period.

PG&E agrees that the *ex-ante* review processes and the level of cooperation between the IOUs and Energy Division are important, however the *ex-ante* review process should not be the basis to determine whether the IOUs should receive an incentive, as the process is not linked to achievement of the Commission’s policy goals, nor provides clear customer value. Further, this proposed method would have more than half of the incentive tied to the subjective opinion of staff members, and could discourage knowledgeable IOU staff from raising concerns or questions about Commission procedures with the Energy Division.

II. COMMENTS

A. **The Modified Management Fee Is Inconsistent With Achievement of California’s Energy Policy Objectives and Customer Benefits.**

The Commission’s policy to provide incentives to the IOUs for their energy efficiency portfolio has always been premised on the IOUs’ energy savings achievements and links to clear customer benefit. Key Action 12 of the Energy Action Plan II is: “[a]dopt verifiable performance-based incentives in 2006 for IOU energy efficiency investments, with risks and rewards *based on performance that will align the utility incentives with customer interests.*”^{3/}

^{2/} D.10-12-049, p. 36.

^{3/} Energy Action Plan II, p. 5, Key Action 12 (emphasis added).

The 2008 Energy Action Plan Update is also clear that the purpose of the mechanism is to “. . . to allow utilities to earn financial rewards *for meeting or exceeding their goals. . . .*”^{4/}

Instead of encouraging the IOUs to use customer funds wisely in the pursuit of greater energy efficiency installations, the proposed performance metrics would grade the IOUs for spending their authorized budgets without regard to outcome^{5/} and be based on their compliance with submitting and correcting *ex-ante* workpapers under a new and insufficiently defined procedure.

The proposed metrics are inconsistent with the thoughtful and well-reasoned White Paper the Energy Division authored regarding the RRIM and evaluation, measurement and verification (EM&V) activities.^{6/} The White Paper was prepared in response to Commission directions to modify the RRIM “in order to make the earnings process more transparent, streamlined, and less controversial, while also encouraging the IOUs to achieve the Commission’s core energy efficiency policy goals.”^{7/} In response to this direction, the Energy Division White Paper proposed several new criteria for an effective incentive mechanism:

1. **Effective and Strategic** – The mechanism must be focused on the Commission’s energy efficiency policy goals.
2. **Feasible** – The CPUC must be able to design and implement the incentive mechanism expeditiously with current staffing.
3. **Timely and Non-Contentious** – Incentive payments or penalties should be quantified and processed in a reasonable time frame and be acceptable to all stakeholders.
4. **Fair and Cost-Efficient** – The mechanism should provide reasonable opportunity for awards to utilities for successful

^{4/} 2008 EAP Action Plan Update, p. 8 (emphasis added).

^{5/} PG&E supports a management fee structure for non-resource programs because they have no incremental energy savings benefits but are important to increase participation in and general knowledge of energy efficiency programs. However the incentive for resource programs should be based on energy savings achievements.

^{6/} California Public Utilities Commission White Paper, *Proposed Energy Efficiency Risk-Reward Incentive Mechanism and EM&V Activities*, (Apr. 1, 2009), p. 3.

^{7/} Order Instituting Rulemaking 09-01-019 (January 29, 2009), p. 4.

management while protecting against unreasonable costs and poorly managed programs.

5. **Simple and Transparent** – The mechanism should be simple and understandable.

6. **Technical Integrity** – the mechanism should maintain the technical integrity of all EM&V research, savings estimates, and energy efficiency forecasts.^{8/}

The proposed mechanism meets “feasibility” criterion 2, as it is simple for the Energy Division to score and calculate. However, it neglects the other important criteria.

B. The Metrics For the Performance Bonus Should be Rejected.

If the Commission considers adopting a metrics-based incentive mechanism, it should follow the previous suggestions of Energy Division, and base metrics on objective criteria that measure actual energy efficiency achievements which drive customer benefits. A metrics proposal should be consistent with the Commission’s criteria for energy efficiency program metrics: “objective, quantitative indicators of the progress of a program toward . . . market transformation goals and objectives in the Strategic Plan.”^{9/}

The proposed metrics are based on a seemingly arbitrary scoring system that would allow Energy Division and its contractors to subjectively grade the IOUs for activities that occurred years ago, including: (1) efforts to implement the Commission’s *ex ante* review process within their organizations; (2) level of due diligence the IOUs applied to their *ex ante* review activities; (3) progress toward *ex ante* activity that is more self-policing; and (4) efforts to implement Commission adopted policy regarding the use of the database of energy efficient resources (DEER). While these activities are beneficial, the metrics do not reward the IOUs for reducing energy usage, helping customers to save money on energy bills, or reducing environmental pollution associated with power production, the primary bases for energy efficiency programs.

^{8/} Id., p. 4.

^{9/} D. 09-09-047, p. 91

C. The *Ex Post* Scoring Of The Proposed Metrics Shows Why The Metrics Are A Poor Substitute For A Performance-Based Incentive.

PG&E provides some background on the activities that are the focus of these metrics and scores contained in the ALJ Ruling to give context to the metrics proposal.

1. The Ex-Ante Workpaper Process Was New In 2010 and There Have Been Many Clarifications And Improvements To The Process.

The *ex-ante* workpaper review process began in 2010 as required by Decision 09-09-047.^{10/} While Decision 09-09-047 provided instructions for the review process, it left many unresolved details to be worked out among Energy Division Staff and the IOUs, particularly regarding the freeze in the DEER *ex-ante* values, the process to correct admitted errors in the most recent version of the DEER data base, the process to add new measures to the frozen DEER database, and several important issues regarding custom projects workpapers.^{11/}

There was no agreement among the Energy Division and the IOUs as late as Fall 2010 on how to correct widely-acknowledged errors in the DEER data base and on other issues regarding the process to review and approve the workpapers. The IOUs filed a petition for modification of D.09-09-047 on September 17, 2010 seeking additional Commission guidance on several issues critical to implementation of the *ex-ante* workpaper review process and other issues that were important to the administration of the IOUs' 2010-2012 portfolios. The Commission subsequently issued three decisions to resolve the IOUs' Petition: D.10-12-054, D.11-04-005, and D.11-07-030.

Decision 10-12-054, issued in December 2010, froze the DEER values as they were set in version 2.05, although the Commission acknowledged that it contained errors that should have been corrected. This decision allowed the *ex-ante* review process to move forward for workpapers, but the uncertainties regarding the custom projects workpapers were unresolved for an additional eight months.^{12/} The Commission issued Decision 11-07-030 on the custom review

^{10/} D.09-09-047, pp. 42-44.

^{11/} *Ibid.*

^{12/} D.10-12-054, p. 9.

process in July 2011, allowing the custom workpaper review process to go forward on an *ex ante* basis. As discussed below, resolving the details of the *ex-ante* review process did not go as smoothly as either the Commission or the IOUs hoped. However, valuable lessons were learned that significantly improved the process and ED and the IOUs technical teams have established regular collaboration meetings to discuss various technical and process issues.

2. The Scores For Several Metrics Would Penalize PG&E For Errors In Third Party Workpapers Which PG&E Has Eliminated For the 2013-2014 Period.

As the comments to PG&E's scores indicate on pages 7 to 9 of the ALJ Ruling, PG&E timely submitted its *ex-ante* workpapers by the March 2010 deadline required in D.09-09-047, including workpapers prepared by its third-party and local-government partners. PG&E's workpapers relied on the correct version of the DEER data base, but certain workpapers prepared by third-parties and local government partnerships used outdated versions of DEER. (ALJ Ruling, p. 7, Metric 1A.) This single problem weighed heavily on PG&E's scores on several metrics and resulted in reduced scores. (See PG&E scores for metric 1A, 1C, 2A, 2 C, and 4 B.) While PG&E understands the importance of working with its third-party and local government partners to comply with Commission directives on such things as the proper version of DEER data, PG&E finds it inappropriate that a single error would reduce its scores in 5 categories.

For the 2013-2014 portfolio, PG&E eliminated the risk that its contractors would not provide accurate workpapers by submitting cumulative workpapers that roll up these programs into PG&E's own programs. In addition, to eliminate the burden on Energy Division associated with work paper review, PG&E reduced the number of its workpapers from 800 to 151.^{13/} Thus, lessons were learned from the 2010 workpaper process and there is a positive foundation for the workpaper process to go more smoothly in the next portfolio period.

^{13/} PG&E Prepared Testimony (A.12-07-001), p. 1-20.

3. Many of the Activities On Which The IOUs Were Scored For 2010 Actually Occurred In 2011 and 2012.

Another problem with the metrics proposal is that it lacks technical integrity as is evidenced by the proposed 2010 scores. (See ED White Paper, Criteria 6.) If (as here) a utility will be judged on behavior such as “coordination” “understanding of rules,” “implementation of rules” and “awareness of rules” rather than customer energy savings, out of fairness, the Commission should issue interim scores to the IOUs throughout the portfolio period to give the IOUs a reasonable opportunity to improve their behavior and earn an incentive award. The 2010 scores for certain of the activities appear to inappropriately cover activities that actually occurred in later years. For example, the score for Metric 1 A (Workpapers) states that there were “some delays in updating Phase 1 workpapers per D.11-07-030, but updated quickly after notification.” The notes for Metric 1A (Custom Projects) discuss PG&E’s December 2011 response to Energy Division instructions in November 2011 regarding the Custom Measure Project Archive (CMPA). Comments on Metric 2 C (Custom projects) and Metric 3C (Workpapers) also appear to score PG&E in 2010 for activities to implement Decision 11-07-030.

D. The Methodology Approved For The 2009 RRIM Should Continue For 2010 to 2012.

The Commission should retain the 2009 methodology as modified in D. 10-12-049 for 2010-2012 because the IOUs planned and administered their programs according to the prior mechanism and should be rewarded for those efforts. PG&E’s 2010-2012 portfolio was designed and is being implemented under the premise that a timely and simple shared savings incentive mechanism would be used, as in prior RRIM cycles. A point of contention with prior incentive mechanisms has been the introduction of new or changed parameters after the start of the program cycle and/or without sufficient notice to the IOUs to enable them to make meaningful and timely decisions. This untimely proposal would unfairly penalize the IOUs, instead of promoting an open and transparent exchange of information as good stewards of customer funds. As the Commission previously discussed:

We are of the opinion that subjecting the IOUs to penalties or substantially reduced incentives based on factors they could not reasonably be expected to anticipate or effectively respond to will do little to motivate them to aggressively pursue energy efficiency and may undermine the interests of the people of the state of California in placing energy efficiency on a par with ‘steel-in-the-ground’ supply side resources.^{14/}

The IOUs successfully executed their 2010-2011 portfolios according to the Commission’s own analysis and should be appropriately awarded for their efforts. The Commission’s September 4, 2012 press release regarding its 2010-2011 Energy Efficiency Annual Progress Evaluation Report^{15/} to the Legislature acknowledges the success of the IOUs’ energy efficiency portfolios:

The California Public Utilities Commission (CPUC) today said that the groundbreaking energy efficiency programs approved by the CPUC resulted in savings of 5,900 gigawatt-hours of electricity in 2010-2011 based on utility reported savings estimates, enough to power more than 600,000 households for a year and the equivalent of two major power plants. In addition, the estimated savings cut CO2 emissions by 3.8 million tons, the equivalent of removing more than 700,000 cars from California’s roads.

The Commission acknowledged last year that regulatory certainty regarding the RRIM is beneficial: “By adhering to the treatment of 2009 incentive claims laid out in D.10-12-049, we underscore our commitment to promoting energy efficiency *and preserve credibility in the consistency of our regulatory treatment.*”^{16/} A continuation of the existing RRIM structure for the 2010-2012 program cycle would be a fair result for the IOUs and their customers, who would retain 93% of the savings under the most recent shared-savings mechanism.

^{14/} D.10-12-049, pp. 6-7.

^{15/} The report is available at www.cpuc.ca.gov/NR/rdonlyres/89718A1B-C3D5-4E30-9A82-74ED155D0485/0/EnergyEfficiencyEvaluationReport.pdf.

^{16/} D.11-12-036, p. 10 (emphasis added).

E. The Commission Should Issue A Proposed Decision That Calculates And Approves Incentive Awards For 2010 and 2011.

The ALJ Ruling proposes to calculate and award an incentive for 2010 only. The Commission should instead issue a decision that calculates and awards incentives for both 2010 and 2011.

The Commission should utilize the data in the 2010 – 2011 Energy Efficiency Annual Progress Evaluation Report presented to the legislature to calculate the 2010 – 2011 earnings claim. The IOUs worked closely with Energy Division’s Reporting Group to ensure the accuracy of the 2010 – 2011 data in the report. The report includes all the information necessary (energy savings and cost-effectiveness results) to calculate an earnings’ claim for the IOUs’ 2010 – 2011 accomplishments under the 2009 RRIM methodology. The earnings claim is simply a calculation using the energy savings, program costs and the shared savings rate – all of which are available to the Commission for 2010 and 2011. Specific other elements not included in Energy Division’s 2010-2011 report can be trued up in the 2012 earnings claim.^{17/}

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^{17/} These elements include: 1) CFL carry-over from prior years 2) 2010 – 2012 workpapers awaiting final Energy Division disposition 3) incremental measure cost factors for custom projects and 4) verified codes and standards savings from 2010 – 2012 (EM&V study is expected to be final in June 2013).

