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 SOLICITING COMMENTS ON MODIFIED METHODOLOGY AND USE OF DATA TO DERIVE INCENTIVE EARNINGS AMOUNTS

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I. INTRODUCTION

Pursuant to direction provided on September 25, 2012 in the Administrative Law Judge's Ruling Soliciting Comments on Modified Methodology and Use of Data to Derive Incentive Earnings Amounts ("September 25 Ruling"), San Diego Gas & Electric Company ("SDG&E") and Southern California Gas Company ("SoCalGas") (also referred to as the "Joint Utilities") provide their comments.

The September 25 Ruling contemplates a "new methodology" to determine utility incentive payment awards for the three year 2010-2012 energy efficiency ("EE") program cycle, of which less than one quarter remains. SoCalGas and SDG&E strongly disagree with this "new methodology" and urge the Commission to reject its premise and mechanics, as they are not in any way rationally related to rewarding the California Investor Owned Utilities ("IOUs") for their delivery of EE savings to California. The Joint Utilities submit that the proposed RRIM:

- Is flawed given that it is not related to program performance or Commission goals;
- Features a scoring methodology that is arbitrary in application, as it is discernibly subjective, and cannot be objectively measured or replicated;
- Over emphasizes one program element rather than reflecting entire portfolio performance;
- Provides the wrong incentive mechanism signals by focusing on administrative processes rather than program progress;

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- Damages California's reputation as an Energy Efficiency program leader by promoting a mechanism that rewards obedience, punishes dissent, and stifles innovation;
- Is not supported by the record for this proceeding and should be dismissed from consideration.

Rather than order the implementation of a RRIM that is flawed by these shortcomings, the Joint Utilities ask the Commission to adopt the mechanism proposed in its earlier comments in this proceeding, namely the Performance Earnings Basis ("PEB") adopted and approved by this Commission in earlier RRIMs. If the Commission will not select an approach that is fundamentally tied to program performance, the Joint Utilities would accept a management fee based on program expenditures in the interest of bringing the 2010 – 2012 earnings methodology process to a close, as described in Section III. However, the Joint Utilities strongly assert disagreement with a management fee approach and it should only be applied as a one-time, *ex post facto* basis.

II. THE "NEW METHODOLOGY" IS INCONSISTENT WITH COMMISSION INCENTIVE MECHANISM PRINCIPLES

This "new methodology" consists of an annual two tier award structure, with the first tier being a baseline "management fee" set at two percent of annual portfolio expenditures. The second tier is described as a "performance bonus," and capped at three percent of annual portfolio expenditures. The "performance bonus" is unfortunately not based on how the IOUs perform in delivering actual EE savings. It is, instead, based entirely on the subjective opinion of Commission staff regarding IOU "conformance" to interpretations of the *ex ante* workpaper and custom project review processes established for the 2010 – 2012 program cycle. This "new methodology" has not been vetted, tested or validated; its results cannot be objectively measured, recreated, disputed, appealed or audited. As proposed to the Commission, the "new methodology" is an *ex post facto* penalty for honest disagreement among knowledgeable EE experts regarding process without regard to actual results.

In an April 1, 2009 white paper titled "Proposed Energy Efficiency Risk-Reward Incentive Mechanism and EM&V Activities" (hereafter, the "White Paper"), the Energy

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Division proposed criteria to serve as a framework for designing an effective incentive mechanism:[1]

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 the current staffing.
3. Timely and Non-Contentious – Incentive payments or penalties should be quantified and processed in a reasonable time frame and acceptable to all stakeholders.
4. Fair and Cost-Efficient – The mechanism should provide reasonable opportunity for awards to utilities for successful 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.

Building upon these foundational characteristics, the ALJ Ruling issued on June 15, 2012 regarding the 2013 – 2014 program cycle incentives (the "June 15 Ruling")[2] discussed the limited record regarding use of alternative incentive models and referred to the Commission's White Paper. The June 15 Ruling recapitulated that "The Energy Division suggested, for example, partitioning incentives into (1) "base incentive earnings" for resource programs based on simplified and more broadly defined performance standards and (2) "bonus incentive earnings" for selected non-resource programs, market transformation programs, and strategic initiatives, based on superior accomplishment of more specifically defined and rigorous performance standards." This is essentially the format of the proposed incentive mechanism now before us for the 2010 – 2012 period, except the bonus component is based solely on a highly

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[1] The California Public Utilities Commission White Paper, Proposed Energy Efficiency Risk-Reward Incentive Mechansim and EM&V Activities, Prepared by the Energy Division, dated April 1, 2009, p. 4.

[2] R.12-01-005, Administrative Law Judge's Ruling Calling for Comments on Incentive Reform Issues, dated June 15, 2012.

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subjective administrative process rather than program achievement. The Joint Utilities demonstrate below how the proposed RRIM fails to follow critical principles reiterated in the June 15 Ruling.

1. *Effective and strategic – The mechanism must be focused on the Commission's energy efficiency policy goals.*

As noted above, portfolio expenditures and unilateral conformance to staff and third party consultant direction to the IOUs in the *ex ante* review process do not focus on and thus will not advance portfolio-wide EE policy goals, and, as a result, are inferior to measurements that capture cost effectiveness and/or energy savings achievements. The optimal arrangement is to base incentives upon measures of energy savings/cost effectiveness achievements. Amory Lovins, a world-renowned energy policy and environmental scientist, states in his book, "Reinventing Fire: Bold Business Solutions for the New Energy Era," that: "Allowing utilities to make money on energy efficiency (rewarding independently measured savings, not expenditures or activities) is critical."[3]

2. *Feasible – The CPUC must be able to design and implement the incentive mechanism expeditiously with the current staffing.*

Because the proposed RRIM is *ex post facto* and does not contemplate measurement of savings and/or cost effectiveness, this principle is simply ignored by the "new methodology."

3. *Timely and Non-Contentious – Incentive payments or penalties should be quantified and processed in a reasonable time frame and acceptable to all stakeholders.*

It appears that in order to be "timely," the proposed RRIM disregards alignment with Commission objectives in favor of simplified calculations. IOU scores for the *ex ante* review process are subjectively given without any due process. This approach is far from non-contentious. Thus, this criterion has been partially and selectively applied. Adoption of such a mechanism, even on an *ex post facto* basis, will not influence behavior to promote Commission goals on a going forward basis. In particular, the performance bonus based on a scoring of IOU interaction with ED staff would stifle innovation and critical thinking.

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[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. *Fair and Cost-Efficient – The mechanism should provide reasonable opportunity for awards to utilities for successful management while protecting against unreasonable costs and poorly managed programs.*

The mechanism as proposed in the September 25 Ruling does not incent cost-effectiveness but instead establishes a series of subjective measures. Portfolio expenditures, per se, are not necessarily an indicator of successful program management.

Furthermore, a disproportionate amount of focus is placed on *one* administrative process by associating a majority of the incentive award with the *ex ante* review. This does injustice to the remaining portfolio of programs, and will demand unwarranted attention be paid to administrative processes, thereby diminishing cost effectiveness, and hampering genuine debate and collaborative resolution between peers.

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

While measurement of program expenditures is simple, it is not transparent in that it does not translate to performance from a savings or cost effectiveness standpoint. As noted elsewhere, the *ex ante* review process scoring is completely opaque. The evaluation was performed unilaterally and without any disclosure. Again the "performance bonus" model provides no clear objective basis for the scoring, and cannot be replicated as it presents itself as purely subjective.

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

This principle does not appear to have been taken into account in the formulation of the proposed RRIM, which disregards energy savings as a measure of program success.

In agreement with the Commission's White Paper, the Joint Utilities stated in earlier comments that a RRIM, based on *ex ante* assumptions, can serve the purpose of motivating superior performance in the utility acquisition of energy efficiency savings. In order to describe how the Joint Utilities would adopt, apply and adhere to these principles, the six principles were distilled and restated into four. The Joint Utilities stated there must be: (1) one 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) objective and replicable measurement of results, i.e. clear, simple accounting

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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. These same restated principles should be applicable to all mechanisms, but are absent from the "new methodology," as described below:

1. Clear goal

In order to influence behavior in a meaningful way, it is important that objectives are clear and consistent. With respect to whether the proposed RRIM achieves a clear goal, it is first necessary to note that the September 25 Ruling contemplates an *ex post facto* mechanism that cannot not be determined / known *during* the program period, and thus did not, cannot, and will not have influence over behavior or results. The Joint Utilities believe the RRIM behavioral objective must thus be evaluated within the context of the primary goals they *were* provided and *would have* focused on in the context of an earnings framework.

The proposed RRIM is based on amount of expenditures (40 percent of potential award) and conformance with Energy Division and third party consultant direction regarding the *ex ante* review process (60 percent of potential award). The Joint Utilities submit these objectives do not coincide with goals the IOUs would have targeted for achieving a more cost effective portfolio for customers, or encouraging / accelerating energy efficiency activities / savings for California. The proposed RRIM thus does not achieve the clear goal criterion. That is not to say that the Joint Utilities did not strive to deploy their programs to the fullest extent or perform as strongly as possible in the *ex ante* process, but unquestioned conformance with subjective direction given by Energy Division staff or their consultants is not a suitable *ex post facto* mechanism for the 2010 – 2012 cycle (i.e., representative of the clear and overarching goal for entire program performance).

2. Clear benchmark

This principle is not applicable for the management fee component of the proposed RRIM (i.e., based on 2 percent of annual program expenditures). For the "performance bonus" component, we note the *ex ante* review process is relatively newly established (the most recent aspects approved in mid-2011), and the Joint Utilities are not aware of any benchmarking. The proposal contains a scoring scale from 1 – 5 associated with four primary metrics (each with

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multiple sub-metrics) for non-DEER workpapers and Custom Projects, resulting in a final score between 20 – 100. The 1 – 5 scale is proposed as follows:[4]

1. Consistent underperformer in meeting the basic Commission expectations;

2. Makes a minimal effort to meet Commission expectations but needs dramatic improvement;

3. Makes effort to meet Commission expectations, however improvement is required;

4. Sometimes exceeds Commission expectations while some improvement is expected; and

5. Consistently exceeds Commission expectations.

The scoring system only rates utility performance relative to "Commission expectations," a subjective criteria resulting in scores that are neither measureable nor replicable. In a process defined through the noted decisions, the Joint Utilities and the Energy Division staff are to work collaboratively, with the utilities submitting workpapers or information regarding selected custom projects, and Commission staff reviewing such materials. This specific scoring system is only now being provided to parties through the September 25 Ruling, nearly three years into the program cycle without having been being vetted, tested, or otherwise exposed to scrutiny on the record. Specific communication with the IOUs translating "Commission expectations" into scores of 1 – 5 (e.g., if you do this specific action, score moves up / down by one point) never occurred.

The Joint Utilities emphatically note a great deal of *effort* has gone into implementing and succeeding at the new *ex ante* review process to optimize program performance. This is acknowledged by Metric 1A, which recognizes for both SDG&E and SoCalGas that they "submitted CMPA in September 2011, first among all IOUs."[5] However it appears little acknowledgement of this effort is expressed in the scoring. It is significant that at no time were the Joint Utilities notified that their conformance with staff/consultant direction, or conversely that disagreement with staff over customer benefits and energy savings, would become the yardstick by which the majority of performance would be measured.

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[4] September 25 Ruling, p. 6.

[5] CMPA is the Custom Measure and Project Archive, an electronic archive of all custom measures and projects containing a series of information.

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Given these considerations, clear benchmarks are not featured in the proposed RRIM.

3. Clearly Measurable and Identifiable

The program expenditure component of the RRIM can be determined and verified through accounting processes. With regard to the "performance bonus," as noted above, no clear benchmark has been established, as scoring is relative to conformance with Commission staff/consultant expectations that have not been articulated in the particular manner expressed in the September 25 Ruling. The Joint Utilities also note that the parameters for each score are qualitative, and thus are based purely on subjective evaluation. The Ruling states: "…the Commission staff and contractors who implemented the *ex ante* review process assigned numerical scores for each IOU's 2010 activities."[6]

We respectfully point out that the September 25 Ruling errs in setting a RRIM for 2010 – 2012 that would result in awards for 2010 and 2011 that are based on the comprehensive *ex ante* review process that was not established for more than half the program cycle. As noted in the September 25 Ruling, the *ex ante* review requirements were established in Decision (D.) 09-09-047 adopting the 2010-2012 energy efficiency portfolios, D.10-04-029 regarding the non-Database for Energy Efficiency Resources (DEER) workpaper review process, D.10-12-054 freezing *ex ante* values for the 2010-2012 energy efficiency portfolios, and D.11-07-030 adopting final *ex ante* values for non-DEER measures and the custom project *ex ante* review process. As such, the custom project review process was not finalized and approved until mid-2011. This is a gross simplification that amplifies flaws inherent in mechanisms that over emphasizes administrative process relative to program achievement.

Second, the limited record regarding possible alternatives to the RRIM that was noted in the June 15 Ruling has not been further developed to support the "new methodology," and in particular the contemplated "performance bonus" component or scoring. Information has not been provided regarding the scoring process that was performed by Commission staff and/or its third party contractors. Although the September 25 Ruling admits the scores into the record in this proceeding, there is no evidence of fact to establish and verify the scores, and the results are

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[6] September 25 Ruling, p. 7. As discussed, this is an erroneous statement as the comprehensive ex ante review process was not established before year-end 2010.

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not replicable. The proposed methodology has not been vetted, tested or validated, and the results cannot be objectively measured, recreated, disputed, appealed or audited.

Notwithstanding these fundamental problems with the "new methodology," the Joint Utilities have reviewed the scoring comments and note a lack of consistency regarding the results.[7] For example, with respect to Metric 1C, incorporation of Commission-adopted policy and direction, all four of the IOUs were given the same evaluation for custom projects. The scoring remark for each utility says:

> *"The IOUs understand they need to conduct ISP studies, establish RUL/EUL, quantify the IE effect and support early retirement claim. Project documents mostly do not demonstrate any effort to apply their understanding of these requirements. For example, early retirement claims are made on the grounds that equipment can be repaired indefinitely."*

However, both PG&E and SCE were given a score of 2, while the Joint Utilities were each given a score of 1.

There are similar issues with Metric 4A, timely action to implement all aspects of the adopted DEER, as three utilities were given the similar remark:

> *"Resisted some of D.09-09-047 but moved quickly to remedy after D.11-07-030 and continue to adopt Commission staff recommendation with minimal dispute,"*

but PG&E was given a score of 4 and SCE and SoCalGas each received a score of 3. These examples highlight the subjectivity of the evaluations and the lack of foundation that predominate the determinations. The Joint Utilities assert the problem is not simply the evaluation process, but the criteria themselves.

The Joint Utilities are compelled to point out one of the more concerning evaluations, for Metric 3B, regarding the incorporation of Commission staff comments and input into project activities. The IOU scores for custom projects were associated to some degree with frequency of disagreements with staff. The Joint Utilities noted a correlation of scoring 4 for rare disagreements, 3 for moderate disagreements but perceived willingness to implement staff directions, and 2 for moderate disagreements with lack of certainty how staff direction is

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[7] The Joint Utilities choose to only discuss selected issues to illustrate noteworthy overarching flaws to the *ex ante* scoring, rather than specific issues with SDG&E / SoCalGas scores, but note disagreement with the scores and objection to their admittance into the record without the benefit of due process or any level of transparency.

implemented. However, the custom process approved in D.11-07-030 mapped out an approach for addressing and resolving disagreements, which did not indicate they would be perceived negatively. To wit, the Resolution of Disagreements section begins: "Should Energy Division and a Utility have a technical disagreement on a project's *ex ante* values, Energy Division and the Utility shall meet to discuss and resolve the differences."[8]

The Commission should not adopt a mechanism that contradicts its own process, rewards obedience, punishes dissent, and stifles innovation. In summary, the "performance bonus" component is not clearly measurable or identifiable.

4. An Appropriate Incentive Level

The September 25 Ruling provides the Joint Utilities the opportunity to receive an incentive equal to 2 percent of annual program expenditures and an additional 3 percent of program expenditures based on the "performance bonus." The Joint Utilities submit that expenditures are *not the goal* of the program, but rather a byproduct of program deployment. Over-emphasis on expenditures to the point of exclusivity should be discouraged given the Commission's policy to strive for cost efficiencies through innovation and administrative achievement. Utilities that have met or exceeded program goals, but done so at a more cost effective level, should not be penalized with lower incentives compared to utilities that did not meet an equal level of cost efficiencies (relative to savings achievements).

III. A NON-PRECEDENTIAL ALTERNATIVE

As noted earlier, the June 15 Ruling foretold an alternative RRIM structure with both base and performance bonus incentive earnings. Although the Joint Utilities are interested in alternative mechanisms and evaluating their effectiveness, timing is a critical element. Plainly, this is not the right time to create an alternative incentive model, the *ex post facto* implementation of which does not provide an opportunity to influence program administration regarding implementation practices, and accordingly, to truly gauge its effectiveness. Given the current circumstances regarding the RRIM for the 2010 – 2012 program cycle, the Commission

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[8] D.11-07-030, p. B9.

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should use an approach consistent with existing Commission decisions and grounded in record evidence, such as the Performance Earning Basis ("PEB") as proposed by the Joint Utilities.

The Joint Utilities describe above the deficiencies and lack of merit of the September 25 Ruling's proposed "new methodology" mechanism. The September 25 Ruling acknowledges that various other options are under consideration, including the 2009 RRIM. The 2009 RRIM provided the correct incentive to motivate superior performance to deliver cost effective savings. Similar to the 2009 situation wherein a new RRIM was not approved prior to the implementation of the program period, the Commission implemented the 2009 RRIM with a lower sharing rate of 7% to reflect the increased certainty of rewards and the inability to provide adequate and timely feedback for program improvement, unpredictable, and contentious impacts of ex post EM&V.

We find ourselves in the same situation wherein the program cycle is at its end and a RRIM will not be in place to make any positive impacts on program delivery or IOU behavior. The Joint Utilities understand and appreciate the Commission's desire for a timely and simple resolution. Although the 2009 RRIM is a preferable mechanism, the Joint Utilities can accept an alternative to the September 25 Ruling based on the proposed RRIM framework, i.e., rewards calculated on a percentage of program expenditures. If the Commission will not select an approach that is fundamentally tied to program performance, the Joint Utilities would accept a management fee based on program expenditures in the interest of bringing the 2010 – 2012 earnings methodology process to a close. In addition, given that the 2011 program annual reports have also been filed with the Commission, this mechanism can be employed so that both 2010-2011 are approved in 2012.

Due to the circumstances under which this mechanism is to be approved, i.e., *ex post facto* relative to the conclusion of the program cycle, it should be considered *only* for this particular program cycle and should *not* be considered precedential. Nor should it prejudice any considerations of future RRIMs. For the 2013 – 2014 programs, where a RRIM can be established to influence behavior during the program cycle, we emphasize the adoption of a mechanism that is consistent with the principles reiterated in these comments, such as the savings-based mechanism proposed by the Joint Utilities in their October 1, 2012 comments. It is critical the Commission maintain a structure based on its principal tenets to:

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- Affirm state policy of making EE the top priority in resource planning;
- Help to make investments in efficiency on par with putting "iron in the ground";
- Encourage performance excellence and innovation in execution of the programs;
- Align the interests of customers and shareholders;
- Maintain the clarity of rules and assumptions, so there is integrity in the RRIM process and methodology, in support of all of the above.

IV. CONCLUSION

The Joint Utilities support an incentive mechanism for the 2010 – 2012 program cycle. However, the RRIM proposed in the September 25 Ruling is not aligned with portfolio-wide Commission policy emphasis and therefore, the primary IOU focus during the three-year period. The "performance bonus" component of the mechanism does not resolve the issue of mitigating contentiousness, as the scoring of the *ex ante* review process is highly subjective, inconsistent, not replicable or verifiable, nor consistent with the Commission's established custom review process and regulatory due process. The process was also not comprehensively in place during two of the three years of the program cycle, so should not be used as a measure for awards in 2010 or 2011. Imposition of an *ex post facto* alternative RRIM framework is not appropriate, as the value of implementing a new approach is severely diminished on an after-the-fact basis.

Given these issues, the Joint Utilities return to the proposal from earlier comments and recommend the Commission rely on the PEB measurement, which is consistent with program-wide goals and rewarding achievements. If, however, the Commission will not select an approach that is fundamentally tied to program performance, the Joint Utilities would accept a management fee based on program expenditures in the interest of bringing the 2010 – 2012 earnings methodology process to a close, as described in Section III. However, the Joint Utilities strongly disagree with a management fee approach and emphasize that it should only be applied as a one-time, *ex post facto* solution.

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Respectfully submitted

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