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)

THE DIVISION OF RATEPAYER ADVOCATES' OPENING COMMENTS IN SUPPORT OF THE PROPOSED DECISION REGARDING PRIORITIES FOR PROSPECTIVE ENERGY EFFICIENCY INCENTIVE REFORM AND IN OPPOSITION TO THE ALTERNATE PROPOSED DECISION APPROVING 2010-2012 INCENTIVE MECHANISM AND DISBURSING 2010 INCENTIVE AWARDS

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I. INTRODUCTION

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure, the Division of Ratepayer Advocates (DRA) submits these comments on the Proposed Decision of ALJ Pulsifer titled *Decision Regarding Priorities for Prospective Energy Efficiency Incentive Reform* (PD) and the Alternate Proposed Decision of Commissioner Ferron titled *Decision Approving 2010-2012 Energy Efficiency Incentive Mechanism and Disbursing 2010 Incentive Awards* (APD). Both the PD and the APD were mailed on November 14, 2012.

Both the PD and APD state that adopting an incentive mechanism at this time cannot have a 'material effect' on behavior influencing effective management of the 2010-2012 energy efficiency (EE) programs.[1] Despite this, the APD concludes that increasing customer rates in order to provide the utilities $42.2 million for 2010 is necessary to ensure continued regulatory certainty and avoid sending a bad market signal. In contrast, the PD concludes that devising a mechanism at this point will not advance the Commission's goals of promoting EE and thus further effort should not be spent and a mechanism for 2010-2012 should not be adopted.

The Commission should adopt the PD and reject the APD. The APD would increase customer rates in order to pay utilities an unearned and unwarranted incentive reward for conduct after the conduct that is purportedly being incentivized. Such a giveaway is unjust and unreasonable under Public Utilities Code Section 454. DRA agrees with the PD in that efforts and ratepayer monies are better focused elsewhere.

II. DISCUSSION

A. Background

It was been widely noted that under cost-of-service regulation, there exists an inherent bias in utility planning towards supply-side procurement. In order to mediate this bias, the Commission has adopted a Risk/Reward Incentive Mechanism (RRIM) that allows the investor owned utilities (IOUs) to earn a return on EE developments (Decision (D.) 07-09-043). This mechanism was aimed at creating a 'win-win' scenario where the IOUs were awarded when energy savings increased and customers saved. Incentives were to be sufficient to ensure that the IUOs viewed energy efficiency as a core part of operations, yet were to be based on real and

[1] APD, p. 23, PD, p. 3.

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verified savings. Ratepayer's financial investments were ensured to be protected.[2] It is difficult to see how the proposal to grant after-the-fact incentives fit at all within this framework, as there is no logical tie between providing incentives for desired utility behavior and the shareholder reward.

The question has been raised by the Assigned Commissioners Ruling concerning whether the RRIM can realistically accomplish what it was designed to accomplish.[3] The 2006-2008 RRIM led to a focus of efforts on disputes over process and measurement protocols instead of focusing on greater innovation in program design as it was intended to do. Efforts to adapt programs to changing markets were dwarfed by an overriding focus on Evaluation Measurement &Verification (EM&V) disputes. The IOUs also shifted resources towards shorter-term savings measures to attain higher RRIM earnings as opposed to longer-term savings measures and market transformation programs.[4]

As of today, the Commission has not been successful in producing sufficient reforms in the RRIM. Now that the 2010- 2012 cycle is complete, no mechanism adopted at this point could have any impact on IOU energy efficiency management, conduct, and performance even if reforms were widely accepted. The APD puts forth a mechanism that is backward looking and far removed from the original goals of the RRIM put forth in D.07-09-043.

B. The Commission should reject the APD as it does not present adequate analysis that rationalizes rate increases

The APD would transfer funds from customers, through bill increases, to the IOUs for the purpose of establishing an incentive for conduct that has already occurred. This purported incentive would be awarded in light of a complete failure to demonstrate measurable benefits to ratepayers. The APD lacks any clear or compelling rationale for applying a backward looking incentive mechanism that it acknowledges cannot have a material influence on the performance of utilities in the 2010-2012 program cycle. Even SCE acknowledges that "because any Commission decision on a RRIM for the 2010-12 cycle would be issued well into 2012, any

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[2] D.07-09-043, p. 4.

[3] *Assigned Commissioner's-Ruling To Refresh The Record On Outstanding Issues*, Rulemaking (R.) 09-01-019, August 30, 2011, p. 4.

[4] ACR, p. 6.

adopted mechanism would provide a weakened incentive signal with respect to construction and execution of the 2010-12 portfolio."[5]

The utilities are not entitled to an incentive:

By using the term 'deny' the APD infers that utilities were rightfully entitled to expect such incentive.[6] This is incorrect. As the PD recognizes, "[t]he IOUs had no foreknowledge of future Commission action regarding how (or whether) a RRIM might be designed or implemented for 2010-2012" and that "ultimately, only Commission action should carry weight."[7] It is clear from the beginning of the program cycle that the Commission intended to examine whether there should be a RRIM in the first place, a threshold policy question on which the Commission must still rule. Even if the previous RRIM was in place, its disbursement would not have been guaranteed and would have been based on each utility's performance. Thus, under these circumstances, it would have been a breach of their fiduciary duty to its shareholders for the utilities to create an expectation among those shareholders that a RRIM payment would be forthcoming for the 2010-2012 program cycle.

No evidence exists which supports the benefits declared in the APD:

The APD claims that "denial of a shareholder incentive payment" would be a "bad policy outcome" and that it would send the "wrong signal" to the greater market place.[8] The APD argues that such an incentive payment is necessary for "continued regulatory certainty" to help motivate the utilities and their investors to support energy efficiency programs. The APD further states that:

> Incentive earnings that are not booked at regular intervals would result in a one-time earnings adjustment and likely would be excluded from earnings used as the basis for utility financial valuation. This uncertainty could result in a higher cost of utility financing. As a consequence, the full potential benefit of shareholder incentives would not be realized.[9]

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[5] PD, p. 16.

[6] APD, p. 23.

[7] PD, p. 26.

[8] APD, p. 23.

[9] APD, p. 24.

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There is no evidence in this proceeding that demonstrates or estimates the incremental increase in utilities' financing costs that would result from the absence of a RRIM. Even the APD acknowledges the speculative nature of its statement (and thus conclusion) by stating that no regular payments "could result in a higher cost of utility financing," thus confirming that there is no evidence that a lack of regular payments 'would' have the same result[10]

There is also no potential benefit from a backward looking incentive mechanism because it cannot influence behavior toward improvements in program design, administration or performance. Just as the proposed mechanism cannot incentivize behavior in this cycle (2010-2012), it also cannot incentivize behavior in the future since the APD indicates that it does not apply to future RRIM analysis.[11]

Regulatory certainty here is only beneficial when a stable, clear, and well-functioning incentive mechanism is already in place. Without this, behavior is not influenced; therefore while earnings may be regular, program management will not improve and benefits will not accrue. The PD correctly observes that "[w]hile our original expectation was to provide an opportunity to earn ongoing annual incentive awards, that expectation was premised on an effectively working mechanism."[12]

The APD does not address ratepayer investment protection:

Most importantly, the APD does not address the welfare of ratepayers who ultimately would absorb the burden of paying for the proposed mechanism without a reciprocal benefit. Rates must rise in order to fund these incentives in which the only stated benefit is 'regulatory certainty,' a claim made without evidentiary support. There is no analysis that determines the value of that proposition or that it is a prudent use of ratepayer funds. Section 451 of the Public Utilities Code requires rates be 'just and reasonable.' If the APD cannot provide sufficient evidence that the proposed mechanism will directly benefit ratepayers, it must not be adopted.

[10] Ibid, emphasis added.

[11] APD, p. 30.

[12] PD, p. 25.

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C. The Commission should adopt the PD, as a backward-looking incentive mechanism cannot provide benefits to ratepayers or to future energy efficiency programs

DRA appreciates the comprehensive, balanced and practical analysis the PD presents. DRA agrees with the PD on multiple accounts:

- The effectiveness of an incentive mechanism depends on the timing of its adoption and implementation. The goals and parameters must be set prior to or at the start of the program in order for the mechanism to properly influence behavior. Therefore, adopting a mechanism at this point would be too late to have a "material effect."[13]
- Implementing a mechanism for the 2010-2012 cycle just for the purpose of a continuous flow of earnings serves no Commission goal and will not advance the Commission's energy efficiency policy objectives.
- The utilities and their shareholders are not entitled to awards. As relevant performance parameters were not known until well into the cycle, and the fact that the previously issued PD[14] was withdrawn so no explicit mechanism for 2010-2012 has been in place, the IOUs had no basis to 'assume' how or whether a RRIM would be adopted or implemented.
- The Commission's effort and resources are much better spent looking ahead and the status of a mechanism for 2010-2012 should not be discussed further.

D. The scorecard proposed in the APD should be adopted as it could serve a useful purpose but it should not be tied to the absence or existence of a RRIM

The proposed scorecard allows the Commission to keep a pulse on utility behavior and compliance to the EM&V process and improve communication and interaction between IOUs and independent program evaluators. However, as proposed, the scorecard is an incentive to comply with Commission direction on which monetary awards should not be based. The purpose of the RRIM was to provide an incentive for innovative program design, planning, and execution, not for following Commission rules and processes. Concerns were raised regarding the proposed scorecard itself in the comments that followed the September 25, 2012 Ruling.

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[13] PD, p. 3.

[14] Issued November 15, 2010.

Therefore, the Commission staff should convene workshops to determine what refinements are necessary before putting it in place on a moving forward basis. Once established, the scorecard should be published by the Commission staff at least once every six months to track improvements and determine if intervention is necessary to improve desired outcomes.

E. If the Commission adopts the APD, the management fee and performance bonus should be applied as originally presented in the September 25, 2012 Ruling

The APD proposes an incentive payment based on the following: a 5% management fee that is derived from EE portfolio expenditures directly (less EM&V) and a performance bonus based on a scorecard awarding conformance with the ex-ante lockdown process. The performance bonus is capped at 1% of expenditures but is weighted according to the utilities scorecard. This incentive framework was introduced in the September 25, 2012 Ruling soliciting comments. However, in this Ruling the management fee was comprised of 2% of EE portfolio expenditures and the performance bonus was capped at 3% of expenditures.

While the scorecard (and each IOU's score) was not altered in the APD, the composition of the management fee and performance bonus was. The APD states that they were persuaded by party comments to increase the management fee in order to promote simplicity and alleviate contention with the performance bonus. Therefore the management fee was increased to 5% of expenditures and the performance bonus cap reduced to 1%. The APD also raises the overall incentive cap from 5% to 6%. This was based on the fact that it was comparable to incentive earnings in 2006-2008 and the reduced risk associated with a more simple mechanism."[15]

The composition of this incentive mechanism is extremely arbitrary as it cannot properly impact performance in hindsight. The APD admits that a mechanical formula cannot be used and that its decision was based on "informed judgment."[16] However, if the Commission cannot come up with an analytically supported mechanism, it should focus on broader principles. The performance bonus signals the importance the Commission places on utility efforts in the implementation of the ex-ante review process. While it may be less contentious, reducing the performance bonus from 3% to 1% dramatically reduces this signal. There is also no reason for

[15] APD, pg. 27.

[16] APD, pg. 27.

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an overall incentive cap of 6% (as opposed to 5%) as there is NO inherent risk associated with a backward looking incentive award.

In the event that the Commission adopts the incentive mechanism proposed by the APD, the incentive should be capped at 5% of expenditures and comprised of a management fee applied to 2% of expenditures and the performance bonus, 3% (as originally presented in the September 25, 2012 Ruling).

III. CONCLUSION

Despite continuing efforts to develop a better RRIM, there remains no evidence or other indication that such efforts will yield a breakthrough. The contention continues in the construction of a forward-looking RRIM for the 2013-2014 programs. Yet, even in the midst of the difficulty in designing a forward looking, fully functioning incentive mechanism, the APD proposes this backward looking mechanism that cannot influence behavior to any extent except by an unclear and unsupported policy objective to provide 'regulatory certainty'. The Commission should ask what *exactly* are the benefits of providing continuity of a policy that has not proven to be effective (and has no promise to be in the future) by allocating payment based on criteria that has no 'material effect' on behavior? The PD states:

> While our original expectation was to provide an opportunity to earn ongoing annual incentive awards, that expectation was premised on an effectively working mechanism. Perpetuating the previous mechanism through the 2010-2012 cycle simply for the sake a continuous flow of annual earnings serves no valid Commission goal or public purpose in advancing energy efficiency goals. Rather than attempting to cobble together a backward-looking mechanism for the 2010-2012 cycle, the superior choice is to focus on design of an effective mechanism for 2013-2014.[17]

The APD's claim that a mechanism designed and applied after the fact to provide an unwarranted bonus to shareholders will create adequate regulatory certainty is not supported by record evidence in this proceeding and therefore does not merit ratepayer funding. The time and

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[17] PD, p. 25.

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effort spent on a developing a backwards mechanism would be better spent on developing new forward-looking incentives that could actually influence energy efficiency performance. The Commission should reject the APD and adopt the PD.

Respectfully submitted,

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