BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Reform the Commission's Energy Efficiency Risk/Reward Incentive Mechanism	R.12-01-005 (Filed January 12, 2012)

COMMENTS OF THE UTILITY REFORM NETWORK ON PROPOSED DECISIONS ON AN ENERGY EFFICIENCY INCENTIVE MECHANISM FOR 2010-2012

Marcel Hawiger, Energy Attorney
Cynthia Mitchell, Energy Economics, Inc.

THE UTILITY REFORM NETWORK
115 Sansome Street, Suite 900
San Francisco, CA 94104
Phone: (415) 929-8876 ex. 311
Fax: (415) 929-1132
Email: marcel@turn.org

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On November 14, 2012 the Assigned Administrative Law Judge ("ALJ") released the "Decision Regarding Priorities for Prospective Energy Efficiency Incentive Reform" ("PD"), and the Assigned Commissioner released the "Decision Approving 2010-2012 Energy Efficiency Incentive Mechanism and Disbursing 2010 Incentive Awards" ("APD"). Pursuant to Rule 14.3 TURN provides these comments on both the PD and the APD in this single pleading.

TURN recommends that the Commission adopt the PD. The APD errs in authorizing incentives for work that was completed without any expectations of an incentive, given the lack of any action by the Commission when considering an incentive mechanism for 2010-2012 in R.09-01-009. Such a retroactive incentive is not just and reasonable, and thus violates P.U. Code Section 451.[1] However, TURN supports the management fee mechanism proposed in the APD as the model for future energy efficiency incentives for 2013-2014; though the total incentive should be limited to a maximum of 5% of actual spending.

1 THE APD VIOLATES § 451 BY AWARDING SHAREHOLDER PROFITS FOR PAST ACTIVITIES CONDUCTED WITHOUT ANY INCENTIVE MECHANISM

Both the PD and the APD recognize that any incentive mechanism adopted now for utility activities in 2010-2012 is " backward looking," and can in no way influence utility activities or performance. The PD provides a cogent summary of the problems with instituting such an 'ex post' incentive mechanism:

[1] All code references are to the PUC unless otherwise noted.

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> The effectiveness of an incentive mechanism depends on the timing of its adoption and implementation. As observed in D.10-12-049, any incentive, to be effective, should be designed based upon the goals, benchmarks and performance parameters in effect at the start of the program cycle. For 2010-2012, as discussed previously, the relevant parameters of any incentive mechanism were not known until well into the cycle. *With the 2010-2012 cycle now nearly complete, any incentive mechanism would have no material effect on the design or execution of 2010-2012 programs*.[2]

The PD declines to authorize any incentives for 2010-2012 based on the fact that 1) such incentives would in no way impact performance or program design for activities already completed, and 2) rather than devote time and resources to potential calculations of savings metrics the PD concludes that the better course of action is to focus on designing an incentive mechanism for 2013-2014.

The APD concludes that as a matter of policy it is important to provide incentives to illustrate "continued regulatory certainty in this area":

> TURN, DRA and WEM all advocate not approving a shareholder incentive for the 2010-12 portfolio. While all of these parties make very compelling arguments, ultimately we disagree. We believe that denial of a shareholder incentive payment *sends the wrong signal to the greater market place*. For 2010-12, the utilities managed a $3 billion portfolio comprising an energy resource at the top of the state's loading order. Effective management of EE also ensures progress towards a significant component of California's greenhouse gas reduction goals. We believe *it would be a bad policy outcome to deny a shareholder incentive for energy efficiency*. Rather, we agree with NRDC and PG&E that *continued regulatory certainty in this area will help motivate the IOUs and investors to continue to support and commit to a long term, aggressive EE program that will help meet state policy goals*. We are persuaded by NRDC that an incentive mechanism is an important tool to promote our state's policy objectives for energy efficiency.[3]

The PD strongly rejects this analysis, concluding that "[p]erpetuating 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

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

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goals."[4]

The fundamental legal question not addressed by the APD is whether it is reasonable to award shareholder profits through an incentive mechanism *ex post facto* when the utility conducted work without any reliance on the existence of an incentive mechanism.

The standard of "just and reasonable" rates is met in practice by ensuring, with a sufficient level of record evidence, that spending is cost effective (meaning it provides positive benefits to ratepayers) or necessary to meet goals inherent in the provision of safe and reliable utility service.[5]

Incentive mechanisms to promote specific utility activities or behaviors came into vogue especially in the 1990's as a component of the "performance based ratemaking" paradigm. Utility incentives were justified as reasonable based on their promotion of utility activities that provide benefits to ratepayers. The design of any particular incentive mechanism was always established *a priori* (with, for example, identified benchmarks and payout targets) so as to promote utility spending or activity in a certain area.[6]

The key assumption of any incentive mechanism is that the potential of utility profits will impact management activity and spending decisions. Even if it may be true that on a *prospective basis*, energy efficiency incentives provide benefits to ratepayers by encouraging cost effective energy efficiency spending, there is no theoretical or practical evidence that paying PG&E, SCE,

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[4] PD, p. 25.

[5] In practice, the just and reasonable standard is applied most often in rate cases or reasonableness reviews. On a prospective basis in rate cases the Commission requires a utility to show by clear and convincing evidence that its forecast of costs is accurate. On an *ex post* basis the Commission conducts a reasonableness review of recorded costs using the prudent manager standard. The goal is to determine whether costs are reasonable based on evidence on the record.

[6] The typical examples of such incentives include DSM incentives (using shared savings or milestones as metrics), reliability incentives (using SAIDI, SAIFI, and MAIFI as metrics), safety incentives (using OSHA reportables as a metric) and customer satisfaction (using a variety of response time or survey results as metrics). TURN provided data on these mechanisms in previous filings in this docket and R.09-01-019.

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SDG&E and SoCalGas $42.161 million at this time, for activities conducted in 2010, influences utility behavior or provides any ratepayer benefits.

The PD explains that based on the actual procedural histories of R.09-01-09 and R.12-01-005, there is no basis for any "belief" on the part of the utilities "that they would ultimately qualify for incentive earnings":

> Although the assigned ALJ previously issued a PD for incentive reform to apply for the 2010-2012 cycle, as discussed previously, the PD was withdrawn. Thus, no explicit incentive mechanism has been in place to influence 2010-2012 EE program results. In fact, since a PD was withdrawn that could even indicate to the parties that the Commission could not reconcile this matter, which in turn makes an inference of certainty that much more suspect. Ultimately, only Commission action should carry weight. The IOUs had no foreknowledge of future Commission action regarding how (or whether) a RRIM might be designed or implemented for 2010-2012.[7]

The APD's assertion that "*continued regulatory certainty in this area will help motivate the IOUs and investors to continue to support and commit to a long term aggressive EE program"* lacks theoretical or factual basis. Investors and the IOUs will be motivated by incentives adopted for 2013-2014. For example, if the Commission were to decide in two months that there will be no energy efficiency incentive mechanism for 2013-2014, no one could reasonably argue that this $42 million payment, together with additional payments of incentives for 2011 and 2012, will somehow impact utility actions in the future with no incentive mechanism in place.

In short, giving away $42 million as gravy for past performance is not just or reasonable.

[7] PD, p. 26.

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2 The APD Promotes a Better Model of Incentive Payments, Though the Total Payment Should be Limited to 5% of Actual Spending

The APD determines that a management fee model that provides an incentive payment equal to 5% of actual spending, plus a performance bonus of up to 1% of actual spending based on metrics related to utility conformance with EM&V implementation policies, is appropriate for 2010-2012. The APD thus authorizes incentive payments for 2010 of $42,160,932 for the four energy IOUs.

TURN has for a long time advocated that if the Commission chooses to continue EE incentives, it should adopt exactly this type of management fee model as appropriate payment for administering energy efficiency, and as a tool to prospectively motivate upper management to devote resources to its energy efficiency departments.

However, as a matter of policy we recommend that the cap on annual incentives be lowered to 5% of actual spending by reducing the management fee component to 4% of actual spending. The APD notes that the level of potential earnings is "a matter of informed judgment,"[8] and also notes that 6% is within the range of incentives provided by other states.

The record evidence is extremely sparse. TURN showed that the average incentives for relevant states is approximately 7%.[9] However, the promotion of energy efficiency relies on several policy mechanisms, including cost recovery, decoupling and incentives. California has adopted all of these policies; and California minimizes utility risks of cost recovery and revenue loss more than most other states. California has full balancing account protection for public purpose program (including energy efficiency) expenditures, and California has full revenue

[8] APD, p. 27.

[9] "TURN Post-Workshop Comments," October 1, 2012, p. 5-6.

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requirement decoupling.[10] Not all states provide balancing account protection for energy efficiency expenses; and some states decouple only that portion of revenues lost due to efficiency investments (so called "lost revenue adjustment mechanisms"). Moreover, the California Commission has authorized DSM spending and activities since the early 1980's, much longer than other states. Thus, California utilities have gained significant experience implementing energy efficiency, which should reduce various costs and risks inherent in running newer programs. For all these reasons, TURN suggests that any shareholder profits for energy efficiency should be capped at a maximum of 5% of spending, rather than the 6% authorized in the APD.

December 4, 2012 Respectfully submitted,

By: ___________/s/_____________

Marcel Hawiger, Staff Attorney

THE UTILITY REFORM NETWORK
115 Sansome Street, Suite 900
San Francisco, CA 94104
Phone: (415) 929-8876
Fax: (415) 929-1132
Email: marcel@turn.org

[10] Complete data concerning balancing account protections and revenue decoupling were submitted by the utilities in the current cost of capital proceeding; and are available from past ERRA and cost of capital decisions.

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