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' REPLY COMMENTS IN RESPONSE TO THE ASSIGNED COMMISSIONER'S RULING REGARDING EFFICIENCY SAVINGS AND PERFORMANCE INCENTIVE DESIGN FOR ENERGY EFFICIENCY 2013-2014 PORTFOLIO

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I. INTRODUCTION

The Division of Ratepayer Advocates (DRA) respectfully submits these reply comments in response to comments on the *Assigned Commissioner's Ruling Soliciting Comments Regarding Efficiency Savings and Performance Incentive Design for Energy Efficiency 2013-2014* (ACR). The commenting parties were the Natural Resources Defense Council (NRDC), The Utility Reform Network (TURN), The Marin Energy Authority (MEA), Pacific Gas and Electric (PG&E), Southern California Edison (SCE), along with San Diego Gas and Electric and Southern California Gas Company (Sempra Utilities). Parties offered recommendations on the ACR's proposed Efficiency Savings and Performance Incentive (ESPI) mechanism for the 2013-2014 energy efficiency program cycle. DRA evaluates the merits of the proposals by other parties in these reply comments and draws the conclusions discussed herein.

II. DISCUSSION

DRA evaluates the proposals of other parties using the same criteria used to evaluate the proposed ESPI in our opening comments.[1] Generally, DRA evaluates the extent to which the parties' recommendations encourage superior EE program performance, are cost efficient[2], and reduce EM&V contention and other unintended consequences. Below, we address specific issues and party recommendations that are of most concern for DRA.

1. The ex post savings component cap should not exceed 6% of authorized expenditures and the total award cap should not exceed 7.4% of EE budgets

DRA recommends a reduction in the ex-post savings component to from 8% to 5.5% of authorized expenditures in order to bring the total award cap to 7% of EE budgets. This is consistent with the national average TURN has previously calculated.[3] TURN, in its opening comments, recommended that the ex post savings component cap be reduced to 6% of authorized expenditures. This would lead to a total award cap of $129 million or 7.4% of EE budgets. DRA

[1] DRA's Opening Comments, pp. 3-4.

[2] Energy Division's 2009 White Paper (p.10) states, Fair and Cost-Efficient: The mechanism should provide sufficient, but not excessive, financial awards to utilities to motivate excellent program design and implementation, with sufficient protection against unreasonable costs and poorly managed programs. The mechanism should minimize the total cost to ratepayers of implementing, evaluating, and incentivizing energy efficiency programs.

[3] TURN's post-workshop comments filed on10/1/2012 in R.12-01-005, p. 6.

supports this recommendation as well. The total award cap should not exceed this amount as doing so would not be cost efficient or fair given that the Investor Owned Utilities (IOUs) face minimal risk and that ratepayers are struggling through an extended recession.[4]

Both NRDC ($188 million) and PG&E (13% for the resource program cap) recommend a larger overall award cap than the 9.14% proposed in the ACR. PG&E states that a 13% cap for resource programs is more in line with the national average.[5] NRDC also reports a national average cap of 12-13% of budgets citing an ACEEE survey. However, TURN addressed the limitations of these survey results in its October, 1, 2012 post workshop comments.[6] TURN updated the state caps that had changed since the survey and eliminated "outlier" states that had mechanisms or programs with fundamental differences. TURN further explains that not all of the states included in the national average calculation have full revenue decoupling as California does. States without decoupling may have to use portions of the incentive awards to compensate for under-collection of revenue requirements. However, California IOUs are assured that energy efficiency will not affect their revenue requirement recovery. That is, since California has full revenue decoupling, California IOUs are 100% compensated and risk-free from any under collection of revenue requirements due to load reductions that result from EE penetration. Therefore, a cap of 7% of budgets (the national average) for California IOUs already provides higher monetary incentives than similar programs across the country.

NRDC also compares the proposed ESPI to the 2006 -2008 RRIM stating, "Moreover, despite the ACR proposal's many similarities to the 2006-08 mechanism, particularly in proposing ex-post updates, this mechanism would provide a maximum earnings opportunity that is only half the level of the past mechanism."[7] However, DRA points out that the proposed ESPI is not similar to the RRIM in a way that would justify making this comparison. The RRIM had dead bands, penalties, and was completely dependent on net benefits calculations. The proposed ESPI does not have a dead band or penalties and has management fee components where the cap can be reached simply by spending the funds allocated. The proposed ESPI is much less risky for

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[4] As explained in TURN's Opening Comments and DRA's Opening Comments

[5] PG&E's Opening Comments, p. 3.

[6] TURN's post-workshop comments filed on10/1/2012 in R.12-01-005, pp. 5-6.

[7] NRDC's opening comments, p. 11.

the IOUs than the original RRIM, and therefore, the ESPI total award cap should also be much less.

2. The ESPI should include an ex post verification approach as opposed to an ex ante lockdown approach

If the Commission decides to implement a savings based mechanism, DRA supports an ex-post verification approach for the reasons put forth in the ACR:

- The utilization of ex ante values creates an incentive for the IOUs to develop estimates that are as large as possible, rather than as accurate as possible.
- Ex post verification provides an incentive for IOUs to update parameter estimates mid-cycle, if errors or updated data are identified, and adjust activities accordingly.
- The use ex ante parameters does not provide a pathway to provide savings claims for new and innovative measures for which there are no ex ante parameter estimates at the beginning of the cycle.
- As ex post savings are used in resource planning, keeping two sets of savings estimates (ex ante and ex post) would cause confusion.[8]

PG&E, SCE, NRDC and the Sempra Utilities recommendations to use ex ante values as a base for incentive awards is without merit and should be denied. The IOUs argue that ex ante values will cause less controversy; however, this claim is unfounded as controversy and significant delays did occur in the ex ante lockdown for the 2010-2012 cycle as stated in D.12-12-032.[9] SCE claims that the use of ex ante values increases the predictability of the awards and that, "The confidence the IOU has that it will be rewarded for its performance is central to a successful mechanism."[10] What SCE fails to address is the fact that, when ex ante values are

[8] ACR, pp. 11-12.

[9] D.12-12-032, p. 11, states that:

> We note that various parties argue that relying on ex ante values for calculating 2010-12 incentive earnings could avoid the delays and controversies previously encountered with ex post evaluations. However, based on our experience so far with the 2010-12 cycle, we now appreciate that the process to develop ex ante values can be just as contentious as ex post evaluations.

[10] SCE Opening Comments, p. 5.

used, the final award amount may be more predictable for the IOU, but ratepayers bear the risk that claimed savings may not materialize. Therefore, uncertainty and risk shifts from the IOU shareholders to ratepayers. It must be noted that, the confidence ratepayers have that the EE savings will actually materialize is also central to a successful incentive mechanism.

SCE further states that "ex post estimates may disadvantage an IOU based on factors outside the IOU's control."[11] Yet it would be in the ratepayers' best interest for the IOUs to better track and recognize these factors. While certain factors may be out of their control now, an ex post verification approach will give the IOUs an incentive to be innovative and thorough in order to better address such factors and ensure that cost effective savings do occur. SCE and PG&E argue that there is no opportunity to respond to changes as the results of the studies are only available after the programs have been administered. Again, it would be in ratepayers' best interest for the IOUs to better track program performance so that they could make adjustments in a more timely fashion. Waiting until study results are published, and for the Commission to order a new direction, is too late. An ex post verification approach will give the IOUs an incentive to better monitor programs and constantly seek improvements.

The Sempra Utilities claim that the EAR (Ex Ante Review) process component is sufficient to minimize the IOUs' incentive to inflate ex-ante estimates.[12] This is not true. The EAR process component cap is only at 3% of authorized resource program expenditures, while the proposed savings component cap is 8%. While the EAR process will aid in the production of more accurate estimates, it is not sufficient as there still exists a larger opportunity for earnings in the savings component. The IOUs may be willing to sacrifice low EAR process scores for additional savings awards attained by inflating ex ante estimates.

NRDC recommends that a more transparent EM&V process needs to be established in order to avoid the unintended consequences that resulted from the 2006-2008 RRIM ex post verification process. However, NRDC does not offer specific advice on how this should work or how exactly it would help. NRDC simply states that a more collaborative, focused and open forum is needed in order to work through technical details and measurement uncertainty so that all parties can be confident in the energy savings estimates. NRDC also states that this process

[11] SCE Opening Comments, p. 5.

[12] Joint Utilities Opening Comments, p. 6.

would save time and resources.[13] However, it is not a forgone conclusion that a 'more transparent' process would reduce or limit the endless amount of debate over the methodology and inputs used in savings calculations. In fact, more opportunity for debate may increase the time and resources necessary for resolution. Also, there is a fundamental reason that the ex post savings verification should not be a fully 'collaborative' process; the IOUs have an inherent bias. As DRA stated in our opening comments, any time financial awards are tied to any kind of measurement, it is likely that considerable effort will be spent on skewing the results in order to increase financial awards to the extreme that the measurements and estimates become unreliable. This is of major concern as ex post savings estimates are used in supply side planning (e.g., Long Term Procurement Planning (LTPP), Renewable Integration Studies) where the accuracy of EE savings forecasts are of the upmost importance. The more influence the IOUs have on this process, the more likely savings estimates will be unreliable. The Commission's approach to EM&V is that of independent verification and this should be respected.

NRDC uses the Regional Technical Forum in the Pacific Northwest as an example of an effective model. DRA is not opposed to such an approach as long as the members and stakeholders of this 'forum' do not have vested interests, such as IOU affiliations. In fact, IOU contribution should be limited. However, DRA is not convinced that such an approach would minimize contention over the ex post results. The controversy arises because estimating values such as savings and NTG ratios is extremely complex, results are highly uncertain, and the IOUs have a vested interest. It is unclear that a different EM&V process could remediate any of these issues.

NRDC further argued that, if such a process was not established, a "formal CPUC dispute resolution process" should exist that would allow the cross examination of EM&V results as testimony.[14] PG&E similarly recommends that, if an ex post verification approach is implemented, then parties should be allowed to request evidentiary hearings to vet ex post savings estimates.[15] Such actions would only increase the amount and time and resources needed to resolve disputes, making this approach costly and unproductive. Also, Energy Division and the EM&V implementers are not parties to the EE proceedings and therefore, not subject to

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[13] NRDC Opening Comments, pp. 3-6.

[14] NRDC Opening Comments, p. 6.

[15] PG&E Opening Comments, p. 16.

cross-examination. If such a need exists for a more focused and open vetting process, this can be better achieved through the use of some interactive Workshops which would provide more opportunities for collaboration.

3. Ex post verification and the use of NTG values will not create a disincentive for market transformation activities

PG&E states that an ex post verification, and the use of Net-to-Gross (NTG) values, will dis-incentivize market transformation because the IOUs will be "penalized" for lower ex post NTG values and for higher savings baselines.[16] NRDC and the Joint Utilities make similar arguments. This is not true. The goal of market transformation is to fundamentally transform a market to the point that it can function effectively without subsidization. While a lower NTG value reflects successful market transformation, it also indicates that funding is now less necessary. The proposed ESPI sets up the right incentive, which is to focus funding on programs with high NTG values and low savings baselines, then to reduce funding as the NTG values decrease and savings baselines increase. It is in ratepayers' best interest for the IOUs to recognize such developments and redirect activities accordingly and in a timely manner.

4. If the Commission removes the NTG value from the ex post savings achievement equation as the Sempra Utilities and NRDC recommend, then the Commission should also reduce the savings component cap to reflect less risk for the IOUs

The Sempra Utilities recommend that the NTG value be removed from the ex post savings achievement component because of the contention that historically has surrounded the NTG calculation.[17] NRDC recommends that ex ante NTG values be used, as opposed to ex post values, again because of the controversy surrounding its estimation.[18] DRA is sympathetic to these recommendations because reliance on the NTG does increase the potential for EM&V contention, given that the NTG is particularly difficult to calculate and highly uncertain.[19]

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[16] PG&E Opening Comments, p. 10.

[17] Joint Utilities Opening Comments, p. 8.

[18] NRDC Opening Comments, p. 6.

[19] DRA only agrees with the arguments concerning heightened contention over NTG estimation not those concerning a disincentive for market transformation. As explained above the use of a NTG in the proposed ESPI does not penalize market transformation activities.

However, the NTG is a very important metric as it reflects free-ridership and measures program attribution. Specifically, it encourages the IOUs to avoid funding EE activities that occur naturally and instead to place more attention on where funding can have a greater impact. The NTG is not only critical for use in program design and portfolio approval, but also in an incentive mechanism to ensure that IOUs are not awarded for savings that are not attributable to the programs at hand.

DRA realizes that the NTG is an important yet particularly contentious metric. If the Commission decides to remove the NTG from the ex post savings achievement equation (or to use ex ante values), it should be noted, the amount of risk faced by the IOUs will significantly decrease. Removing the uncertainty that surrounds the NTG will make the IOU awards more predictable and the cap easier to reach. Therefore, if the NTG is removed, the cap on the ex post savings component should be decreased in order to reflect the significant decrease in risk faced by the IOUs.

5. Codes and Standards programs should not be included in the ex post savings achievement award due to the complicating factors in verifying savings

NRDC argues that removing Codes and Standards (C&S) programs from the ex post savings component would create a disincentive for C&S investment as C&S development increases the baselines for other the resource programs.[20] However, while the savings component of the proposed ESPI does not include C&S programs, there is a management fee component for C&S programs in order to encourage investment. There are also other reasons why the IOUs invest in C&S regardless of the mechanism design. One reason is that its high cost effectiveness is critical to keep the entire portfolio cost effective, which is necessary for program approval. C&S programs should not be included in the ex post savings component because savings are particularly difficult to verify, as explained in the ACR. Further, for these reasons, DRA, PG&E, SCE, TURN, and the Sempra Utilities all support a management fee approach for Codes and Standards programs.

NRDC also recommends that, if C&S programs are kept separate within the incentive mechanism, the associated award should be increased to be more reflective of the proportion of savings that C&S produces. NRDC recommends an award of around $12-36 million (up from

[20] NRDC Opening Comments, p. 8.

$2.5 million). This is not justified, as any award above $28 million would be larger than the entire C&S budget! The purpose of the management fee is to encourage the IOUs to adequately invest in C&S and this should be done in a cost-efficient manner. As the IOUs naturally have the incentive to invest in C&S (because of its high cost effectiveness values), DRA believes that the management fee of 10% of spending is too generous. TURN also voiced concern that a 10% management fee for the total C&S category would be excessive under any higher spending levels.[21] Therefore, the C&S component cap should be no larger than what was proposed in the ACR (10% of C&S budget).

6. The ESPI should include the DRA proposed Cost Effective guarantee

DRA and NRDC both recommend that the ESPI should include a cost effectiveness guarantee. NRDC's proposed guarantee is based on the program administrator cost (PAC) test that includes incentive earnings as costs. In addition to this guarantee, NRDC proposed that the IOUs be required to compensate ratepayers for the losses occurred with a non-cost effective portfolio.[22] While DRA appreciates this recommendation, this proposed guarantee increases the risk to the IOUs and may cause undue controversy. Specifically, NRDC's recommendation includes a penalty component. In order to limit possible contention and IOU risk, DRA proposes that a cost effectiveness guarantee be based on a total resource cost (TRC) test without the inclusion of incentive earnings. Moreover, it should only apply to the ex post savings achievement component and it should not be subject to a penalty. As explained in our opening comments, DRA's proposed cost effectiveness guarantee would significantly reduce possible contention that could occur from the use of a cost effectiveness guarantee as it poses no downside risk.

PG&E, SCE, and the Joint Utilities state that there is minimal risk that the TRC results could become non-cost effective, and therefore they do not recommend the use of a cost effectiveness adder or further ratepayer protection. However, DRA believes that ratepayers should not be subject to any level of risk of paying shareholder incentives for non-cost effective resource programs. DRA's proposed cost effectiveness guarantee would protect ratepayers from

[21] TURN Opening Comments, p. 11.

[22] NRDC Opening Comments, p. 18.

this outcome. Even if the risk is only minimal, there is no downside to applying DRA's proposed cost effectiveness guarantee; there is only increased protection for ratepayers.

7. DRA does not comment on the Marin Energy Authority's request for participation in the ESPI mechanism because it is not currently within the Scope of the proceeding

Because Marin Energy Authority's request for participation in the ESPI mechanism it is not currently within the Scope of the proceeding, DRA does not comment on it at this time.

III. CONCLUSION

A utility shareholder incentive mechanism should achieve a higher level of EE program performance while maximizing benefits to ratepayers through cost efficient incentive awards. If the Commission decides to implement a variation of the proposed ESPI, it should include DRA's recommended modifications as discussed in our opening comments. To the extent that the Commission considers other parties' recommendations, DRA urges the Commission to consider the tradeoffs between shareholder and ratepayer risk when designing and adjusting incentive mechanisms.

Considering the responses by parties, which debate the use of ex ante and ex post values for the determination of incentive awards, it appears that a savings based mechanism will not be able to significantly avoid EM&V contention. DRA appreciates the ACR's and other commenting parties' recommendations for steps to minimize EM&V contention. However, it is unclear that any of these recommendations will adequately reduce controversy. Because of this, it is unclear that the proposed ESPI will succeed at motivating superior EE performance in a way that maximizes ratepayer benefit and minimizes the consumption of Commission and IOU time and resources.

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DRA opposes the use of shareholder incentive mechanisms for multiple reasons, one being, the unlikeliness that a meaningful and successful mechanism is at all feasible. But, if the proposed ESPI mechanism is to be created, the Commission should include DRA's recommended modifications as they minimize possible contention and maximize ratepayer protection.

Respectfully submitted,

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