**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)

REPLY COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL (NRDC) ON THE ASSIGNED COMMISSIONER'S RULING SOLICITING COMMENTS REGARDING EFFICIENCY SAVINGS AND PERFORMANCE INCENTIVE DESIGN FOR ENERGY EFFICIENCY 2013-2014 PORTFOLIO

May 3, 2013

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I. INTRODUCTION AND SUMMARY

Pursuant to Rules 1.9 and 1.10 of the California Public Utilities Commission's (CPUC or Commission) Rules of Practice and Procedure, the Natural Resources Defense Council (NRDC) respectfully submits these reply comments pursuant to the "Assigned Commissioner's Ruling Soliciting Comments Regarding Efficiency Savings and Performance Incentive Design for Energy Efficiency 2013-2014 Portfolio" (ACR) issued April 4, 2013. NRDC is a non-profit membership organization, with nearly 100,000 California members with an interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption.

NRDC's responses to parties' comments are summarized as follows:

- There is widespread agreement that the ACR's proposal is moving in the right direction to design an efficiency incentive mechanism.
- The CPUC should take the time during this transition period to improve the EM&V process, as we agree with parties' concerns that the current process is not likely to reduce contention.
- There is widespread agreement that the CPUC should eliminate the TRC multiplier. NRDC agrees with DRA that the Commission should use a cost-effectiveness threshold instead.
- The CPUC should increase the magnitude of potential earnings for energy efficiency proposed in the ACR; NRDC opposes DRA and TURN's proposals to further diminish the potential impact of the incentive mechanism.
- Incentives for program implementers, including CCAs, should be addressed through the bidding and contracting process when their programs are selected.
- Codes and standards efforts are a critical part of the utilities' market transformation efforts and the savings should be counted on an even footing with programs.

II. REPLY COMMENTS

A. There is widespread agreement that the ACR's proposal is moving in the right direction to design an efficiency incentive mechanism.

NRDC commends the Assigned Commissioner and CPUC staff for putting forward a proposal that parties generally agree is moving in the right direction for the design of an incentive mechanism.[1] In particular, there is broad support for focusing on maximizing long-term energy savings to meet the CPUC's overarching objectives, rather than maximizing net economic benefits. Although parties had a variety of recommendations to modify the ACR's proposal, the general agreement around the core element of the proposal is notable.

B. The CPUC should take the time during this transition period to improve the EM&V process, as we agree with parties' concerns that the current process is not likely to reduce contention.

Although DRA supports the ACR's proposal to use retroactive adjustments to energy savings estimates (ex-post EM&V) to assess performance under the incentive mechanism, DRA expresses concern that the proposal may not adequately lessen the contention around EM&V. DRA concludes: "Overall, DRA believes that the proposed ESPI mechanism, as modified in these comments, is largely in alignment with Commission goals and has the potential to encourage the utilities to improve performance in a way that is in ratepayers' best interest. However, DRA is concerned that this potential may not be reached due to the risk of contention in the EM&V process." (p. 21) We agree.

Many parties share the goal of reducing contention in the EM&V process and expressed concern that the process outlined in the ACR would not achieve that goal. NRDC agrees with SDG&E and SoCalGas that the process outlined in the ACR is largely a "statement of the status quo" and will be unlikely to reduce contention. (p. 9) We strongly agree with DRA that reducing contention on EM&V is critical, and that "the Commission and stakeholders should continue to explore opportunities to address this issue on an ongoing basis." (p. 12) As such, NRDC urges the CPUC to use ex-ante EM&V estimates for the 2013-14 incentive mechanism while developing an improved approach to enable continuous updating of estimates in the future.

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[1] We acknowledge both DRA and TURN's opposition to incentives, and their general support for the ACR's direction is only in the context of a continued incentive mechanism.

If the Commission uses ex-post EM&V for 2013-14, contrary to NRDC's recommendations, then we agree with PG&E that "parties should have an opportunity to publicly vet the results on the record." (pp. 2, 16) Absent a more collaborative and transparent process to build greater confidence in EM&V results up-front, the CPUC would need to use its formal process to resolve disputes (i.e. a litigated proceeding) in order to avoid the problems with lingering contention that the CPUC experienced with the 2006-08 incentive mechanism.

C. There is widespread agreement that the CPUC should eliminate the TRC multiplier. NRDC agrees with DRA that the Commission should use a cost-effectiveness threshold instead.

Nearly all parties agree that the CPUC should simplify the mechanism proposed in the ACR by eliminating the cost-effectiveness "multiplier." (DRA pp. 8-9, TURN pp. 2-4, PG&E p. 3, SDG&E p. 20, SCE p. 2) For example, we agree with DRA that the cost-effectiveness multiplier "amplifies uncertainty and complexity" and is not worthwhile addition to the mechanism. (p. 9)

DRA and TURN propose replacing the multiplier with a "cost-effectiveness guarantee," however they each define it differently.[2] Historically, the CPUC has used a "cost-effectiveness guarantee" as a penalty that requires utility shareholders to guarantee customers will not lose money on their efficiency investments by reimbursing any negative net benefits. DRA's proposed "cost-effectiveness guarantee" appears to be what has typically been called a "threshold" (i.e., with no penalty) applied to only the savings part of award. (pp. 8-9) NRDC agrees that a cost-effectiveness threshold would be a simpler and more effective approach.

TURN also proposes to include an adder for reducing the portion of program funds spent on non-incentive activities. (pp. 2, 4-5) While NRDC agrees with TURN's desire to maximize program participation, we oppose TURN's proposed adder. NRDC strongly urges the CPUC not to attempt to change the details of how programs are designed through the incentive mechanism; program design issues should be addressed through the up-front approval process. In addition, in many cases there may be more effective ways to overcome the barriers that customers face than by emphasizing only incentives. For example, information, availability of products in stores, contractor knowledge and training, technical assistance, direct installation, etc, have all been

[2] TURN proposes a "cost-effectiveness guarantee" that reduces earnings down to zero but does not provide a penalty. (p. 13)

shown to be effective in various market sectors at increasing participation; it would be inappropriate for the CPUC to guide programs away from other approaches that might be more effective. In addition, it would contradict the Commission's emphasis on market transformation approaches.

D. The CPUC should increase the magnitude of potential earnings for energy efficiency proposed in the ACR; NRDC opposes DRA and TURN's proposals to further diminish the potential impact of the incentive mechanism.

Both DRA and TURN propose significant cuts to the potential earnings. The ACR's proposal would cap earnings at approximately $150 million (for all four utilities over both years). In NRDC's opening comments, we demonstrated that the ACR's proposal is too low to meet the CPUC's criteria. However, DRA and TURN propose even lower caps: DRA's proposal would cap total earnings at $122 million, while TURN proposes a cap of $130 million. (DRA p. 7, TURN p. 7) Both TURN and DRA justify their proposals with the false claim that this would put California on par with the national average.[3] (TURN p. 6, DRA p. 7) In fact, the American Council for an Energy Efficient Economy's latest survey of efficiency incentives around the country found that earnings caps range from 5% to 20% of program spending and average 12% to 13%, while actual earnings average 10% to 11% of spending.[4] TURN and DRA's proposals would put California at the bottom of the national range, at approximately 6% to 7% of the total budget.[5] In contrast, PG&E proposed a cap of approximately $194 million, which would put California more in-line with the national average.[6]

Moreover, since the ACR's proposal would rightly set the cap at a very high level of performance, well above expectations, the likely earnings under TURN and DRA's proposals would be only about 4% of the budget, or *less than half* the national average. Moreover, the expected earnings proposed by DRA and TURN would be one-third lower than the CPUC's

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[3] TURN asserted that the average cap nationally is 7% of investments, but as NRDC discussed in prior comments, this is based solely on selective use of data from other states. The most recent comprehensive survey of efficiency incentives nationally was done by American Council for an Energy Efficient Economy in 2011.

[4] ACEEE, *Carrots for Utilities: Providing Financial Returns for Utility Investments in Energy Efficiency*, U111, January 2011, p. 10. Of course, it is important to note that most of these states award incentives based on performance at saving energy and lowering customer bills, not based on how much money is spent; the comparison of incentives as a percent of spending is simply to provide a consistent point of comparison across states.

[5] TURN and DRA propose total earnings caps of $130 million and $122 million (for all four utilities over both years), which is approximately 7% and 6% of the total budget for 2013-14 of $1.9 billion.

[6] This cap is NRDC's estimate calculated by using PG&E's proposed 3% for EAR and 10% for savings in the spreadsheet distributed by Energy Division, and then multiplying by 95% to account for the fact that authorized budgets are lower than the original utility applications.

average awards for 2006-2010. As we noted in prior comments, cutting potential earnings even as the CPUC is asking more of the utilities would send the wrong signal.

In opening comments, NRDC demonstrated that the magnitude of earnings proposed in the ACR was too low to meet the key criteria that the CPUC outlined in D.07-09-043. TURN and DRA's proposals for even lower earnings similarly fail to meet the criteria. The Commission should carefully evaluate the magnitude of potential earnings against the clear criteria adopted in D.07-09-043 to ensure it is properly balancing the most important factors. NRDC continues to recommend that the CPUC moderately increase the magnitude of potential earnings for energy efficiency proposed in the ACR to balance those factors,[7] while at the same time remaining conservative as the CPUC continues to iterate on the best design for an incentive mechanism.

E. Incentives for program implementers, including CCAs, should be addressed through the bidding and contracting process when their programs are selected.

Marin Energy Authority (MEA) urges the CPUC to make it eligible to receive awards through the incentive mechanism. However, the incentive mechanism should be applied to the utilities based on their performance as efficiency portfolio administrators (in the context of the overall financial incentives that the CPUC provides to the utilities as resource portfolio managers to guide long-term investments) not to program implementers. MEA and other Community Choice Aggregators (CCA) are program implementers not administrators, as defined by the CPUC.[8] Incentives for program implementers, including CCAs, should be addressed through the bidding and contracting process when their programs are selected.

NRDC agrees that many entities involved in the efficiency industry including program implementers such as third party program deliverers, contractors, etc., should be able to earn a profit on energy efficiency work, and that the profit opportunities should be tied to performance. These business opportunities are critical to grow the efficiency industry. However, the CPUC should stay focused on its role of oversight of portfolio administrators, not program implementers.

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[7] In prior comments, NRDC recommended a cap of $188 million for all four utilities over both years.

[8] See D.03-07-034, which interprets "administrator" in the context of AB 117 to mean "implementer" as the CPUC uses the terms. D.03-07-034 states: "We interpret 'administrator' in this context to mean any entity implementing an energy efficiency program which is the subject of Section 381, which authorizes the expenditure of certain funds on energy efficiency programs. This contrasts with the Commission's energy efficiency policy manual, which distinguishes 'administrators' from 'implementers.'" D.03-07-034, p. 7.

F. Codes and standards efforts are a critical part of the utilities' market transformation efforts and the savings should be counted on an even footing with programs.

TURN claims that it would be "inequitable" to include codes and standards (C&S) savings in the performance-based element of the incentive mechanism, and further claims that C&S programs have "absolutely no 'performance risk'." (pp. 9-10) In reality, the inequity arises if C&S savings are *not* counted. As NRDC explained in opening comments, the ACR's proposed approach would significantly devalue C&S savings, even though pursuing C&S upgrades and compliance is often the most cost-effective approach and essential to avoid lost opportunities. Moreover, the C&S achievements are not automatic as TURN appears to assume. There is considerable work to affect the C&S, and significant performance risk as the ultimate outcome of CEC and DOE decisions, compliance rates, attribution, etc. are all uncertain. The CPUC should be motivating utilities to seek the best C&S *outcome* wherever possible, not just to spend money on the activity. In addition, C&S are a critical part of the utilities' market transformation efforts which the CPUC rightly seeks to expand. Therefore, NRDC urges the CPUC to continue counting C&S savings on an even footing with program savings.

III. CONCLUSION

NRDC commends the Commission for crafting an incentive mechanism that parties broadly agree is moving in the right direction. We urge the Commission to adopt a simplified version of the proposed mechanism (as described in our opening comments) as soon as possible, and to focus on establishing an improved EM&V process during the remainder of the 2013-14 transition period.

Dated: May 3, 2013

Respectfully submitted,

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