

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)

REPLY COMMENTS OF THE UTILITY REFORM NETWORK  
ON THE PROPOSED DECISION ADOPTING AN EFFICIENCY SAVINGS  
AND PERFORMANCE INCENTIVE MECHANISM



Lower bills. Livable planet.

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## REPLY COMMENTS OF THE UTILITY REFORM NETWORK ON THE PROPOSED DECISION ADOPTING AN EFFICIENCY SAVINGS AND PERFORMANCE INCENTIVE MECHANISM

The Utility Reform Network (“TURN”) submits these reply comments pursuant to Rule 14.3.

### 1. Comparison of Incentive Caps in Other States

Both PG&E and NRDC claim that TURN’s analysis of the ACEEE data concerning incentive caps in other states is flawed, and that the Commission should find that caps in other states average “12-13 percent *of budget*.”<sup>1</sup> Both PG&E and NRDC fail to properly account for differences in regulatory policies among states in their use of the ACEEE incentive data as a benchmark.

First, the ACEEE found that the average incentive cap is 12-13% “of *program spending*,” not program budgets.<sup>2</sup> TURN explained that our analysis of caps in other states - based on actual costs - should translate into a ‘budget cap’ in California based on about 5% of budget.<sup>3</sup>

Second, NRDC and PG&E attack TURN’s specific choice of states as the best comparison group. NRDC claims that TURN failed to support its rejection of

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<sup>1</sup> PG&E, p. 2-4; NRDC, p. 11-13 (emphasis added). All citations are to comments on the PD submitted on August 15, 2013 unless otherwise indicated.

<sup>2</sup> ACEEE, *Carrots for Utilities*, 2011, p. 10.

<sup>3</sup> TURN Post-Workshop Comments, October 1, 2012, p. 4-6. TURN agrees that some of the descriptions of the caps in the ACEEE document are not totally clear; moreover, the “spending caps” apply to programs that have different mechanisms for calculating shareholder profits.

certain “outliers,”<sup>4</sup> and PG&E explicitly demonstrates the different outcome of using two different state peer groups.<sup>5</sup> However, a close inspection of PG&E’s table shows that TURN’s selection of states provides a more appropriate comparison to California. The ACEEE itself explained that incentives are just one policy piece, and, as frequently emphasized by the NRDC, the promotion of energy efficiency depends on the mix of policies concerning cost recovery, decoupling, and incentives.<sup>6</sup> Five of the seven states with the lower incentive caps (included in TURN’s analysis) have adopted full decoupling,<sup>7</sup> while *all but one* of the five states with the higher caps (excluded by TURN) either have no decoupling or only partial (lost revenue adjustment) decoupling.<sup>8</sup> In other words, except for Minnesota, all of the states TURN excluded from calculating the cap differ from California by not having full decoupling. The available evidence thus supports the PD’s conclusion that comparisons to other states “offer only a rough indicator” due to different regulatory programs, risks and opportunities, and

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<sup>4</sup> NRDC at 12.

<sup>5</sup> See, PG&E, Table on p. 3.

<sup>6</sup> ACEEE, “Carrots for Utilities,” 2011, p. 3-4 (“ACEEE Report”).

<sup>7</sup> Those states are NH, CT, MA, VT and the District of Columbia.

<sup>8</sup> While the evidence on the record is limited, the Commission can find information concerning state decoupling policies on the ACEEE website (<http://www.aceee.org/sector/state-policy/toolkit/utility-programs/lost-margin-recovery>). TURN also reproduces a relevant table from PG&E’s rebuttal testimony in A.12-04-018 as Attachment 1 to this pleading. The information in columns 3, 4 and 9 can be compared for the states listed in the ACEEE Report.

that TURN's calculation "offers the most accurate measure of comparison with other states."<sup>9</sup>

## 2. Use of *ex post* Verification of Resource Program Performance

The utilities and NRDC advance several arguments in support of using only *ex ante* values for calculating resource program savings. The Sempra utilities claim that an *ex post* mechanism is unfair because, due to the timing of evaluations after the program year, the utilities cannot anticipate and respond to changes in parameters.<sup>10</sup> PG&E claims that if a parameter is "sufficiently certain" for portfolio implementation, then it should suffice for performance evaluation.<sup>11</sup> These arguments reiterate policy disputes that have been vetted multiple times and do not raise factual or legal errors.

The key issue in performance evaluation is not just whether the utilities can make mid-term changes in program design, but whether utility shareholder profits should be based on forecast or actual performance. The Efficiency Savings and Performance Incentive mechanism is renamed from the former "Risk/Reward" mechanism for a good reason. Unlike any other PBR incentive mechanism, it provides the utilities with *only an upside profit potential*. There is

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<sup>9</sup> PD, at 26. TURN agrees that it may have inappropriately excluded Ohio, with a cap of 15%, from the original mathematical calculation of outliers. Including Ohio results in an average cap of 8.225%. If one also excludes the lowest value (Vermont), the resulting average cap is 8.7%, still lower than the 9.1% adopted in the PD. However, TURN cautions that the more accurate comparison would be only for those states that have adopted full decoupling.

<sup>10</sup> Sempra Utilities at 4.

<sup>11</sup> PG&E at 4.

absolutely zero risk of a negative, or even a zero, shareholder payout. Given this elimination of utility risk, it is only fair to ratepayers that the reward should be more strictly based on actual verified performance.

However, *if* the Commission accepts the argument that more, or all, of the incentive should be based on *ex ante* values, then the possible maximum reward should be capped at 5% of budget. *If* an ESPI mechanism is adopted using *ex ante* parameters, it becomes a management fee based on program spending, since there is no performance risk to the utility.<sup>12</sup> The total elimination of utility risk requires a reduction in potential earnings, and the correlation coefficients should be based on a maximum earnings cap of 5% of spending, rather than 8%.

While TURN has reservations about returning to a mechanism based on *ex post* verification, the PD strikes a balance by requiring *ex post* verification of only about 50% of the portfolio.<sup>13</sup>

### **3. Incentives for Codes and Standards (C&S) Advocacy**

The NRDC is the only party that continues to advocate for including Codes and Standards (“C&S”) savings as part of the resource savings mechanism. NRDC claims that historically differential treatment of C&S had “created a

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<sup>12</sup> If money is spent on a resource program, then by definition it will achieve the savings forecast using *ex ante* numbers. The level of savings will depend only on program participation (measure installation), which is closely related to resource program spending.

<sup>13</sup> NRDC states that the PD would “make roughly 75% of the portfolio savings subject to *ex post* adjustment.” That figure appears to be based on the 2010-2012 numbers in Attachment 3, rather than the 2013-2014 compliance filing numbers.

perverse incentive for the utilities to keep measures in programs” rather than promoting changes to codes and standards.<sup>14</sup>

TURN certainly agrees with the NRDC that the Commission should be wary of perverse incentives. However, the outcome of NRDC’s recommendations is that the utilities would reap shareholder profits of between \$11 million and \$34 million for spending about \$25 million of ratepayer money to assist the CEC with C&S development. Does such a profit margin for this type of work, which involves no risk and supports the work of the CEC, even pass the smell test? In this case, it seems that the proper response to the identified potential problem – the fact that a conflict precludes the IOUs from pursuing optimum changes to building and appliance C&S - is to transfer the money directly to CEC to take charge of the C&S development work.

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Respectfully submitted,

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<sup>14</sup> NRDC at 9.

ATTACHMENT 1

Table Reproduced from PG&E Rebuttal Testimony, Ex. 23 in A.12-04-018, served  
on August 29, 2012.

Attachment I

**Regulatory Mechanisms Across U.S. States**

State	Forward Test Years	Decoupling		Fuel/Purchase Power Balancing Account	Other Balancing Accounts	Capex Cost Tracker	CWIP in Rate Base	DSM Performance Incentives
		Full	Partial					
[1]*	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
Alabama	Yes			Yes	Yes			
Alaska				Yes				
Arizona			E		Yes			Yes
Arkansas	Hybrid		E	Yes	Yes	G&E		Yes
California**	Yes	G&E		Yes	Yes	G&E		Yes
Colorado**	Pending	G	E	Yes	Yes	E	Yes	Yes
Connecticut**	Yes	E	G		Yes			Yes
Delaware	Hybrid				Yes			
D.C.	Hybrid	E			Yes			
Florida**	Yes		G	Yes	Yes	E	Yes	Pending
Georgia	Yes		G	Yes	Yes	G&E	Yes	Yes
Hawaii	Yes	E		Yes	Yes	E		Yes
Idaho		E		Yes	Yes			Pending
Illinois**	Yes	G	G		Yes	G		
Indiana**		G	E	Yes	Yes	G&E	Yes	Yes
Iowa**				Yes	Yes	E		
Kansas			E	Yes	Yes	G&E	Pending	Pending
Kentucky**	Yes		G&E	Yes	Yes	G&E		Yes
Louisiana				Yes	Yes	E	Yes	
Maine	Yes				Yes	E		
Maryland		G&E			Yes		Yes	
Massachusetts**		G&E	G&E		Yes	G&E		Yes
Michigan**	Yes	G&E			Yes		Pending	Yes
Minnesota**	Yes	G, E-Pending		Yes	Yes	E	Yes	Yes
Mississippi	Yes		E	Yes	Yes	E	Yes	
Missouri			G, E-Pending	Yes	Yes	G		Pending
Montana			G					Pending
Nebraska				Yes	Yes		Yes	
Nevada		G	E		Yes			
New Hampshire		G, E-Pending			Yes			Yes
New Jersey**	Hybrid	G			Yes	G&E		
New Mexico	Pending	E-Pending		Yes	Yes		Pending	Yes
New York	Yes	G&E			Yes	G&E		Yes
North Carolina**		G	E	Yes	Yes		Yes	Yes
North Dakota	Yes		G	Yes	Yes		Pending	
Ohio**	Hybrid	E-Pending	E		Yes	G&E		Yes
Oklahoma			G&E	Yes	Yes	E	Pending	Yes
Oregon	Yes	G&E	G		Yes	G&E		
Pennsylvania**	Hybrid				Yes	E		
Rhode Island	Yes	G&E			Yes			Yes
South Carolina**			E	Yes	Yes		Yes	Yes
South Dakota			E	Yes	Yes		Pending	
Tennessee	Yes	G		Yes	Yes			
Texas						E	Yes	Yes
Utah	Yes	G, E-Pending	E-Pending	Yes	Yes	G		Pending
Vermont		G&E			Yes	E		Yes
Virginia**		G	E-Pending		Yes	E	Yes	
Washington		G		Yes	Yes			
West Virginia				Yes	Yes		Yes	
Wisconsin**	Yes	G&E		Yes	Yes		Yes	Yes
Wyoming	E Only	G	E	Yes	Yes			

\* See next page for sources, notes, and definitions

\*\* States where PG&E's and TURN's PG&E comparator utilities operate



**Sources:**

[2] – [4], [7] -[8]: From "Innovative Regulation: A Survey of Remedies of Regulatory Lag", Edison Electric Institute, April 2011, Table 1 and Table 9.

[http://www.eei.org/whatwedo/PublicPolicyAdvocacy/StateRegulation/Documents/innovative\\_regulation\\_survey.pdf](http://www.eei.org/whatwedo/PublicPolicyAdvocacy/StateRegulation/Documents/innovative_regulation_survey.pdf)

[5], [9]: From "IEE State Electric Efficiency Regulatory Frameworks Report," July 2012.

[http://www1.eere.energy.gov/buildings/betterbuildings/neighborhoods/pdfs/iee\\_state\\_reg\\_framework.pdf](http://www1.eere.energy.gov/buildings/betterbuildings/neighborhoods/pdfs/iee_state_reg_framework.pdf)

[6]: Adjustment Clauses and Rate Riders ~ A State-By-State Overview ~, Regulatory Research Associates, March 21, 2012.

**Notes:**

[5], [8], [9]: Data is for electric utilities only.

[6]: Information on other balancing accounts is listed in the following state-by-state table.

**Definitions:**

[2]: A forward test year is a twelve month period that begins after the rate case is filed.

[3] - [4]: Full decoupling or partial decoupling (lost revenue adjustment mechanisms and/or fixed customer charge) assists the utility in recovering authorized revenue requirements associated with fixed operating costs, despite increases or decreases in sales.

[5]: Fuel/Purchase Power Balancing Accounts include 1) fuel riders that allows fuel costs to adjust intra-year if recoveries or deferrals differ from budget by more than specified amount and 2) Energy Cost Recovery (ECR) mechanisms established on the basis of estimates of electric sales, fuel-related costs, and purchased power costs, and reflects accumulated over- or under-recovered amounts

[7]: Trackers for the annual cost of plant additions are sometimes called capital expenditure ("capex") trackers.

[8]: Many commissions address the delay in receiving a return on investment by including costs of construction work in progress ("CWIP") in the rate base, so that a return on investment can start sooner.

[9]: Performance Incentives are mechanisms that reward utilities for reaching certain energy efficiency program goals, and, in some cases, impose a penalty for performance below the agreed-upon goals.