

DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**Agenda ID 12597
RESOLUTION E-4633
December 19, 2013**

R E S O L U T I O N

Resolution E-4633. Southern California Edison (SCE) requests approval of program year 2011 energy efficiency awards, in compliance with Ordering Paragraph 8 of D.12-12-032.

PROPOSED OUTCOME: This Resolution reduces the award amount of \$18,605,624 requested in Advice Letter 2946-E and awards SCE an initial 2011 incentive award of \$13,554,610, with the potential to earn up to \$18,560,138, based on audit findings for the 2011 portfolio.

SAFETY CONSIDERATIONS: This Resolution pertains to incentive awards to SCE and thus is not expected to have an impact on public safety.

ESTIMATED COST: The 2011 incentive award for SCE is estimated to cost between \$13,554,610 and \$18,560,138.

By SCE Advice Letter 2946-E (U 338-E) filed on October 4, 2013.

SUMMARY

This Resolution addresses Southern California Edison's (SCE's) Advice Letter 2946-E seeking approval of program year 2011 incentive award for its energy efficiency portfolio in compliance with Ordering Paragraph 8 of D.12-12-032. This Resolution reduces the award amount of \$18,605,624 requested in Advice Letter 2946-E and awards SCE an initial 2011 incentive award of \$13,554,610, with the potential to earn up to \$18,560,138, based on audit findings for the 2011 portfolio.

BACKGROUND

The California Public Utilities Commission (CPUC) adopted a shareholder incentive mechanism for energy efficiency programs beginning with the 2006-08

portfolio to motivate investor-owned utility (IOU) management to pursue energy efficiency as a core business strategy. However, significant controversy over the 2006-08 incentive mechanism caused the CPUC to reconsider the incentive mechanism structure.

The Commission opened a proceeding to consider reforms to the original mechanism, but had not completed its deliberations on the appropriate reforms as the 2010-12 cycle was drawing to a close. The Commission recognized that the mechanism reforms could not influence the IOUs' 2010-12 portfolio implementation activities, but found it reasonable to continue to disburse shareholder incentives for energy efficiency to send the proper investment signal to the market place and affirm the state's commitment to energy efficiency.¹ On December 20, 2012, the CPUC adopted decision D.12-12-032,² which implements a simplified shareholder mechanism for the 2010-12 portfolio that consists of a management fee with a performance bonus based on each IOU's compliance with the Commission's ex ante review process.

D.12-12-032 set the management fee equal to 5% of audited annual utility programmatic expenditures, plus up to 1% for ex ante review performance, excluding evaluation, measurement, and verification (EM&V) costs. Ex ante review performance is assessed using a set of 11 metrics covering the following four categories:

- Category 1: IOUs' efforts to implement the Commission's ex ante review process within their organizations
- Category 2: Level of due diligence the IOUs applied to their ex ante activities
- Category 3: Progress toward ex ante activity that is more self-policing
- Category 4: Efforts to implement Commission adopted policy regarding the use of the Database for Energy Efficient Resources (DEER)

The Decision adopted an ex ante performance score of 56/100 for SCE, resulting in an overall incentive award earnings rate of 5.56% for SCE (5% management fee plus 0.56% ex ante performance bonus). In order to determine the actual expenditures to calculate its respective incentive awards, D.12-12-032 directed SCE to use the public version of the CPUC Utility, Audit, Finance, and Compliance Branch (UAFCB or Commission audit team) final audit report.

¹ D.12-12-032 at page 43.

² D.12-12-032 available at <http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M039/K604/39604336.PDF>.

The 2011 audit was performed to comply with the timeline set in D.12-12-032. As such, the audit was conducted over a two month period rather than the usual six month period. As a result of the short time frame, the Commission audit team elected to limit the audit scope to SCE's energy efficiency costs and reporting related to (1) administrative costs (including third party and local government partnership administrative costs); (2) Energy Efficiency contracts; (3) On-Bill Financing; and (4) Multifamily Energy Efficiency Rebates. These four portfolio areas represent approximately 34% of SCE's portfolio expenditures. It should be noted, however, that within those four portfolio areas, the audit team did not examine 100% of the reported costs and that the final UAFCB report is limited to misreported or misrecorded expenditures. The final UAFCB report for SCE was made public on September 30, 2013.³ The service list for R.12-01-005 was notified of the availability of the UAFCB audit.

D.12-12-032 directs SCE to file a Tier 3 Advice Letter seeking incentive awards for 2011 program activities using the adopted earnings rates and the audited expenditure amounts.

NOTICE

Notice of SCE AL 2946-E was made by publication in the Commission's Daily Calendar. SCE states that a copy of the Advice Letter was mailed and distributed in accordance with Section 4 of General Order 96-B.

PROTESTS

No protests were filed in response to SCE AL 2946-E.

DISCUSSION

Energy Division has reviewed AL 2946-E and finds that the requested incentive award, as calculated by SCE, is not appropriate because it does not apply disallowances recommended in UAFCB's final audit report. Additionally, as stated in the *Energy Efficiency Financial Compliance Examination Report of Southern California Edison (SCE) For the Period January through December 31, 2011* (Final Report), the Commission audit team found material errors and widespread non-compliance with CPUC policies in SCE's 2011 reported expenditures, as described below.⁴ As such, this Resolution removes the

³ Financial Compliance Audit Reports for Energy Efficiency (EE) Programs
<http://www.cpuc.ca.gov/PUC/Water/Available+Documents/Reports/Financial+Compliance+Audit+Reports+for+EE+Programs.htm>

⁴ *Energy Efficiency Financial Compliance Examination Report of Southern California Edison*

\$818,092 in disallowances identified by the Commission audit team from SCE's 2011 expenditures for the purpose of incentive award calculation. Additionally, this Resolution holds back the incentive award for an additional \$90,027,474 from SCE's 2011 expenditures until a more extensive audit of SCE's 2011 expenditures can be completed. Consequently, this Resolution reduces the requested award amount of \$18,605,624 to an initial payment of \$13,554,610, with the potential to earn up to an additional \$5,005,528, for a total of \$18,560,138, pending additional audit results.

UAFCB's 2011 audit of SCE's reported expenditures included a limited scope that included a sample of costs and reporting in four portfolio areas (administrative costs, Energy Efficiency Contracts, On-Bill Financing, and Multi-Family Energy Efficiency Rebates). The four portfolio areas sampled represent approximately 34% of SCE's total portfolio expenditures;⁵ however, the Commission audit team did not have the time or resources to test all of the costs within these areas or all of the areas of the portfolio. In the areas sampled, the audit team found \$30,796,647 of recording and reporting discrepancies in SCE's 2011 reports (equal to 9.2% of 2011 reported expenditures and at least 27% of the expenditures sampled).⁶

In its comments on UAFCB's draft report, SCE indicated that it strongly disagreed with the findings and stated that the majority of UAFCB's observations were factually incorrect, without merit, and not supported. Within its detailed responses to the draft report findings, however, SCE admitted to many of the audit team's observations. In the time between SCE's comments on the draft report and the publication of the Final Report, the audit team encouraged SCE to provide additional documentation in an effort to allow SCE every opportunity to disprove the audit team's findings. During that time period, SCE was able to clear \$226,218 of UAFCB's original findings. The audit team updated the Final Report to reflect comments and source documentation from SCE. Ultimately, SCE agreed in principle that it had recording and reporting discrepancies up to \$25,544,138.⁷

In the Final Report, the Commission audit team notes that SCE did not

(SCE) For the Period January through December 31, 2011 (Final Report), dated September 20, 2013. Available online at:
<http://www.cpuc.ca.gov/PUC/Water/Available+Documents/Reports/Financial+Compliance+Audit+Reports+for+EE+Programs.htm>

⁵ Ibid pages B-2-B-5.

⁶ Ibid at page 1.

⁷ Ibid at pages 1-2.

demonstrate compliance with Public Utility Code Sections 314(a), 581, and 584, General Order 28, the Uniform System of Accounts (USOA), the Commission's directives on administrative costs, the terms of SCE's contracts, and SCE's own policies and procedures.⁸ Specifically, these directives require the following:

- Public Utility Code §314(a) states “The Commission, each commissioner, and each officer and any person employed by the Commission may, at any time, inspect the accounts, books, papers, and documents of any public utility.”
- Public Utility Code §§ 581 and 584 require that the utility provide complete and accurate data to the Commission.
- General Order 28 requires the utility to maintain adequate documentation.
- The USOA requires the utility to maintain adequate documentation and that “the utility is required to keep its accounts on the accrual basis. This requires the inclusion in its accounts of all known transactions of appreciable amounts which affect the accounts. If bills covering such transactions have not been received or rendered, the amounts shall be estimated and appropriate adjustments made when the bills are received” (See FERC USOA General Instructions 11).
- ALJ Gottstein's Ruling in R.01-08-028, dated February 21, 2006, addressed and listed allowable costs and delegated authority to Energy Division to provide further clarification to the reporting requirements and list of costs.⁹ Energy Division's memo, dated October 22, 2009, expanded cost definitions and defined how costs should be treated.
- D.09-09-047 set a 10% cap on IOU administrative costs, defined as overhead, labor, human resources support and development, and travel and conference fees. The decision explicitly excludes Evaluation, Measurement, and Verification (EM&V), marketing and outreach, and direct implementation costs from administrative costs.¹⁰

UAFCB's observations of SCE's 2011 expenditure reporting and tracking practices that led to non-compliance with the aforementioned policies included the following:

⁸ Ibid at page 2.

⁹ The February 21, 2006 Ruling is available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/RULINGS/53817.PDF.

¹⁰ In defining “administrative costs” and mandating a 10% cap, the CPUC expects IOU accounting practices to directly report allowable administrative costs. Given that SCE did not comply with ALJ Gottstein's 2006 Ruling or Energy Division's 2009 memo on cost categories and reporting, the CPUC cannot clearly ascertain whether SCE is in compliance with the 10% administrative cost cap set in D.09-09-047.

- Quarterly reports on EEGA do not tie with SCE's recorded data;
- Misclassified costs including (1) reporting costs in an incorrect program area; (2) using estimated allocation factors for administrative costs; (3) permitting direct implementation contractors to allocate total costs between direct implementation, administrative, and marketing costs instead of directly charging costs to those areas;
- Inadequate supporting documentation;
- Untimely accrual;
- Inability to verify labor charges sample;
- Overstated On-Bill Financing committed funds and customer overbillings; and
- Lax or unenforced internal controls.¹¹

As previously noted, these observations amounted to \$30,796,647 of recording and reporting discrepancies. SCE agreed in principle with \$25,544,138 of these discrepancies.¹² The audit team elected not to disallow the majority of these recording and reporting discrepancies from SCE's 2011 expenditures because the errors did not change the entire amount spent during the 2011 program year.

With regard to the 2011 incentive award, the Commission audit team recommended that the Commission remove \$818,092 of the \$30,796,647 of reporting and recording discrepancies from SCE's energy efficiency expenses prior to calculating the incentive due to inadequate supporting source documentation (amounting to \$76,226) and untimely accruals (amounting to \$741,866) in SCE's Multifamily Energy Efficiency Rebates and Third Party programs.¹³ The Commission audit team limited its recommended adjustment to \$818,092 because these were the only misreported expenditures that would have changed the total amount spent in 2011.

In AL 2946, SCE calculated the 2011 award as 5.56% of its 2011 expenditures without any adjustments. SCE stated that it does not support the UAFCB recommended disallowances and recommends that the Commission reject the disallowances. Despite numerous opportunities, however, SCE was unable to provide any documentation to support its reasoning for rejecting the Commission audit team's recommended adjustments.

¹¹ Final Report at pages 1-5.

¹² No additional information was provided in the UAFCB final report regarding SCE's agreement or disagreement with the remaining \$5,252,509 in reporting and recording discrepancies.

¹³ Final Report at pages 1, 3-4.

Further, the Commission audit team states that it experienced substantial difficulty in getting reliable and timely responses from SCE throughout the audit 2011 program review process, including:

- Frequently missed deadlines for data requests, which suggests that SCE did not have its documents readily available for audit.
- SCE responses to data requested were often incomplete or inaccurate. The auditor consistently had to make several requests in order to obtain the complete information needed.
- SCE had the tendency to provide more than one answer to each discrepancy found during the examination – when the first answer did not remove a discrepancy, SCE would provide a different answer hoping to remove the exception. This inconsistency caused several edits to the auditor’s work paper or report and delayed the audit process.

Staff finds the observations noted in the Final Report and the Commission audit team’s experience in the audit to be troubling and disappointing. SCE is responsible for managing millions of dollars of ratepayer money every year to implement energy efficiency programs. If SCE cannot effectively track and report its expenditures, and the CPUC cannot reasonably verify the expenditures, then ratepayer money invested in energy efficiency programs is at risk of being misspent and lost.

The shareholder incentive mechanism is an important tool to promote California’s energy efficiency policy objectives and to motivate IOUs to continue to support and invest in energy efficiency, and the mechanism adopted for the 2010-12 portfolio recognizes the importance of portfolio implementation in conformance with Commission policy and processes (e.g., the ex ante performance bonus and the audit requirements), and rewards the IOUs accordingly.

The Commission audit team finds, and this resolution confirms that SCE's accounting processes did not comply with the Public Utilities Code, the USOA, and other Commission policies and directives for the 2011 program implementation period. Additionally, SCE did not demonstrate a good faith effort to comply with the 2011 audit or Commission staff performing the audit. This Resolution recognizes that the audit team only explicitly disallowed a small portion of the identified discrepancies, suggesting that a more exhaustive audit which disaggregates various booked expenditures could reconcile many of the identified discrepancies; however, a more exhaustive audit may also reveal additional errors in SCE’s expenditure tracking and reporting practices. More importantly, this Resolution notes that the incentive is an award to shareholders for utility excellence in implementing the portfolio and that the CPUC emphasized

the importance of utility conformance with Commission policy in the adopted 2010-12 mechanism.

UAFCB's 2011 audit findings for SCE found SCE's 2011 reports to be less than accurate and reliable.¹⁴ Staff is concerned about the potential of awarding shareholder incentives for reporting practices that limit the Commission's ability to fully understand SCE's expenditures. Consequently, Energy Division finds it reasonable to disallow the expenditures recommended in UAFCB's Final Report (\$818,092) with a holdback for potentially misrecorded expenditures for the purpose of calculating SCE's 2011 incentive award.

In addition, staff recognizes that the audit sample is not sufficiently robust to represent SCE's entire 2011 energy efficiency portfolio. Extrapolating the \$30,796,647 in misreported expenditures identified in the four areas that UAFCB audited to the remainder of SCE's expenditures would result in approximately \$90.8 million in total misreported expenditures, or an additional \$60 million above the identified \$30,796,647.¹⁵ To prevent awarding shareholder incentives for inaccurate reporting practices based on the findings of this limited audit, Energy Division finds it reasonable to hold back the incentive award corresponding to this extrapolated estimate of approximately \$90 million until a more extensive audit of SCE's 2011 expenditures can be completed.

As such, Commission staff will oversee the scoping and implementation of an additional audit into SCE's 2011 expenditures. Staff will consult with SCE when developing the audit scope; however, aside from providing initial input on the audit scope, SCE will not otherwise manage or provide input into the audit. SCE will rely on the final public version of this follow up audit when calculating additional 2011 incentive awards.

Disallowance of the full value of potential reporting and recording errors (i.e., \$90.8 million) reduces SCE's 2011 expenditures from \$334,633,524 to \$243,787,958 for incentive calculation purposes. By applying SCE's adopted earnings rate of 5.56%, SCE's initial payment for the 2011 incentive award is equal to \$13,554,610. SCE has the opportunity to earn up to an additional \$5,005,528, for a total of \$18,560,138, for their 2011 incentive depending on the findings of the subsequent audit of SCE's 2011 portfolio expenditures.

¹⁴ Ibid at page A-1.

¹⁵ The four program areas the Commission audit team reviewed covered approximately 34% of SCE's 2011 expenditures, which is equal to approximately \$113.4 million. Given that \$30.8 million of misreported expenditures were found within that \$113.4 million sample, one can infer that an audit of all of SCE's 2011 expenditures (\$334.6 million) could show misreported expenditures up to \$90.8 million. That is, $(30.8/113.4) = (90.8/334.6)$.

Category	Amount
Total 2011 Expenditures	\$334,633,524
Recommended Disallowance	\$818,092
2011 Estimated Audit Sample Size	\$113,440,765
Misreported Funds	\$30,796,647
Percentage of Misreported Funds within Sample	27.1%
Extrapolation of Misreported Funds to Total Expenditures	\$90,845,566 ¹⁶
Maximum Incentive Award	\$18,560,138 ¹⁷
Minimum Incentive Award	\$13,554,610 ¹⁸
Holdback	\$5,005,528 ¹⁹

SCE should make every effort to comply with the recommendations contained the UAFCB Final Report, and Commission Energy Division and audit staff will work with SCE in the coming months to support this effort. Additionally, SCE should make every effort to facilitate UAFCB's 2012 audit of SCE's energy efficiency programs. Per D.12-12-032 and D.13-09-023, the UAFCB audit reports will continue to be the source documentation for the IOUs' annual expenditures for incentive mechanism purposes. It is imperative that auditors have reliable, accurate, and timely data to enable an efficient and effective audit.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived or

¹⁶ $\$334,633,524 * 27\% = \$90,845,566$

¹⁷ $(\$334,633,524 - \$818,092) * 5.56\% = \$18,560,138$

¹⁸ $(\$334,633,524 - \$90,845,566) * 5.56\% = \$13,554,610$

¹⁹ $\$18,560,138 - \$13,554,610 = \$5,005,528$

reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from today.

FINDINGS

1. D.12-12-032 directed SCE to file an Advice Letter to seek the 2011 incentive award adopted in that decision.
2. Per D.12-12-032, SCE and the CPUC will rely on the public version of the UAFCB final report to verify energy efficiency program expenditures.
3. The UAFCB audit scope was limited to four portfolio areas: administrative costs (including third party and local government partner administrative costs), energy efficiency contracts, On-Bill Financing, and Multifamily Energy Efficiency Rebates. These four areas comprise approximately 34% of SCE's 2011 expenditures.
4. The UAFCB final report for SCE found \$30,796,647 in recording and reporting discrepancies. This is equal to 9.2% of SCE's total 2011 expenditures and at least 27% of the audit sample size. SCE agreed in principle with \$25,544,138 of these discrepancies.
5. UAFCB recommended that the Commission remove \$818,092 from SCE's 2011 expenditures prior to calculating the incentive award. These were the only funds identified during the audit process that would have changed SCE's total 2011 expenditure amount.
6. The UAFCB audit was limited in time and resources. If additional time and resources were devoted to examining SCE's 2011 expenditures, it is possible that some or most of the \$30,796,647 in reporting discrepancies would be cleared; it is also possible that additional errors in SCE's 2011 reporting and recording practices would be discovered.
7. In SCE AL 2946-E, SCE stated that it did not agree with the UAFCB adjustment and recommended that the Commission should not adopt it. Despite numerous opportunities, SCE was not able to provide documentation supporting its reasoning for why the adjustment should not be adopted.
8. SCE did not put forth a good faith effort to comply with the UAFCB audit and often provided incomplete or inaccurate data.
9. SCE did not demonstrate compliance with Public Utility Code Sections 314(a), 581, and 584, General Order 28, USOA, the Commission's directives on administrative costs, the terms of SCE's contracts, and SCE's own policies and procedures during the 2011 energy efficiency program year.
10. Given SCE's lack of compliance, Energy Division finds it reasonable to disallow the recommended \$818,092 from SCE's 2011 energy efficiency expenditures for the purpose of incentive calculation.
11. Extrapolating the \$30,796,647 in misreported expenditures identified in the four areas that UAFCB audited to the remainder of SCE's expenditures would

- result in approximately \$90.8 million in total misreported expenditures, or an additional \$90 million above the recommended adjustment of \$818,092.
12. To prevent awarding shareholder incentives for inaccurate reporting practices based on the findings of this limited audit, Energy Division finds it reasonable to hold back the incentive award corresponding to this extrapolated estimate of approximately \$90 million until a more extensive audit of SCE's 2011 expenditures can be completed.
 13. Disallowance of the full value of potential reporting and recording errors (i.e., \$90.8 million) reduces SCE's 2011 expenditures from \$334,633,524 to \$243,787,958 for incentive calculation purposes. By applying SCE's adopted earnings rate of 5.56%, SCE's initial payment for the 2011 incentive award is equal to \$13,554,610. SCE has the opportunity to earn up to an additional \$5,005,528, for a total of \$18,560,138, for their 2011 incentive depending on the findings of the subsequent audit of SCE's 2011 portfolio expenditures.
 14. Commission staff will oversee an additional audit of SCE's 2011 expenditures. Staff will consult with SCE when developing the audit scope; however, aside from providing initial input on the audit scope, SCE will not otherwise manage or provide input into the audit.
 15. SCE will rely on the final public version of the follow up audit when calculating additional 2011 incentive awards.
 16. SCE should make every effort to comply with the recommendations in the UAFCB Final Report to improve the accuracy of reporting and recording of its energy efficiency programs.
 17. SCE should make every effort to facilitate the UAFCB 2012 audit of its energy efficiency programs.

THEREFORE IT IS ORDERED THAT:

1. The request of the SCE to be awarded \$18,605,624 for the 2011 energy efficiency incentive award as requested in Advice Letter AL 2946-E is denied. SCE is instead awarded an initial payment of \$13,554,610, and can earn an additional \$5,005,528 for a total payment of up to \$18,560,138, pending the results of a subsequent audit. The initial payment of \$13,554,610 can be recovered in SCE rates from customers through its Base Revenue Requirement Balancing Account for its rates effective in 2014.
2. Commission staff will oversee an additional audit of SCE's 2011 expenditures. Staff will consult with SCE when developing the audit scope; however, aside from providing initial input on the audit scope, SCE will not otherwise manage or provide input into the audit.
3. Upon completion of the follow up audit, SCE will file a Tier 3 Advice Letter to claim additional 2011 incentive awards, as appropriate. SCE will rely on the final public version of the follow up audit when calculating additional 2011 incentive awards.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on December 19, 2013; the following Commissioners voting favorably thereon:

PAUL CLANON
Executive Director