R.06-03-004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Regarding Policies, Procedures and Rules for the California Solar Initiative, the Self-Generation Incentive Program and Other Distributed Generation Issues.	RULEMAKING 06-03-004 (Filed March 2, 2006)

Reply Comments of the San Diego Regional Energy Office to ALJ's April 25, 006 Ruling Requesting Comments on Staff Proposal for Performance Based Incentives and Other Elements of the California Solar Initiative

San Diego Regional Energy Office

May 26, 2006

Susan Freedman
Senior Policy Analyst
San Diego Regional Energy Office
8520 Tech Way, Suite 110
San Diego, CA 92123
Tel: (858) 244-1186
Fax: (858) 244-1178
Susan.freedman@sdenergy.org

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Regarding Policies, Procedures and Rules for the California Solar Initiative, the Self-Generation Incentive Program and Other Distributed Generation Issues.	RULEMAKING 06-03-004 (Filed March 2, 2006)

I. INTRODUCTION

The San Diego Regional Energy Office (SDREO) respectfully submits these reply comments to ALJ's April 25, 006 Ruling Requesting Comments on Staff Proposal for Performance Based Incentives and Other Elements of the California Solar Initiative. SDREO responds to opening comments on the following sections.

- Section 6-Non-Utility Program Administration

  Residential Tax Treatment | CSI-EE Administration Comparison | SDREO SGIP Administration is Not a "Pilot" | IOU- Nonprofit Contracting/Oversight | Utility Ineligibility to Receive Rebates
- Section 3- Solar Thermal Pilot Program
- Section 4- Incentive Level Trigger
- Section 5-Funding Levels

II. SECTION 6.2—NONPROFIT ADMINISTRATION FOR SMALL SYSTEMS

SDREO reiterates its support of the staff proposal for administration of the CSI by a nonprofit, objective, public benefit corporation in order to limit the potential for conflicts of interest, an appearance for conflicts, and to minimize program costs. Northern California Solar Energy Association (NCSEA) presents other benefits of nonprofit administration and some concerns over utility administration.

A. Tax Implications from Non-Utility Management of a Utility Program

Several commenters expressed concern over the possibility of negative tax treatment for residential program participants if a nonprofit administers residential CSI. SDREO does not believe this will be the case but we reiterate our recommendation and that of other commenters for the Commission to seek an IRS determination on residential subsidy treatment under Section 136. SDREO has retained the services of a tax expert[1] to advise us on this matter and we have gained some familiarity with the IRS determination process. If the Commission desires, we can assist with identifying appropriate steps. We recommend that the Commission continue on schedule to competitively bid the CSI program administration to a 501(c)3 nonprofit entity while it obtains IRS determination.

In our opening comments, we stated that we would share details of our ongoing assessment of residential tax treatment. The basis of questions in the staff proposal and opening comments stem from a March 2006 Lawrence Berkeley Lab and the Clean Energy States Alliance report, entitled "Exploring the Economic Value of EPAct 2005's PV Tax Credits. SDREO agrees with the report conclusion that due to the lack of guidance in Section 136, it is prudent to seek an IRS determination on residential tax implications. But we disagree with the LBL report's supposition leading up to that conclusion.

Based on the tax advice we have received, SDREO believes that, contrary to the LBL report, the IRS did not take a "position" in PLR 8530004 that is relevant to the question of whether subsidies paid out to a utility customer by someone other than the utility will qualify for the section 136 exclusion from gross income. Please see Appendix A for further detail. We are continuing to work with Chadbourne and Parke to resolve questions about non-utility management of residential CSI and are happy to assist the Commission as they see fit.

---

[1] SDREO has retained Chadbourne & Parke LLP, which is considered one of the most well-known and well-regarded tax practice groups in the United States. A major part of their tax practice involves all phases of tax controversies and IRS determinations. In 2005, Chadbourne was named by Infrastructure Journal the "Renewables Legal Adviser of the Year."

B. Response to IOU Comments on Energy Efficiency Portfolio Administration[2]

In opening comments, the IOUs each mention the Energy Efficiency Administration decision and discussions surrounding the change in Administration therein as being relevant to the discussion of the CSI administration. To quote:

> The Commission recently looked at third party administration in the context of Energy Efficiency and rejected that model in favor of utility administration. The Commission found that there are wide ranging benefits to utility administration, especially given the utility's role in integrated resource planning. [SCE, p.16]
>
> In 2003 and 2004, the CPUC heard extensive debate, hearings, and briefing concerning whether utilities should administer energy efficiency programs. Eventually, the CPUC concluded that these programs are properly administered by utilities. See D.05-01-055. [PG&E, p. 16]
>
> Decision 05-01-055 returned the utilities to the lead administrative role in energy efficiency program selection and portfolio management – a role fulfilled by the utilities in California prior to electric industry restructuring. In returning administration to the utilities, the Commission was confident that the utilities have the requisite expertise and capability to administer programs and meet aggressive savings goals under a structure that holds them directly accountable for program results. [SDG&E/SoCalGas, p. 17]

SDREO here provides a more comprehensive review of that proceeding. Decision 05-01-055 was not a ringing endorsement of IOU Administration. Attached in our Appendix B are Concurring Letters of Commissioner Peevey and Commissioner Brown included in that decision, in which they state that granting utility administration of energy efficiency programs should not be viewed as permanent and that new/innovative approaches should be considered. Furthermore, the utility administration structure for energy efficiency portfolio management has yet to be proven effective. The CPUC is holding an All Party Meeting on May 30, 2006 to address 2006-08 Energy Efficiency Portfolio issues. The IOUs will present a status report and third party program implementers/partners will discuss the successes and failures under this structure thus far.

---

[2] R.01-08-028, Decision 05-01-055: www.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/43628.htm

C. IOUs are Not the Only Effective Program Delivery Mechanism.

Contrary to some utility comments,[3] SDREO again points out that non-utilities can also optimize synergies amongst and across energy efficiency, demand response and onsite generation programs. In San Diego, this optimization is already taking place with increased coordination amongst SDREO, SDG&E and other third party energy efficiency programs. SDREO also coordinates with the US DOE Million Solar Roofs Program as well as both SDG&E and SCE's demand response programs.

D. SDG&E/SoCalGas Depiction of SDREO SGIP Administration as a "Pilot" is Inaccurate

In opening comments, SDG&E/SoCalGas once again mischaracterized the SDREO administration of the SGIP as a "pilot program." It is true that in Decision 01-03-073, the Commission notes that designating "the San Diego Regional Energy Office as program administrator for the self-generation program in SDG&E's service territory provides us with an opportunity to explore non-utility administration on a limited, pilot basis."[4] This opportunity was "limited" in that SDG&E's territory is the smallest in the state and SDG&E retained significant oversight. That it was a done on a "pilot basis" meant that there would be a trial period to assess effectiveness and success.

SDREO successfully managed the SGIP during the initial four-year program period. The SGIP Program Administrator Comparative Assessment Report concluded that both utility and non-utility administration approaches were equally effective. When the legislature through AB1685 and the Commission through D.04-12-045 chose to extend the SGIP and retain SDREO as the program administrator, our role ceased to be a pilot.[5] SDREO does appreciate SDG&E/SoCalGas' support of the current administrative structure, stating in their opening

---

[3] Opening Comments of SDG&E/SoCalGas, p. 20, question 4; PG&E p. 21; and SCE p. 2 and p.25.

[4] R.98-07-037, D.01-03-073: www.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/6083.htm

[5] R.04-03-017, D.04-12-045: Order to Modify the Self Generation Incentive Program and Implement Assembly Bill 1685, December 16, 2004. www.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/42455.htm

comments that, "Each of the current SGIP administrators has demonstrated competency in carrying out the program and complying with program guidelines."[6]

E. Contracting Method between IOU and Nonprofit Administrator

SDREO reiterates its support for the proposed contracting method between a nonprofit administrator and PG&E similar to the current SGIP administration contract which exists between SDREO and SDG&E. The Commission should reject SDG&E/SoCalGas' suggested contracting method that calls for a return to an already determined less effective, slower, and duplicative Administrative process.

They recommend that administrative funds be provided to the non-IOU administrator(s) after the entity has incurred expenditures and submitted requests for reimbursement of costs from the utility or utilities along with all supporting documentation subject to review and approval by the utility or utilities.[7] In the R.98-03-017 proceeding, the Commission recognized the inefficiencies in the then current administrative arrangement between SDG&E and SDREO and asked explicitly what improvements could be made to reduce utility involvement.[8]

D.04-12-045 specifically addressed SGIP fiscal and administrative issues between SDG&E and SDREO:

> The contractual arrangements we adopted for administrative services in D.01-03-073 places SDG&E in the role of overseeing a contract with a third-party deliverer (SDREO) of administrative services for the SGIP program. In that role, we expect SDG&E to exercise prudent oversight to ensure that SDREO performs administrative services effectively and consistent with program guidelines. At the same time, SDG&E's oversight should not entail unreasonable duplication of effort (e.g., re-reviewing in detail every single SGIP application that SDREO has processed) or unreasonably delay payments of incentives to qualified projects or to SDREO for administrative services rendered. We are extremely concerned about the timeliness of rebates to projects, as well as the additional cost associated with a duplicative review process. Thus, we

---

[6] Opening Comments of SDG&E/SoCalGas, p. 18.

[7] Opening Comments of SDG&E/SoCalGas, p. 19, question 1.

[8] ALJ'S Ruling Requesting Comments on AB970 SGIP Evaluation Reports and Related Issues, 12-10-03, p.2 of Attachment A.

> believe that SDG&E and SDREO should be able to negotiate modified contract terms that allow for periodic progress payments or other similar provision, subject to random auditing or cross checking by SDG&E. Energy Division should continue to mediate between SDREO and SDG&E on these issues.[9]

To be clear on oversight concerns, under the SGIP interval payment structure, SDREO is still under contract to SDG&E. SDREO continues to report to CPUC and SDG&E on all program activities and expenditures. SDREO reiterates its position that forecasted quarterly interval method for IOU transfer of funds is effective. Under the current SGIP program, SDREO receives quarterly forecasted payments from SDG&E to cover anticipated *administrative costs*. If a forecast is high, then SDREO reflects that credit in the following quarter's forecast request. To date, using quarterly forecasts, SDREO estimates have been within 0.67% of actual expenditures. SDREO believes that this is a suitable structure to ensure that a nonprofit administrator has adequate administration funds to meet program participant needs in a timely fashion. While these changes have streamlined the incentive payment process, using quarterly forecasts for both *incentive payments* and *administrative costs* could further streamline the process.

F. IOUs are Not Eligible for Rebates

SDG&E/SoCalGas recommend that the Commission allow utilities to be eligible to receive incentives for projects they own and operate.[10] SDREO disagrees and believes that CPUC Decision 01-03-073, which prohibited utility distribution companies from receiving SGIP incentives should stand. In 2004, this question came up again and the SGIP Working Group sought further clarification. The Commission upheld the earlier decision in D. 04-12-045, which stated "We clarify that public and investor-owned gas or electricity distribution utilities which generate or purchase electricity or natural gas for wholesale or retail sales, are not eligible to receive incentives."[11] As we've stated in the past,[12] SDREO is concerned that if utilities begin

---

[9] R.04-03-017, D.04-12-045: Order to Modify the Self Generation Incentive Program and Implement Assembly Bill 1685, December 16, 2004. www.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/42455.htm

[10] Opening Comments of SDG&E/SoCalGas, p. 10.

[11] R.04-03-017: D.04-12-045, Section 3.9.1-Program Eligibility.

installing systems and include the total cost (or net cost after a possible incentive) in rates, ratepayers could pay twice – once for the rebate and again for the capital equipment.

III. SECTION 3—SOLAR THERMAL PILOT PROGRAM

SDREO submitted a proposed Solar Water Heating Pilot Program with the Commission and the R.06-03-004 service list on May 24, 2006. A number of organizations, including the DRA, CalSEIA/PV Now and ASPv have recommended that the pilot program be extended statewide in order to maximize its potential economic and energy conservation benefits. This was also a recommendation for the CPUC to consider within SDREO's SWH Pilot Program proposal.

IV. SECTION 4—INCENTIVE LEVEL TRIGGER

In their opening comments, several parties supported a volume based (MW) trigger for CSI rebate reductions. In their joint comments, CALSEIA, PVNow and VoteSolar (Joint Solar Parties) suggest that volume based triggers are "simple and responsive" to market conditions.[13] TURN suggests a volume-based trigger to be "self-correcting."[14] Uncoupling the time element and basing a rebate reduction solely on MW of committed projects (i.e., paid application fees and conditional reservations issued) appears logical. Removing the time element may also eliminate the "rush" to submit applications during the final days before a scheduled rebate

---

[12] R.04-03-017: SDREO Reply Comments in response to the 6-14-05 Assigned Commissioner and Administrative Law Judge's Ruling Seeking Comment on Staff Solar Report, July 21, 2005, Section 11.

[13] CalSEIA, PVNow and VoteSolar Joint Opening Comments, Item B. p. 4.

[14] Turn Opening Comments, Section IV, p. 4.

reduction. The Joint Solar Parties provide some other plausible suggestions for implementing a trigger mechanism.

To date, tracking cumulative MW reserved statewide has proved challenging, SDREO believes a statewide database could be designed to eliminate this issue. Properly implemented, a web-based database could also allow for trigger data to be displayed on the CSI Program website(s) for maximum transparency to applicants. While at this time, SDREO supports a statewide trigger, we are open to regional trigger method if additional analysis determines it appropriate. SDREO has previously suggested that regional differences in external factors such as market conditions, utility tariffs, permitting requirements, etc. be evaluated when determining rebate levels.

V. SECTION 5—FUNDING LEVELS

A number of opening comments presented ideas on how to split the overall incentive budget between large and small systems. Breakpoints for small/large systems ranged from 8 kW – 100 kW and suggested budget splits ranged from 30-50%. Perhaps funding should simply be split between residential and non-residential projects. Streamlining things further, an EPBB could apply to all residential customers, and a PBI could apply to all non-residential customers.

SDREO appreciates the opportunity to provide comment and look forward to actively participating in the further development of the CSI. SDREO strongly supports the development of a long-term and predictable state solar program.

Susan Freedman
Senior Policy Analyst
San Diego Regional Energy Office
8520 Tech Way, Suite 110
San Diego, CA 92123
Tel: (858) 244-1186

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of these *Reply Comments of the San Diego Regional Energy Office to ALJ's April 25, 006 Ruling Requesting Comments on Staff Proposal for Performance Based Incentives and Other Elements of the California Solar Initiative* on all known parties of record in this proceeding by delivering a copy via email to the current service list.

Executed on May 26, 2006.

Susan Freedman
Senior Policy Analyst
San Diego Regional Energy Office
8520 Tech Way, Suite 110
San Diego, CA 92123
Tel: (858) 244-1186
Fax: (858) 244-1178

Appendix A. Tax Implications from Non-Utility Management of a Utility Program

SDREO has retained Chadbourne & Parke LLP, which is considered one of the most well-known and well-regarded tax practice groups in the United States. A major part of their tax practice involves all phases of tax controversies and IRS determinations. In 2005, Chadbourne was named by Infrastructure Journal the "Renewables Legal Adviser of the Year."

Several commenters expressed concern over the possibility of negative tax treatment for residential program participants if a nonprofit administers residential CSI. SDREO does not believe this will be the case but we reiterate our recommendation and that of other commenters for the Commission to seek an IRS determination on residential subsidy treatment under Section 136. SDREO has retained the services of a tax expert to advise us on this matter and we have gained familiarity with the IRS determination process. If the Commission desires, we can assist with identifying appropriate steps. We recommend that the Commission continue on schedule to competitively bid the CSI program administration to a 501(c)3 nonprofit entity while it obtains IRS determination.

In our opening comments, we stated that we would share details of our ongoing assessment of residential tax treatment. The basis of questions in the staff proposal and opening comments stem from a March 2006 LBL report ("Exploring the Economic Value of EPAct 2005's PV Tax Credits"). SDREO agrees with the report conclusion that due to the lack of guidance in Section 136, it is prudent to seek an IRS determination on residential tax implications. But SDREO disagrees with the report's supposition leading up to that conclusion.

Based on the tax advice we have received, SDREO disagrees with the LBL report authors' positing that the IRS took a "position" in PLR 8530004 that is relevant to the question of whether subsidies paid out to a utility customer by someone other than the utility will qualify for the section 136 exclusion from gross income.

Prior to reaching that conclusion, the LBL report [at page 5] discusses several IRS rulings from the 1980s interpreting tax code sections other than section 136, positing that these rulings may be instructive as to how the IRS would interpret section 136. In particular, the report states that Private Letter Ruling (PLR) 8530004 (Apr. 30, 1985) shows that the IRS may be inclined to focus on who administers a subsidy, rather than who funds a subsidy, in characterizing a subsidy, thereby "suggesting that utility-funded,

government-administered programs would not qualify for the Section 136 exclusion." The report states later in the same paragraph: "One might, therefore, expect the IRS to stick to its position taken in Private Letter Ruling [8530004] that characterizes a government-administered program as a government program, regardless of the funding source."

PLR 8530004, like the other rulings from the 1980s cited in the Berkeley Lab report, concerned whether financing was considered "subsidized energy financing" within the meaning of former tax code section 48(l) [and former tax code section 44C]. That section defined subsidized energy financing as financing "provided under a federal, state, or local program, a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy." The 1985 ruling concludes that the program at issue there was a government program, but it did not have a "principal purpose" of providing subsidized financing. Therefore, the financing was not subsidized energy financing. But the ruling goes on to make the following observation: "One condition for subsidized energy financing is that the 'program' be administered by a governmental unit, however, the definition makes no mention of the source of the funds be they governmental or otherwise." This sentence from the ruling simply acknowledges that section 48(l) didn't focus on the source of funds; it focused on fund administration.

Section 48(l) defined subsidized energy financing as financing "provided under a federal, state, or local program." The language of section 136 is different. Section 136 defines a qualifying subsidy as a subsidy "provided (directly or indirectly) by a public utility." Section 136 doesn't mention a "program." Because the wording of section 136 is different from the wording of former section 48(l), and because PLR 8530004 was merely construing the wording of section 48(l), we do not think that the IRS took a "position" in the 1985 ruling that is important to our interpretation of section 136.

SDREO is continuing to work with Chadbourne and Parke to resolve questions about non-utility management of residential CSI and we are happy to assist the Commission as they see fit.

Appendix B.

From Decision 05-01-055 on Energy Efficiency Administration

-Concurring Letter of Commissioner Peevey

- Concurring Letter of Commissioner Brown

(pages 169-171 of the EE Decision)

R.01-08-028
D.05-01-055

Commissioner Peevey, concurring:

It is my understanding that the question of who should administer the efficiency funds has been asked but not answered by this Commission for more than eight years now, following the passage of AB1890 and the first phase of electricity deregulation. Thus, I believe that we need to act now to provide some certainty to the administrative structure at least for the next program cycle.

When I came to this commission more than two years ago now, I was of the view that the utilities should not be administering energy efficiency any longer. Having worked at a utility, and then working as a competitor to them, I understand all of the obstacles and issues that are inherent in utility administration of programs. I know that utilities require any decision on a program to be vetted through multiple layers of bureaucracy and that therefore action is often extremely slow, as a consequence.
But as of the time of this vote, I do not see immediate viable options for non-utility administrators. Perhaps options can be developed, but I have not yet seen a proposal that seems to me to have a reasonable chance of success in the near term.

However, I do not wish my vote on this matter to be taken as a sign that I am not open to new and innovative approaches to this issue. I also want to put the utilities on notice that this decision today is not a guaranteed entitlement to utility administration of energy efficiency for the rest of eternity. We intend to monitor the efforts of the utilities to meet their aggressive energy efficiency goals very carefully, and the new evaluation structure included in this decision is designed in large part to make sure that review happens.

In order to meet their goals, the utilities absolutely must become more nimble and innovative when it comes to delivering energy savings to their customers. If this happens, then we will be on the right path. If this does not happen, I will be the first on this Commission to propose that we find a different administrative option by the end of this next three-year program cycle.

/s/ MICHAEL R. PEEVEY
MICHAEL R. PEEVEY
Commissioner

San Francisco, California
January 27, 2005

Commissioner Geoffrey F. Brown, Concurring:

There are a lot of things to like about the Proposed Decision. It continues the Commission's strong commitment to energy efficiency; California has been and should continue to be a leader in this area. It provides a level of certainty to the energy efficiency world about the question of administration. It adds important elements of independence and expertise to both the programmatic selection and evaluation processes. Overall, I believe it is better than the current method of administering energy efficiency, and an improvement upon previous experience with utility administration.

At the same time, there are some issues which continue to concern me about this decision.

I have long felt that utilities, while they have developed and implemented a number of fine energy efficiency programs, are not particularly innovative. Their overly-bureaucratic focus on the "tried and true" can discourage new ideas. This is especially true when the new ideas are "not invented here" – that is, at the utility. Historically, utilities have wanted programs to stay within their control as much as possible, even at the expense of innovation and additional energy savings.

I would like to see a system where the best programs – the most cost-effective, the highest energy savings – are implemented regardless of source. Utilities should be in the game, but they have no monopoly on good ideas. I have seen many examples of programs run by local government and private entities that are innovative and effective. I am concerned that the 80/20 allocation in the decision, and the overall utility control of the programs, will limit the explorations of new frontiers.

We must not let that happen. As the policy rules and implementation issues are worked out, we can't fall back on the easy answer of letting utilities assume full control of all aspects of the programs. My intention is to scrutinize any follow-up items from this decision to ensure an open playing field for any entity that can develop and deliver quality energy efficiency services on behalf of the ratepayers and the citizens of California.

I encourage the utilities to develop a standard contract with implementers, similar to the standard contract used when the Commission administered certain programs. Having a standard contract levels the playing field and ensures that utilities and implementers know what their expected roles are. Standard contracts can minimize the complaint that some implementers are treated more or less fairly than others. They also give utilities a basis to exercise their due diligence over all of their program implementers. Further. a standard contract imposes the same expectations across the state. Standard contracts also have proven to substantially reduce the expenses of all parties on legal work. I encourage Energy Division to help utilities work together to draft a set of standard contracts to be used statewide with all energy efficiency implementers and providers.

Administrative costs are another issue. The PUC's own consultant found a number of examples of high administrative costs for utility programs. This cannot continue. My alternate attempted to address this issue. I am now convinced that the PD will allow scrutiny of administrative costs. My desire is that we keep our eye on the ball here – ratepayer funds should go to programs, not overhead, to the greatest extent possible.

I ask that Energy Division work in their oversight of utility administration to take every step in their power to ensure that energy efficiency expenditures by the utilities and their contracted program implementers are limited to what are actually necessary to ensure productive and effective programs. If Energy Division believes administrative and overhead costs exceed prudent levels, I encourage staff to come forward and seek Commission remedial action.

I proposed a pilot program on independent administration in my alternate. The PD says this is unnecessary, duplicative and defeats the purpose of long-term stability. There is some validity to these points. However, there are also good reasons to consider a pilot. These include innovation, competitive pressures, removal of utility conflicts, and consistency with future community choice aggregation programs.

My purpose in putting forth the alternate was to allow us to use a pilot program to see if these benefits would spring forth. The PD dismisses the pilot based on policy arguments without actually seeing what would happen. I would have preferred to have a real-life experiment and find out for sure. If there are opportunities for experimentation in this area in the future, I will support such efforts.

/s/ GEOFFREY F. BROWN
Geoffrey F. Brown
Commissioner

San Francisco, California
January 27, 2005