

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to
Examine the Commission's Energy
Efficiency Risk/Reward Incentive
Mechanism.

FILED
PUBLIC UTILITIES COMMISSION
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SAN FRANCISCO, CALIFORNIA
RULEMAKING 09-01-019

ORDER INSTITUTING RULEMAKING**1. Summary**

This Order Instituting Rulemaking (OIR or Rulemaking) will address the Commission's policies related to an energy efficiency risk/reward incentive mechanism (RRIM). Incentives for energy efficiency activities administered by Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company ("the utilities")¹ will be subject to this new rulemaking.

In this rulemaking, we will evaluate modifications to the RRIM for energy efficiency first adopted in Decision (D.) 07-09-043. For 2006 through 2008 energy efficiency activities, we suspend the schedule for verification and review of incentive claims in favor of this rulemaking. For RRIM issues only, this rulemaking serves as a successor to Rulemaking 06-04-010, our post-2005 rulemaking on Policies, Programs, Evaluation, Measurement and Verification, and Related Issues.

¹ For the purpose of this Rulemaking, energy efficiency programs exclude low-income assistance activities, including the Low-Income Energy Efficiency (LIEE) program.

2. Background

Rulemaking (R.) 06-04-010 has been our broad inquiry into post-2005 energy efficiency policies, programs, evaluation, measurement and verification, and related issues. We have issued a number of decisions in this docket on topics ranging including from energy efficiency goals (e.g., D.08-07-047) to the risk/reward incentive mechanism (RRIM).

The RRIM was initially adopted in D.07-09-043. In that decision, we adopted an incentive mechanism designed to align shareholder and consumer interests to create a “win-win” regulatory framework for energy efficiency that provides both a meaningful level of shareholder earnings and a return on ratepayers’ investment in energy efficiency as the utilities reach towards and attempt to exceed our 2006-2008 energy savings goals. One part of the adopted RRIM would provide utilities with 65% of their incentive claims on an interim basis – subject to verification of such claims by the Energy Division – with 35% held back until a later final verification of achieved energy savings. D.07-09-043 foresaw a relook at the overall RRIM in 2011.

In D.08-07-047, regarding energy efficiency goals, the Commission indicated that changes to the goals could result in a need for modifications to the RRIM. That decision called for an Energy Division study and a decision in 2009 to analyze the impact of lowering the \$450 million earnings cap in the RRIM and the impact of lowering the 9% and 12% incentive earnings rate as methods for mitigating possible unfair earnings outcomes from adopting a gross goal standard in D.08-07-047. The decision also instructed Energy Division to analyze the possibility of changing the way certain energy efficiency activities should be counted toward satisfying 2009-2011 portfolio goals, if such changes are needed to mitigate any unreasonable outcomes.

In their July 2008 applications regarding the 2009-2011 portfolios, the utilities suggested a number of changes related to the RRIM. The Scoping Memo in the 2009-2011 energy efficiency portfolio proceeding deferred certain issues related to the RRIM to this rulemaking, but kept certain policy issues in the proceeding.²

As part of the RRIM adopted in D.07-09-043 (with modifications in D.08-01-042), the Energy Division was required to produce verification reports of utility energy efficiency costs and installations and services completed. These reports would serve as the basis for interim and final incentive payments to utilities, if warranted. The first verification report, due in August 2008 regarding 2006 and 2007 activities, became controversial both because of delays and utility concerns about methodologies used by Energy Division in calculating interim incentive payments. In addition, concerns have been raised about the efficacy and fairness of the underlying incentive structure which dictates the methodologies Energy Division must follow.

In response to the controversies surrounding the first verification report, the utilities filed a Petition for Modification of D.07-09-043 and D.08-01-042 in August 2008. In December 2008, we issued D.08-12-059 which modified D.07-09-043 and D.08-01-042. D.08-12-059 noted the controversy surrounding the first Verification Report, which in draft form recommended that the utilities receive little or no interim incentive payment for 2006 and 2007 (this report has not yet been finalized). D.08-12-059 determined that timeliness and consistency

² Policy issues raised by the utilities in A.08-07-021 *et al.* include savings credit for activities associated with the Strategic Plan (also known as ringfencing).

considerations should allow the utilities to receive 35% of their incentive claims, with 65% held back for further review.

D.08-12-059 required a review of the Energy Division Verification Report on 2006 and 2007 energy efficiency activities through a Commission Resolution. Under D.07-09-043, utilities could claim any interim incentive payments for 2006 and 2007 based on that Report. However, the utilities have already received interim payments of 35% of their claims per D.08-12-059. Thus, we anticipate that the upcoming Commission Resolution will consider the Energy Division report moot for the purposes of 2006 and 2007 interim incentive payments, although the report may be adopted for other informational purposes concerning utility energy efficiency program performance in 2006 and 2007 as well as for upcoming planning purposes.

3. Preliminary Scoping Memo

This rulemaking is instituted on the Commission's own motion to adopt, repeal, or amend rules, regulations, and guidelines for the electric and gas utilities named herein, under the authority of Rule 6.1. The preliminary scoping memo for this rulemaking identifies the energy efficiency issues related to the RRIM which are under consideration here.

We see a need to reconsider the RRIM earlier than in 2011 as anticipated in D.07-09-043. The controversies raised concerning the first Verification Report show that methodologies of the RRIM process are quite complex and are not as easily or as timely resolved as we had hoped. We believe it is necessary to consider a more transparent, more streamlined and less controversial RRIM program. This may require making small but significant changes to the existing RRIM, or may require wholesale adoption of a new incentive mechanism. Any new or revised RRIM must continue to provide incentives to utilities to provide

the maximum verifiable and socially-desirable level of energy efficiency programs and services, while protecting ratepayers through necessary cost containment mechanisms.

In this rulemaking, it is our intent to first develop a new framework for the interim review of 2008 energy efficiency activities and the final review of 2006 through 2008 energy efficiency activities (now set for 2010). Next, we intend to develop a long-term framework for energy efficiency activities in 2009 and beyond.

The interim review of 2008 energy efficiency activities is set to begin on February 28, 2009 when the utilities submit their 2008 measure and cost report to the Energy Division, according to a Ruling issued by ALJ Gamson in R.06-04-010 on January 20, 2009 (pursuant to direction given in D.08-12-059), and is scheduled to result in Commission consideration of the Energy Division Verification Report for 2008 in August 2009. The utilities' February report includes valuable data concerning utility activities and should be submitted as per the January 20, 2009 Ruling. However, except for this report, we will suspend the schedule in that Ruling in order to allow us to consider a new framework for the RRIM which may supersede and make moot the efforts under the current framework and schedule. It is our intent to adopt a new framework for the review of the remainder of 2006 through 2008 energy efficiency activities in a timeframe consistent with interim payments for 2008 no later than December 2009, and any final payments for 2006 through 2008 no later than December 2010.

In this proceeding, we may also consider RRIM issues raised in D.08-07-047 and the policy issues related to RRIM raised by the utilities in the 2009-2011 portfolio proceeding (A.08-07-021 *et al.*). However, certain policy issues raised by the utilities have important impacts that reach beyond the RRIM

and affect portfolio cost-effectiveness and the mix of programs selected for implementation. It is critical that these issues be addressed in the context of the 2009-2011 portfolio filings to ensure full consideration of the impacts of the various proposals on the portfolios, and the impact of these policy issues on the Commission's overall policy goals for energy efficiency. These policy issues have been briefed in A.08-07-021 *et al.* and we anticipate issuing a decision on these policy issues prior to the development of a new RRIM in this proceeding because the 2009 - 2011 portfolios must be approved this year. Therefore, the outstanding policy issues will be decided in A.08-07-021 *et al.* These policy issues will then be implemented via the RRIM developed in this proceeding for 2009 and beyond.

The Commission's Energy Division will soon distribute a White Paper addressing certain RRIM issues. The White Paper may also touch upon related evaluation, measurement and verification issues, and other issues related to the RRIM. All issues raised by the White Paper, and all issues related to the RRIM, are preliminarily considered to be within the scope of this proceeding. Comments on this White Paper will be considered in this rulemaking, as directed by the Assigned Commissioner. The Assigned Commissioner may also raise other RRIM-related issues as part of this proceeding.

For issues related to RRIMs, R.06-04-010 is superseded by this rulemaking.

4. Category of Proceeding

Rule 6(c)(2) of our Rules of Practice and Procedure provides that the order instituting rulemaking "shall preliminarily determine the category" of the proceeding. We believe the issues in this proceeding should be categorized as "ratesetting," as that term is defined in Rule 5(c). We preliminarily determine that ratesetting is the most suitable category for this subject matter, since the

incentive payments that result from the RRIM will have an impact on utility rates.

5. Respondents and Service List

The Respondents to this rulemaking are Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company.

The service lists in R.06-04-010 and A.08-07-021 *et al.* shall serve as the temporary service list in this proceeding. A permanent service list shall be established at the first prehearing conference (PHC). Persons who wish to become a “party” to this proceeding should appear at the first PHC and fill out the “Notice of Party/Non-Party Status” form (appearance form) at that time.

Service of documents in this proceeding shall be made by electronic mail consistent with the Commission’s Rules of Practice and Procedure 1.9 and 1.10. In addition, a hard copy of all documents shall be mailed to the ALJ and Commissioner.

6. Schedule

The Assigned Commissioner or ALJ shall schedule a PHC as soon as practicable. A preliminary schedule for this proceeding will be discussed at the first PHC. Those who wish to file comments on the issues identified in this OIR shall submit and serve their comments in accordance with the schedule identified at the first PHC, or established by assigned Commissioner or ALJ ruling.

Consistent with Rule 6.2, we expect this proceeding to be concluded within 18 months.

7. Objection to Category

Any person who objects to the preliminary categorization of this rulemaking shall raise such objection no later than 10 calendar days after the Commission issues this OIR.

8. *Ex Parte* Communications

This proceeding is subject to Article 8 of the Commission's Rules, which specifies standards for engaging in *ex parte* communications and the reporting of such communications. These requirements become effective upon the issuance of this OIR, based on the preliminary determination of category discussed above. Following the assigned Commissioner's appealable determination of category, the applicable *ex parte* communication and reporting requirements shall depend on such determination unless and until the Commission modifies the determinations pursuant to Rule 7.5 or 7.6.

Therefore, **IT IS ORDERED** that:

1. A rulemaking is instituted on the Commission's own motion under the authority of Rule 6.1 to examine the existing energy efficiency risk/reward incentive mechanism (RRIM) and to consider alternatives to this mechanism.

2. Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and the Southern California Gas Company are Respondents to this proceeding.

3. The interim review of 2008 energy efficiency activities set in a January 20, 2009 Ruling in Rulemaking (R.) 06-04-010, is suspended, except for the February 28, 2009 utility measure and cost report.

4. The requirement in Decision 08-12-059 that the Energy Division Verification Report be issued via resolution as a basis for earnings claims for 2006 and 2007 activities is suspended pending resolution of those issues in this

rulemaking, though the Verification Report may be issued for other informational or planning purposes.

5. The Executive Director shall cause this Order Instituting Rulemaking (OIR) to be served on Respondents, the California Energy Commission, and the service lists in R.06-04-010 and Applications (A.) 08-07-021 *et al.* Those organizations and individuals listed under the state service list and information-only categories will be served electronically only.

6. The service lists in R.06-04-010 and A.08-07-021 *et al.* shall serve as the temporary service list in this proceeding. A permanent service list shall be established at the first prehearing conference (PHC). Persons who wish to become a “party” to this proceeding should appear at the first PHC and fill out the “Notice of Party/Non-Party Status” form (appearance form) at that time.

7. The category for this rulemaking, as defined herein, is preliminarily determined to be “ratesetting” as that term is defined in Rule 1.3(e) of the Commission’s Rules of Practice and Procedure.

8. Any person who objects to the preliminary categorization of this rulemaking shall raise such objection no later than 10 calendar days after the Commission issues this OIR.

9. For issues related to RRIMs, R.06-04-010 is superseded by this rulemaking.

10. All comments and other filings in this rulemaking shall be served pursuant to the Electronic Service Protocols consistent with Rules 3.2 and 3.2.1.

11. As soon as practicable, the assigned Commissioner or Administrative Law Judge shall schedule a PHC in this rulemaking.

This order is effective today.

Dated January 29, 2009, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

I reserve the right to file a concurrence.

/s/ DIAN M. GRUENEICH
Commissioner

I reserve the right to file a concurrence.

/s/ TIMOTHY ALAN SIMON
Commissioner

Concurrence of Commissioner Dian M. Grueneich

Today we vote to open a new Order Instituting Rulemaking (OIR) on our risk-reward incentive mechanism (RRIM) for investor-owned utility (IOU) energy efficiency programs. I vote in favor of opening this new docket.

Based on our recent experience, it is clear that performance evaluation under the current incentive mechanism is a complex and controversial undertaking. To the extent that this rulemaking brings about a streamlining of the savings verification process for purposes of a shareholder incentive mechanism so that the results are available in a more timely fashion, overall costs of verification are lowered, and garners more confidence in the results, we will be better served in the future than we have been in the past.

As we open this new OIR, there are two items of particular concern.

The first area concerns the provision of the OIR that suspends the issuance of the Energy Division verification report, detailing our staff's best estimates of utility energy efficiency savings for 2006-2007. The OIR makes this determination with no notice or opportunity for public input. I dissented from the majority decision in December, D.08-12-059, because it delinked payment of shareholder incentives from the pillar of independent verification. The December decision awarded utility shareholders \$80 million in incentives based on utility self-reported earnings. We had before us a draft staff report that concluded, based on the third party evaluation results, that the utilities' performance in 2006-2007 justified no earnings, or perhaps a penalty.

In directing in this OIR that the final staff report, which was scheduled to be released in mid-January but by direction of this Commission has been delayed until Friday February 6, will not be used to determine incentives, we have confirmed that December's \$80 million payment – which is not subject to reconsideration or refund – is based solely on utility self-reported savings, which were and remain a matter of vigorous dispute. We need to have public confidence in the integrity of our decision making process with regard to the energy efficiency incentive mechanism and this sort of activity does not foster such confidence.

Second, I urge caution in our attempts to root out the “controversy” we have encountered with the mechanism thus far. In adopting the principle that we rely upon independent, non-utility performance assessment for determining energy efficiency savings, we rely on facts offered by non-biased evaluators. Nevertheless the facts, when they exhibit findings which run contrary to conventional wisdom or results preferred by parties, are and will be controversial. This is inherent.

So far in the workings of this mechanism, there has been a natural tendency to avert controversy by way of compromise. In the case of energy efficiency, where we rely on accurate savings assumptions to guide expectations in procurement practices and greenhouse gas strategies, this is a disservice with real consequences.

Above all, we must maintain the integrity of this agency and its oversight responsibilities. In the context of energy efficiency, this means maintaining an independent Evaluation, Measurement, and Verification (EM&V) process, an incentive mechanism that is transparent and based on verified facts, and exhibiting a willingness to act on the information our EM&V process provides, even when the facts are inconvenient.

I ask each of my fellow Commissioners to keep this in mind as we move forward with this rulemaking.

Dated January 29, 2009, at San Francisco, California.

/s/ DIAN M. GRUENEICH

Dian M. Grueneich
Commissioner

**Concurrence of Commissioner Timothy A. Simon to Item No. 56 [8243]
January 29, 2009 Commission Meeting**

I wish to express my concurrence for this Rulemaking (R.09-01-019),³ which seeks to examine the Commission's Risk/Reward Incentive Mechanism (RRIM), as set forth in D.07-09-043.⁴ As currently conceived, the Commission's process for reconciling the shareholder incentive claims of our Investor Owned Utilities (IOU) has been subject to controversy and delay, and will likely continue to be problematic for the foreseeable future. While concurring with the need for a revised verification process, I must express my disappointment with the participants whom in my view failed to meet the level of cooperation required for timely and accurate delivery of the essential data needed to render a competent decision.

In D.07-09-043, this Commission departed from a cost-of-service regulatory framework for energy efficiency savings in favor of the RRIM. This transition was meant to introduce the efficiencies of an incentive framework with penalties and rewards as a win-win proposition for both ratepayers and shareholders.⁵ Regardless of whether a new or revised risk/reward mechanism is developed and adopted in this proceeding, it will be incumbent on the Commission and parties to work collaboratively and proactively to resolve any differences that arise over the course of evaluating shareholder incentives.

As noted in R.01-09-019, our most recent experience with the Commission's issuance of timely verification reports finalizing IOU incentive claims clearly proved contentious in large part due to the lack of agreement among parties and Energy Division about modeling inputs, assumptions, and results.⁶

If we are to preserve California's status as a worldwide leader in energy efficiency, then we must provide the proper incentives to our IOUs in a timely manner. We made a pledge to equalize demand-side programs with "steel-in-the-ground" supply-

³ Order Instituting Rulemaking to Examine the Commission's Energy Efficiency Risk/Reward Incentive Mechanism (R.09-01-019), January 29, 2009

⁴ Interim Opinion on Phase I Issues: Risk/Reward Incentive Mechanism for Energy Efficiency Programs (D.07-09-043), September 20, 2007.

⁵ *Id.* at 4.

⁶ *See* R.09-01-019.

side investments by incorporating energy efficiency as a core part of utility operations.⁷ This means that the evaluation, measurement, and verification of energy savings must be performed in accordance with a unified and reliable set of standards.

Thus, in order to successfully bridge this impasse, this rulemaking must result in a constructive verification process that is governed by the principles of accuracy, timeliness, transparency, and efficiency. Unless alterations to the existing methodology are made in this proceeding that facilitate these principles, we will continue to run the risk of failing to deliver timely, accurate incentive payments to our IOUs. We should take great care in setting our incentive mechanism on the right path in order to avoid undermining the progress that California has made in this essential area of energy procurement.

Dated January 29, 2009, at San Francisco, California.

/s/ TIMOTHY ALAN SIMON

Timothy Alan Simon
Commissioner

⁷ D.07-09-043 at 4.