

**PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE
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November 4, 2008

Agenda ID # 8083
and
Alternate Agenda ID # 8086
Ratesetting

TO PARTIES OF RECORD IN RULEMAKING 06-04-010

Enclosed are the proposed decision of Administrative Law Judge (ALJ) Gamson previously designated as the presiding officer in this proceeding and the alternate proposed decision of Commissioner Peevey. The proposed decision and the alternate proposed decision will not appear on the Commission's agenda for at least 30 days after the date it is mailed.

Pub. Util. Code § 311(e) requires that the alternate item be accompanied by a digest that clearly explains the substantive revisions to the proposed decision. The digest of the alternate proposed decision is attached.

This matter was categorized as ratesetting and is subject to Pub. Util. Code § 1701.3(c). Upon the request of any Commissioner, a Ratesetting Deliberative Meeting (RDM) may be held. If that occurs, the Commission will prepare and publish an agenda for the RDM 10 days beforehand. When an RDM is held, there is a related ex parte communications prohibition period. (See Rule 8.2(c)(4).)

When the Commission acts on these agenda items, it may adopt all or part of the decision as written, amend or modify them, or set them aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision and alternate proposed decision as provided in Pub. Util. Code §§ 311(d) and 311(e) and in Article 14 of the Commission's Rules of Practice and Procedure (Rules), accessible on the Commission's website at www.cpuc.ca.gov. Pursuant to Rule 14.3, opening comments shall not exceed 15 pages.

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Comments must be filed either electronically pursuant to Resolution ALJ-188 or with the Commission's Docket Office. Comments should be served on parties to this proceeding in accordance with Rules 1.9 and 1.10. Electronic and hard copies of comments should be sent to ALJ Gamson at dmg@cpuc.ca.gov and Commissioner Peevey's advisor, Andrew Schwartz at as2@cpuc.ca.gov. The current service list for this proceeding is available on the Commission's website at www.cpuc.ca.gov.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:jt2

Attachment

ATTACHMENT

R.06-04-010: Order Instituting Rulemaking to examine the Commission's post-2005 energy efficiency policies, programs, evaluation, measurement, and verification, and related issues.

Pursuant to Public Utilities Code § 311(e), this is the digest of the substantive differences between the proposed decision of Administrative Law Judge David Gamson (mailed on November 4, 2008) and the alternate proposed decision of Commissioner Michael Peevey, (mailed simultaneously on November 4, 2008).

The proposed decision (PD) denies the Petition for Modification of D.07-09-043 and D.08-01-042, filed by Southern California Edison Company (SCE), Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SCG), and San Diego Gas & Electric Company (SDG&E) (Joint Utilities). Joint Utilities sought to modify how the first and second interim claims for energy efficiency savings would be calculated, so as to eliminate Energy Division review of interim claims for 2006 and 2007 incentives. Per the PD, these claims for 2006 and 2007 will be determined by utility Advice Letter following the final Energy Division verification report due January 15, 2009.

In contrast, the alternate decision grants in part and denies in part the Petition for Modification to D.07-09-043 and D.08-01-042. Specifically, for the 2006-2008 period, the alternate decision grants the request that the interim claim amounts under the energy efficiency risk reward incentive mechanism be based on the utility submitted quarterly savings reports rather than on the Energy Division's verification reports. However, in these instances, the interim payments will be subject to increases in the holdback amounts as described below. The alternate also grants the request that earnings related issues raised in the verification reports be subject to Commission review by requiring, on a prospective basis, the verification reports to be issued via resolution.

The alternate finds that the timely payment of interim incentive awards, if owed, is critical to the efficacy of the incentive mechanism and therefore Commission policy is better achieved by granting interim payments for the 2006 and 2007 periods based, in part, on utility submitted performance information rather than waiting for the completion of Energy Division's Verification Reports, which have encountered significant delay. However, the alternate also finds that reliance on utility submitted savings reports as the basis for interim claims necessarily increases the risk of overpayment. Increasing the holdback amounts in a manner that adjusts for and mitigates this increased risk is therefore reasonable. An analysis presented by Natural Resources Defense Council indicates higher risk of overpayment for SDG&E's requested claim relative to the other utilities justifying a larger increase in the holdback amount applied to its interim claim.

The alternate authorizes interim incentive rewards in the amounts of \$59.3 million, \$35.3 million, \$6.2 million, and \$7.4 million for PG&E, SCE, SDG&E, and SCG, respectively, for a total amount of \$108.2 million. This represents a reduction from the requested amount of \$44.5 million. The amounts granted reflect the interim utility claims as filed in the Petition for Modification, adjusted to reflect an increase in the holdback amount from 35% pursuant to D.08-01-042 to 50% for PG&E, SCE, and SCG and to 80% for SDG&E's interim claim.

This deviation from the provisions established in prior Commission decisions is granted only for the 2006 and 2007 interim claims. However, for the 2008 interim claim, should Energy Division's

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verification reports again be delayed such that any interim claims that may be owed cannot be authorized in 2009 pursuant to the schedule established in D.07-09-043, interim claims will be based on the IOU submitted savings reports subject to a higher holdback amount of at least 50% with the specific holdback amount determined at the discretion of the assigned Commissioner based on the risk of overpayment.

The alternate decision denies without prejudice the Petitioners' request to eliminate the requirement that the *ex ante* assumptions be updated for purposes of calculating interim claims.

(END OF ATTACHMENT)

Decision **ALTERNATE PROPOSED DECISION OF COMMISSIONER PEEVEY**
(Mailed 11/4/08)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to examine the Commission's post-2005 energy efficiency policies, programs, evaluation, measurement, and verification, and related issues.

Rulemaking 06-04-010
(Filed April 13, 2006)

**DECISION GRANTING IN PART AND DENYING IN PART
THE PETITION FOR MODIFICATION**

1. Summary

On August 15, 2008 Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SoCal Gas) (collectively Petitioners), filed a joint Petition for Modification to Decision (D.) 07-09-043 and D.08-01-042, seeking changes to the Energy Efficiency Risk Reward Incentive Mechanism. Specifically, Petitioners ask that in instances where Energy Division has not met the established schedule for the completion of the verification reports used to validate interim claims, the Commission authorize interim incentive payments based on utility submitted savings reports. To that end Petitioners ask that for the 2006 and 2007 interim claim the Commission authorize payments of \$77.1 million, \$45.9 million, \$20.1 million, and \$9.6 million for PG&E, SCE, SDG&E and SoCal Gas, respectively. In addition, Petitioners ask the Commission to modify D.08-01-042 to eliminate the requirement that the *ex ante* savings parameters, used in calculating interim claims, be updated. Lastly,

Petitioners ask that the evaluation, measurement and verification reports developed by Energy Division be subject to review by the Commission rather than left to the discretion of Energy Division, as is current policy.

This decision grants in part and denies in part the petition for modification. With respect to the request to allow interim payments to be based on the Investor-owned Utilities' (IOUs) quarterly savings reports in light of the delays encountered in the completion of Energy Division's verification reports, we will authorize payments in the amounts of \$59.3 million, \$35.3 million, \$6.2 million, and \$7.4 million for PG&E, SCE, SDG&E and SoCal Gas, respectively for the 2006 and 2007 periods. This reflects the amounts Petitioners' request adjusted to include a higher holdback amount to address the increased risk of overpayment ratepayers bear as a result of relying on utility submitted reports. Similarly, for the 2008 interim claim, should Energy Division's verification reports be delayed such that any interim claims that may be owed cannot be authorized in 2009 pursuant to the schedule established in D.07-09-043, interim claims will be based on the IOU submitted quarterly savings reports subject to a holdback amount of at least 50% with the specific holdback amount determined at the discretion of the assigned Commissioner based on the risk of overpayment. We deny without prejudice Petitioners request to amend the process going forward by which the *ex ante* values used to calculate interim claims are updated. However, we grant Petitioner's request regarding Commission review of earnings-related issues by requiring the verification reports developed by Energy Division to be issued by resolution.

2. Background

In September of 2007, the Commission adopted D.07-09-043, establishing the Energy Efficiency Risk/Reward Incentive Mechanism or RRIM. This

mechanism was developed with the objective of providing incentives to encourage deployment of energy efficiency measures such that energy efficiency would be viewed by the IOUs as comparable to investments in supply side resources. The mechanism is composed of two primary elements, the minimum performance standard (MPS) and the performance earning basis (PEB). The MPS represents the minimum percent of the energy efficiency goals, as adopted by the Commission, the IOUs must have met through the execution of their programs in order to be eligible for incentives. If a utility is eligible for incentives, the specific amount is determined by applying a “shared savings rate” associated with a given level of goal achievement to the PEB, where the PEB represents an estimate of the costs ratepayers would have otherwise born but for the deployment of energy efficiency. The same basic framework is used to determine penalties if utility program performance falls below a certain threshold.¹ D.07-09-043 also established an earnings claim and recovery process that afforded the IOUs the opportunity to file interim claims based on estimated performance achieved in years one and two of the three year program cycle. These interim claim amounts were to be based on verified measure installation and cost reports combined with *ex ante* performance estimates. 30% of the interim claims were subject to hold-back, with this amount being trued-up based on an *ex post* review of performance after the close of the three-year cycle, using updated performance estimates. Under these rules, the IOUs could be required to return interim payment received if the *ex post* review indicated the IOUs had received in excess of what was warranted based on those updated planning assumptions. Similarly, if the *ex post* review indicated that the IOUs should receive more in incentives than

¹ For a more detailed description of the incentive mechanism, refer to D.07-09-042 in its entirety.

was assumed for purposes of the interim claims, the final payment would be adjusted accordingly. The Commission also established a schedule, subject to change as deemed necessary by the assigned Administrative Law Judge (ALJ) in consultation with the assigned office, for the submission, review and payout of incentive claims

On October 31 and November 7, 2007, Petitioners filed a Petition for Modification and Amended Petition for Modification specifically asking that the interim claim process be modified such that any interim incentives provided to the IOUs would not be subject to potential “claw-back” should the *ex post* review find that overpayment had occurred. Petitioners argued that the uncertainty created by potential claw-back prevents booking of any interim claims and thus undermined the value of any interim incentives, thus compromising the effectiveness of the incentive mechanism. In D.08-01-042, the Commission granted Petitioners request, modifying the interim claim process to reduce the uncertainty associated with interim payments. Specifically the decision allows the IOUs to retain any interim incentives received except in circumstances where *ex post* review indicates that the IOUs’ performance fell within the penalty band. Under these circumstances any interim incentives received would have to be returned in addition to whatever penalties are owed. Furthermore, the decision established that if the *ex post* review indicates that utility performance falls within the “deadband,” the utility would continue to earn at the 9% shared savings rate, applied to the *ex post* PEB.² Because this decision reduced the share of IOU incentive claims that would be subject to *ex post* review and true-up, all else equal it necessarily increased the risk of incentive overpayment. To address

² D.08-01-042, Ordering Paragraph 2, p. 24.

this concern, the Commission further modified the RRIM in two ways. First, for interim claims, D.08-01-042 increased the holdback amount from 30% to 35%. Second, the decision required that the *ex ante* assumptions used to calculate interim claims be updated with 2008 and 2009 DEER measure savings parameters including updated net-to-gross ratios and expected useful lives.

In February of 2008 the IOUs filed their interim quarterly savings reports. Since then, Energy Division has encountered delays in the completion of the verification reports and updates to the *ex ante* assumptions including updates to the Database for Energy Efficiency Resources (DEER). To that end, on October 20, 2008, ALJ Gamson issued a ruling exercising his prerogative to adjust the schedule for the completion of Energy Division's final verification reports.

On August 15, 2008, Petitioners filed the extant petition. Specifically, Petitioners ask that the Commission authorize interim incentive payments to the utilities reflecting their performance in deploying energy efficiency measures in 2006 and 2007 based on the quarterly savings reports submitted by the utilities rather than on Verification Reports Energy Division is in the process of developing. In addition, Petitioners ask the Commission to modify D.08-01-042 to eliminate the requirement that the *ex ante* savings parameters used to calculate interim claims, specifically the assumptions included in the Database for Energy Efficiency Resources, be updated. Lastly, Petitioners ask that any updates to the assumptions used to evaluate energy efficiency measure and program performance be reviewed by the full Commission rather than left to the discretion of Energy Division as is current policy. The justification offered by Petitioners for each of these changes is provided below.

With respect to authorizing interim payments based on utility submitted performance reports rather than Energy Division verification reports, Petitioners

argue that the effectiveness of the mechanism is dependent on timely receipt of any interim incentives that might be owed. Thus, the delays experienced in completing the verification reports and the *ex ante* updates, as described above, and the associated delay in the ability of the IOUs to book interim incentive payments, undermines the ability of the mechanism to provide meaningful incentives for the deployment of energy efficiency measures.

Regarding the requested elimination of the requirement to update the *ex ante* DEER values used in calculating interim claims Petitioners allege that the studies underlying these updates are limited and outdated. This concern dovetails with their third request, namely that the Commission retain the ability to review “earnings related issues raised in evaluation measurement and verification reports”.

On August 22, 2008, the assigned Commissioner issued a ruling imposing an *ex parte* ban through September 15, 2008, the deadline for submitting responses to the Petition to Modify (PTM). This ban was imposed to give parties the opportunity to pursue alternative dispute resolution (ADR). ADR was specifically supported by the assigned Commissioner and ALJ. To that end the Commission offered ADR resources to facilitate a mediated solution. No settlement or mediated outcome was reached.

Responses to the petition were filed by the Natural Resources Defense Council (NRDC), as well as the Division of Ratepayer Advocates, the Utility Reform Network and the California Environmental Council (Joint Respondents), who filed jointly, on September 15, 2008.

In its response, NRDC articulates general support for Petitioners request to authorize interim claims such that the IOUs can receive interim incentive payments consistent with the schedule established in D.08-01-042. In NRDC’s

view, allowing the delays in Energy Division's verification reports and updates to the DEER database to prevent issuance of interim incentive payments will compromise the effectiveness of the incentive mechanism in "[making] the incentive mechanism credible to both company managements and a financial community that are unused to any material relationship between the utilities' earnings and their energy efficiency achievements." NRDC goes on to acknowledge concerns regarding potential overpayment reliance on utility submitted performance reports invites and provides its assessment of the likelihood such overpayment would occur. NRDC finds that the results reported by PG&E, SCE, and SCG that serve as the basis for the requested interim claim amounts, "represent robust lower bounds for the final total incentive payment entitlement" if those results are not updated to reflect adjustment to the net to gross (NTG) ratios. For SDG&E, NRDC cannot, on the basis of their analysis, assert that SDG&E's results are sufficiently conservative to support interim incentive payments. NRDC also suggests that for purposes of implementing the incentive mechanism for the 2006-2008 program cycle, the Commission should retain the *ex post* true-up provisions (to the 35% hold-back amounts and the last year's claim), but exclude updates to the NTG ratios from that assessment.

Joint Respondents oppose the PTM and recommend that the Commission reject it in its entirety. Joint Respondents argue that granting the PTM would alter the careful balance embodied by the incentive mechanism between ratepayer and utility interests, dramatically shifting that balance in favor of the utilities. By basing interim claims on unsubstantiated reports submitted by the utilities themselves as well as removing updates to the *ex ante* DEER estimates on a going-forward basis, Joint Respondents argue that the petition seeks to remove key elements that play a crucial role in limiting the extent to which ratepayers

provide incentives under the incentive framework where such incentives cannot be credibly attributed to the utility programs. With respect to the specific amounts requested by Petitioners for 2006 and 2007, Joint Respondents assert that were the mechanism applied as currently designed, the utilities would earn far less than the \$152 million and could conceivably earn nothing. Joint Respondents also argue that the Commission already considered and rejected a proposal by the IOUs to allow interim claims to be awarded on the basis of the IOU performance reports in the event the schedule established in D.07-09-043 encountered delays.

Petitioners filed a Reply to the Responses to the Petition for Modification September 25, 2008.

On October 3, 2008 the assigned ALJ convened a prehearing conference to discuss the PTM and any updates to parties' respective positions on the issues raised therein.

On October 28, 2008, the assigned Commissioner issued a ruling taking Judicial Notice of the Final DEER 2006-2007 Measure Updates, as well as all comments and Energy Division responses developed in the process leading up to final adoption of the updates, thereby incorporating this information into the record of this proceeding.

3. Discussion

In D.08-01-042, the Commission agreed with the Petitioners that in order for the incentive mechanism to be effective in motivating the utilities to treat energy efficiency investments as comparable to supply side investments, it must provide the opportunity for the utility to recognize and book incentives on a regular basis. The decision accepted the IOUs' argument that if incentives are not booked at regular intervals they will be excluded from operating revenues,

and will instead be treated as a one time adjustment, and thus will not factor into a company's financial valuation, greatly diluting the value of the incentive mechanism.³ The IOUs argue in this petition that the schedule established in D07-09-043 for the submission, verification and payment of interim claims has experienced significant delays, and thus will postpone the timing of when they will receive any interim payments that may be owed to them. Petitioners associate these delays with two activities that Energy Division was tasked with pursuant to D.07-09-043 and D.08-01-042: measure installation and expenditure verification reports and updates to the *ex ante* assumptions included in DEER. No one disputes that there have been delays in the completion of these activities. Because of these delays, any interim awards to which the IOUs may be entitled will fall outside of the schedule established in D.07-09-043. This fact has been formally recognized by the assigned ALJ, who, on October 20, 2008, issued a ruling extending the timeline for the issuance of Energy Division's final verification reports to January 15, 2009. As a result of this delay, Petitioners suggest that one of the key characteristics that the Commission has accepted as being necessary for the incentive mechanism to be effective, namely its timeliness, has been compromised. To address this, the IOUs suggest that the Commission allow them to earn incentives based on the measure and cost reports they have submitted rather than waiting for the final verification reports to be completed by Energy Division.

Taken together, D.07-09-043 and D.08-01-042 sought to create a balance between providing IOUs, and by extension the financial community, certainty that investments in energy efficiency will yield regular and meaningful returns,

³ D.08-01-042 pp. 9-10.

while simultaneously ensuring that ratepayers only pay incentives where the efforts of the IOUs have provided real and additional savings beyond what would have otherwise occurred. D.08-01-042 modified the earlier decision in response to IOU concerns that 100% true-up of the interim claims would prevent the IOUs from being able to book interim claims in light of the significant risk that these interim amounts would be "clawed back." The CPUC agreed in principle with the IOUs that the risk of interim claim "claw-back" compromised the value of the mechanism and accordingly altered the incentive framework to remove "full, *ex-post* true-up," under which all incentives received by the IOUs throughout a given program cycle, including interim amounts received, would be adjusted to reflect the results of an *ex post* evaluation of program performance. Instead, under the provisions established in D.08-01-042, the IOUs were allowed to retain interim claim amounts, except in circumstances where the *ex post* evaluation indicated that program performance fell within the penalty band. Furthermore, if the *ex post* evaluation resulted in the IOU program performance falling in the deadband, the IOUs would continue to earn incentives at the 9% shared savings rate, but that rate being applied to a fully trued-up PEB. However, in making these adjustments to the mechanism, the decision recognized that the risk to ratepayers of incentive overpayment necessarily increased. To mitigate this risk D.08-01-042 increased the "hold-back" amount from 30% to 35% and furthermore, clarified that the *ex ante* factors and DEER estimates used in determining IOU performance and incentives under the incentive framework would be updated. Combined with Energy Division measure installation and verification reports as required by D.07-09-043, the Commission concluded that these elements would be sufficient to allow IOUs to

book and retain interim payments without unduly exposing ratepayers to risk of overpayment.

The petition before us suggests that the approach adopted in these two decisions has, in the context of the 2006 and 2007 interim claims, resulted in a process that fails to meet a key criterion that the Commission has accepted as necessary for the energy efficiency incentive mechanism to be effective, namely its timeliness. In order to preserve this feature of the mechanism, Petitioners request that the Commission rely on the IOUs' fourth quarter savings reports in lieu of Energy Division Verification reports. The risk that the schedule for the issuance of verification reports, and thus the provision of interim claim amounts, might not be strictly adhered to was specifically recognized by the Commission in D.07-09-043, in which the Commission stated:

However, the actual due dates for those claims are tied to the issuance date of Energy Division's reports, as discussed in Section 8.4 below. Our staff is fully committed to meeting the deadlines established by our EM&V protocols for their reports. Nonetheless, no one can guarantee that unforeseen circumstances will never require some delay to that schedule. Therefore, should circumstances warrant, we permit the assigned ALJ to modify the schedule set forth in Attachment 6, in consultation with the assigned Commissioner.

On October 20, 2008, ALJ Gamson issued a ruling exercising his prerogative to adjust the schedule for the completion of Energy Division's final verification reports.

It is worth noting that Petitioners were well aware of the uncertainty surrounding the specific timing of any interim claim awards. Parties present uncontroverted evidence that the utilities' own statements in their Securities and Exchange Commission filings anticipated potential delays in Commission authorization for any earnings. For example, SCE's 10-K report dated

February 27, 2008 stated: “Timing of progress payment claims is linked to the completion of CPUC reports. Delays in CPUC reports could cause delays in recognizing earnings for these claims.” In an August 6, 2008 10-Q Report referenced the unsuccessful ADR attempt initiated by NRDC, PG&E stated: “It is uncertain whether this alternative dispute process will be successful or whether the CPUC will issue a decision by the end of 2008.” We find that the utilities were aware of potential delays in the Energy Division review process and understood that earnings claims might not be finalized in 2008.

Furthermore, the Commission specifically addressed and rejected an earlier proposal to rely on unverified utility savings reports in circumstances where the schedule for the verification reports has encountered delays.

Some parties to this proceeding suggest that we authorize the utilities to submit earnings claims and pay out some portion of the estimated savings if those Energy Division reports are delayed in any way. We do not adopt this suggestion. Ratepayers’ interests are best served when the payout of earnings (or imposition of penalties) occurs only after the installations, program costs and (for the final claim) load impacts have been verified by our staff and its contractors.⁴

As explained, in D.08-01-042 the Commission accepted the notion that regularity and timeliness of interim claims is part and parcel of an effective incentive mechanism. The language noted above, however, seems contradictory to this notion in that it essentially allows for interim payments to be postponed indefinitely, based on the completion of the verification reports. The provisions adopted in D.08-01-042 further tie the schedule for when interim payments, if

⁴ D.07-09-043 pp. 120-121.

owed, would actually be made to the ability of Energy Division to complete updates to the *ex ante* parameters and DEER estimates.

DRA, TURN and CEC argue that the lengthening of the schedule resulting from delays in the completion of the verification reports and *ex ante* parameter updates are relatively modest, at only a few months.⁵ Furthermore, whatever adverse consequences such delays might have is more than offset by the substantial potential benefits to ratepayers in terms of avoiding overpayment of incentives.⁶

In contrast, NRDC suggests that providing incentives on a timely basis is a critical element in making the incentive mechanism “credible to both company managements and a financial community that are unused to any material relationship between utilities’ earnings and their energy efficiency achievements.” As explained below, NRDC specifically supports the IOUs proposal to authorize interim claims based on the quarterly savings reports filed by the utilities with the exception of SDG&E.

In an effort to evaluate the extent to which authorizing interim claims as proposed in the PTM would put ratepayers at risk for overpayment, NRDC has attempted to assess the risk of overpayment in their response to the petition by comparing the claims sought by the Petitioners and the claim amounts that would be provided were the assumptions updated to reflect the proposed

⁵ DRA, TURN, CEC Joint Response to Petition for Modification, p. 2.

⁶ DRA, TURN and CEC suggest that the entire interim claim amount sought by the IOUs in their petition should be treated with great skepticism as this amount, \$152 million is based on unverified claims by the IOUs. Furthermore, DRA et al., suggest that if the *ex ante* parameters and DEER updates were updated as established in D.08-01-042, the IOUs interim performance may fall within the deadband, and thus would not be eligible for any incentives. *See* Response of DRA, TURN and CEC, p. 10.

2006-2007 DEER updates, excluding net-to-gross adjustments. NRDC finds that the interim earnings amounts requested by PG&E, SCE, and SCG are reasonably conservative as the amounts that would be earned were the assumptions updated as described would exceed the amounts the IOUs request in the petition. For SDG&E, NRDC believes that because SDG&E's 2006 and 2007 performance puts them at 87% of goal, there remains substantial risk of overpayment; a relatively modest change could easily put SDG&E's interim performance within the deadband and thus reduce the amount of incentive payments to which SDG&E would be entitled to zero. In the Petitioners' reply to the responses to the Petition for Modification, SDG&E and SCG assert that NRDC's analysis is unfair in that it doesn't account for 2004 and 2005 savings that, in SDG&E's estimation, are appropriately included given Commission direction on the use of cumulative savings in assessing utility performance under the incentive mechanism. According to SDG&E and SCG were a cumulative savings approach used, SDG&E's goals achievement would be 110%, corresponding to a shared savings rate of 12%.

Needless to say, because the interim claim amounts proposed by the IOUs have not been verified by Energy Division as required pursuant to D.08-01-042, we, like DRA, TURN, and CEC, have profound concerns that accepting the IOU proposal as is would subject ratepayers to significant risk of overpayment. Despite NRDC's assertions that, with the exception of SDG&E, the interim claim amounts sought by the IOUs are sufficiently conservative, we remain uncomfortable with the prospect of making payments on this basis. However, we also believe that allowing the schedule for interim payments to slip undermines the effectiveness of the mechanism. While it is clear, based on statements made in their respective SEC filings, that the utilities were well-aware

of the significant potential for such delays, that recognition is not, in of itself a reasonable or logical counterargument to the concern that such delays undermine the effectiveness of the incentive mechanism. Thus we find ourselves confronted with the apparent dilemma of either choosing to proceed with the process we approved in prior decisions, which places a premium on protecting ratepayers from overpayment, but compromises timeliness; or choosing to grant interim payments as proposed by the IOUs, which places a premium on timeliness, though potentially to the detriment of ratepayers.

However, this need not be an either/or proposition. Although Energy Division has not yet completed its verification reports, we believe the quarterly reports submitted by the utilities can serve as a meaningful basis for interim claim amounts provided the increased risk of overpayment this necessarily engenders is taken into consideration. One means of mitigating this risk is via the hold-back amount applied to interim claims. With the verification reports and *ex ante* updates in place, the Commission found that a hold-back of 35% was reasonable.⁷ Absent these protections it follows that the hold-back amount would need to be increased. After reviewing comments submitted with regard to the risk faced by ratepayers we believe that allowing the utilities to earn interim incentives based on their savings reports could be reasonable provided the hold back amounts are increased substantially. A higher holdback amount will reduce the risk that overpayment occurs by subjecting a greater amount of the interim claims to *ex post* true-up. Based on the information on the record thus far regarding potential sources of upward bias in utility claims we believe a hold-back of 50% reasonably protects ratepayers from the risk of overpayment for

⁷ D.08-01-042. p. 14.

PG&E, SCE, and SoCal Gas. For SDG&E, in light of the concerns raised by NRDC and whether SDG&E's interim claim amount is sufficiently conservative, we believe it is appropriate to increase the hold back to 80%. We do not, at this time, decide whether a cumulative approach assessing savings is the appropriate basis or not, however, we agree with NRDC's assertion that SDG&E's claim is subject to a higher level of overpayment risk than that of the other utilities.

These increased holdback amounts when applied to the interim claim amounts proposed by the IOUs result in payments of \$59.3 million, \$35.3 million, \$6.2 million, and \$7.4 million for PG&E, SCE, SDG&E, and SoCal Gas respectively.

Pursuant to D.07-09-043 as modified by D.08-01-042, these amounts represent 65% of the total interim claim. Absent further Commission action, the amounts held back will continue to be subject to the true-up provisions as established in the prior decisions. For now, the deviation from the approach established in D.07-09-043 as modified by D.08-09-042 only applies to the 2006 and 2007 interim claim. However, in the event that similar circumstances arise in the context of the 2008 interim claim, we establish here a similar approach should Energy Division's verification reports be delayed such that an interim payment that may be owed cannot be authorized in 2009 pursuant to the schedule established in D.07-09-043. In this case, interim payments will be based on the utilities' savings reports but subject to a holdback of at least 50% with the specific level to be determined at the discretion of the assigned Commissioner. In such instances, the assigned Commissioner shall issue a ruling notifying parties of their intent to rely on the utilities' savings reports as the basis for determining interim claim amounts and solicit comments from parties on those reports and what holdback amounts should be applied. Once comments have been

submitted, the assigned Commissioner will issue a final ruling adopting interim payment amounts.

The IOUs also ask that on a prospective basis we eliminate the requirement that the *ex ante* savings parameters used to calculate interim claims be updated with more recent savings parameters and DEER estimates. This request is made largely on the grounds that the rigor of the studies underlying those updates is limited. To that end, the IOUs also ask that updates to the measurement assumptions be elevated to the Commission level for review.

Regarding updates to the *ex ante* assumptions used to assess interim claims, in D.08-01-042 we clarified what specific *ex ante* assumptions would be relied upon for purposes of calculating the 2006-2007 interim claims. Ordering Paragraph 3 of D.08-01-042 states:

For the 2006-2008 program cycle, the following *ex ante* assumptions of energy savings and demand reductions shall be used in conjunction with verified installations and verified costs to calculate the 1st and 2nd Claims:

- (a) Except as otherwise provided for below, the *ex ante* measure savings parameters that are contained in the utilities' E3 calculators, as of the 4th quarter 2007 report for the 1st Claim and as of the 4th quarter 2008 report for the 2nd Claim.
- (b) For measures contained in the Database for Energy Efficient Resources (DEER), the 2008 and 2009 DEER updates of *ex ante* measure savings parameters, including net-to-gross ratios and expected useful lives. The 2008 DEER update shall apply to the 1st Claim and the 2009 DEER update shall apply to the 2nd Claim.
- (c) For customized measures or customized projects that represent aggregated measures in the E3 calculator, Energy Division shall identify the appropriate installed measure(s) based on its measure verification results and develop the

associated *ex ante* load impact values. For this purpose, Energy Division may use the utilities' tracking system information, engineering workpapers, DEER values and methods, or other current measurement and verification results that are available."

For the first claim, representing 2006 and 2007 performance under the incentive mechanism, today's decision, which relies on the utility submitted savings reports subject to higher hold back amounts, renders this direction moot. For the 2008 interim claim, our process remains unchanged, unless Energy Division's verification reports are delayed as described above. Thus, as it currently stands, the second interim claim for the 2006-2008 program cycle, representing program performance in 2008, will be based on Energy Division verification reports incorporating updated *ex ante* assumptions. The *ex post* true-up provisions for the 2006-2008 cycle also remain unchanged.

While we deny without prejudice Petitioners' request that we eliminate the requirement to update the *ex ante* assumptions, we share the concerns expressed by the Petitioners regarding the robustness of assumptions and updates thereof used to assess utility performance under the incentive mechanism. These concerns are particularly notable with respect to the net-to-gross ratios used for assessing the impact of utility programs in driving energy efficiency deployment beyond what would have occurred absent these programs. In light of these concerns, we believe it is reasonable to elevate the level of review to which these assumptions and the resulting reports they inform are subject. Currently, updates to the energy efficiency performance metrics embodied in DEER are left to the discretion of Energy Division. Prospectively, beginning with the verification report currently scheduled to be issued in August 2008, we will require that Energy Division issue its verification reports via draft resolution for

consideration and adoption by the Commission before those reports are used to determine incentive payments or penalties under the RRIM.⁸ The resolution should include detailed information regarding the underlying assumptions used and supporting documentation that provides the basis for those assumptions.

Findings of Fact

1. In D.07-09-043 the Commission established the Risk Reward Incentive Mechanism which sought to put investments in energy efficiency on equal footing with supply side investments by creating a comparable earnings opportunity for the successful deployment of energy efficiency measures.
2. D.07-09-043 determined that interim claims under which the utilities could receive incentives for mid-cycle program achievements would enhance the overall effectiveness of the mechanism.
3. Regular and timely issuance of incentive payments is critical to the ability of the risk reward incentive mechanism in creating a meaningful linkage between utility investments in energy efficiency and utility earnings.
4. Under the provisions established in D.07-09-043 as modified by D.08-01-042, payment of interim claims are based on Energy Division Verification Reports reflecting updates to the *ex ante* planning assumptions and validation of measure installation and costs.
5. The interim claim provisions include a holdback of 35% as a means of reducing the risk to ratepayers of overpayment.
6. Reliance on Energy Division Verification Reports coupled with the 35% hold back significantly reduces the risk of overpayment.

⁸ Energy Division should issue its draft verification reports via resolution such that these resolutions can be adopted by the Commission in the same timeframe as envisioned in D.07-09-043 for the issuance of the final verification reports.

7. To date there have been significant delays to the completion of the verification reports on which interim claims to the utilities are to be based such that any interim award, to the extent owed, would not be approved until 2009.

8. All else equal relying exclusively on utility submitted quarterly savings reports as the basis for determining interim claim amounts necessarily exposes ratepayers to more risk of overpayment than if interim claims were based on energy division verification reports.

9. NRDC's analysis indicates that the interim claim amounts sought by PG&E, SCE, and SCG are reasonably conservative and, thus, combined with the existing holdback provisions are unlikely to result in overpayment.

10. NRDC was unable to assert that SDG&E's interim claim is sufficiently conservative to adequately mitigate the risk of overpayment.

11. Notwithstanding NRDC's analysis, relying on utility submitted savings reports that have not been verified by Energy Division as a basis for assessing interim claims increases the risk of overpayment.

12. All else equal imposing a higher holdback amount can help mitigate the risk of incentive overpayment.

13. Updates to the DEER energy efficiency performance assumptions and the methodologies supporting those updates have been the subject of considerable controversy over the course of this proceeding, particularly with respect to net-to-gross ratios.

Conclusions of Law

1. In the interest of preserving the timeliness and efficacy of the incentive mechanism while still protecting ratepayers from the risk of overpayment, in circumstances where the issuance of Energy Division's verification reports have encountered significant delays, the Commission should authorize interim

payments to the IOUs based on their quarterly performance reports but subject to a higher holdback amount.

2. Although NRDC has provided an analysis indicating that the interim claim amounts requested by PG&E, SCE, and SCG are reasonably conservative, because reliance on these reports as the basis for assessing interim claim necessarily involves greater risk of overpayment a higher holdback amount of 50% is warranted and reasonable.

3. For its 2006-2007 interim claim a higher holdback amount for SDG&E of 80% is warranted and reasonable in light of NRDC's analysis indicating that its interim claim request is not sufficiently conservative.

4. The Commission should deny Petitioners' request to eliminate the requirement that the *ex ante* assumptions used in the calculation of interim claims be updated.

5. The Commission should grant the Petitioners' request regarding Commission review of earnings-related issues by requiring the verification reports developed by Energy Division to be issued by resolution.

O R D E R

IT IS ORDERED THAT:

1. The Petitioners' request that in instances where Energy Division has not met the established schedule for the completion of the verification reports used to validate interim claims, the Commission authorize interim incentive payments based on the utility submitted performance reports is granted in part for the 2006 and 2007 interim claim period, subject to the higher holdback amounts as described herein.

2. For the 2008 interim claim, should Energy Division's verification reports be delayed such that any interim amounts that may be owed cannot be authorized

in 2009 pursuant to the schedule established in D.07-09-043, interim claims will be based on the IOU submitted quarterly savings reports subject to a holdback amount of at least 50%, with the specific holdback amount to be determined at the discretion of the assigned Commissioner based on the risk of overpayment. In such instances, the assigned Commissioner shall issue a ruling notifying parties of their intent to rely on the utilities' savings reports as the basis for determining interim claim amounts and solicit comments from parties on those reports and what holdback amounts should be applied. Once comments have been submitted, the assigned Commissioner will issue a final ruling adopting interim payment amounts.

3. D.08-01-042 is modified as follows:

Ordering Paragraph 3 is changed from:

For the 2006-2008 program cycle, the following *ex ante* assumptions of energy savings and demand reductions shall be used in conjunction with verified installations and verified costs to calculate the 1st and 2nd Claims:

- (a) Except as otherwise provided for below, the *ex ante* measure savings parameters that are contained in the utilities' E3 calculators, as of the 4th quarter 2007 report for the 1st Claim and as of the 4th quarter 2008 report for the 2nd Claim.
- (b) For measures contained in the Database for Energy Efficient Resources (DEER), the 2008 and 2009 DEER updates of *ex ante* measure savings parameters, including net-to-gross ratios and expected useful lives. The 2008 DEER update shall apply to the 1st Claim and the 2009 DEER update shall apply to the 2nd Claim.
- (c) For customized measures or customized projects that represent aggregated measures in the E3 calculator, Energy Division shall identify the appropriate installed measure(s) based on its measure verification results and develop the

associated *ex ante* load impact values. For this purpose, Energy Division may use the utilities' tracking system information, engineering workpapers, DEER values and methods, or other current measurement and verification results that are available.

to (underline added to highlight change):

For the 2006-2008 program cycle, the following *ex ante* assumptions of energy savings and demand reductions shall be used in conjunction with verified installations and verified costs to calculate the 1st and 2nd Claims unless the schedule for the issuance of Energy Divisions Verification Reports is delayed such that interim claims cannot be authorized in the calendar year in which the claim was submitted. In such circumstances, interim claims will be based on the utilities' savings reports, with the resulting claim amounts subject to a higher holdback to reflect and mitigate the additional risk to ratepayers of overpayment:

- (a) Except as otherwise provided for below, the *ex ante* measure savings parameters that are contained in the utilities' E3 calculators, as of the 4th quarter 2007 report for the 1st Claim and as of the 4th quarter 2008 report for the 2nd Claim.
- (b) For measures contained in the Database for Energy Efficient Resources (DEER), the 2008 and 2009 DEER updates of *ex ante* measure savings parameters, including net-to-gross ratios and expected useful lives. The 2008 DEER update shall apply to the 1st Claim and the 2009 DEER update shall apply to the 2nd Claim.
- (c) For customized measures or customized projects that represent aggregated measures in the E3 calculator, Energy Division shall identify the appropriate installed measure(s) based on its measure verification results and develop the associated *ex ante* load impact values. For this purpose, Energy Division may use the utilities' tracking system information, engineering workpapers, DEER values and methods, or other current measurement and verification results that are available.

4. Pacific Gas & Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company are authorized interim incentive payments in the amounts of \$59.3 million, \$35.3 million, \$6.2 million, and \$7.4 million, respectively, reflecting their mid-cycle performance for the 2006 and 2007 periods under the Energy Efficiency Risk Reward Incentive Mechanism.

5. On a prospective basis, beginning with the verification report currently scheduled for issuance in August 2009, Energy Division shall issue its verification reports via draft resolution that includes detailed information regarding the underlying assumptions relied upon as well as supporting information and documentation that provides the basis for those assumptions.

6. The process adopted in D.07-09-043 and as identified in Attachment 6 thereof for the completion of Energy Division's verification reports should be amended to reflect the resolution process established here for adoption of the final verification reports.

7. Petitioners' request that the requirement to update the *ex ante* planning assumptions be eliminated is denied without prejudice.

Dated _____, at San Francisco, California.