FER/gd2/oma 12/16/2011

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12-16-11
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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

ASSIGNED COMMISSIONER'S RULING SOLICITING FURTHER COMMENTS AND PRODUCTION OF DATA REGARDING ENERGY EFFICIENCY INCENTIVE REFORMS

On August 30, 2011, I issued an Assigned Commissioner's Ruling (ACR) calling for comments to refresh the record regarding prospective reforms to the Commission's Energy Efficiency (EE) Risk Reward Incentive Mechanism (RRIM) program. Among other things, the ACR asked what shared savings percentage would result for the 2010-2012 cycle based on the ex-ante values approved in Decision (D.) 09-09-047 (as modified by D.10-12-054) and in D.11-07-030, taking into account the applicable adjustment for reduced risk. It was my expectation to be able to use these comments to give me insights for the future of the incentive mechanism, for both the current 2010-2012 EE portfolio cycle and beyond.

The comments received, however, were not adequately responsive. In order to move forward with a proper evaluation of the effects on ratepayers and shareholders of the various options for designing appropriate incentives, a better record is required. In particular, examples and numbers are needed to understand the context of the reduced level of risk, the need for incentives for EE when compared to other supply side investments, how incentives influence utility management and other broader market impacts. In this regard, I ask in

this ruling for specific step-by-step calculations necessary to derive energy efficiency incentive earnings formulas for the 2010-2012 period based on the assumptions outlined below.

I recognize that I issue this ruling at the end of 2011, which means that the responses are being given almost two thirds of the way through a program cycle. Accordingly, parties should consider the relevant implications of how the design of a 2010-2012 incentive program may be informed or impacted by the timing of Commission adoption of any revised EE incentive design. Nothing in this ruling, however, should be construed as prejudging the range of possible options for design of EE incentives, either for the current 2010-2012 or the proposed 2013-2014 cycle. The range of possible options includes whether any explicit awards of earnings are warranted at all in order to produce effective incentives to meet and exceed the Commission's EE goals.

EE Incentive Design Issues for the 2013-2014 Time Horizon

In the current EE policy proceeding (Rulemaking 09-11-014) I have issued several ACRs with a vision for how EE program should be changed for the post 2010-2012 EE program cycle, including the need for a transition period for the 2013-2014 time horizon.[1] Therefore, I am also asking parties to comment on how their responses related to the incentive mechanism for 2010-2012 program cycle would change, if at all, for the proposed 2013-2014 program timeframe. It is my belief that in order for a risk reward incentive mechanism to be most effective and to generate maximum ratepayer benefit from its use, the mechanism itself

[1] In particular, I issued on October 25, 2011 an Assigned Commissioner's Ruling and Scoping Memo Regarding 2013-2014 Bridge Portfolio and Post- Bridge Planning, Phase IV.

needs to be designed contemporaneously and in coordination with the guidance and design for the EE program portfolio. Since the 2013-2014 EE portfolios must be developed and approved in the next twelve months, I want input now from the parties on the differences between the mechanism on the 2010-2012 and the 2013-2014 programs.

In the 2013-2014 timeframe, I expect there to be a greater emphasis on programs designed for deeper savings, measures with higher up-front costs and longer design lives, and market transformation efforts (with correspondingly increased challenges associated with program participation levels and achieving savings from these programs). Not unsurprisingly, I see far less of these challenges associated with the traditional resource acquisition programs. As a result, this suggests that perhaps we should be creating an incentive that is calibrated to the different types of programs in the portfolio with programs addressing harder-to-achieve savings rewarded at a different incentive rate than programs with easier-to achieve savings. If parties wish to suggest different shared saving rates for resource acquisition vs market transformation programs-or entirely different incentive designs or performance benchmarks-please provide a description of your proposal(s), and the underlying rationale and assumptions.

Once the responsive comments and requisite calculations have been presented and evaluated in response to this ruling, I will provide further directions on the next steps in concluding this phase of the proceeding.

Prior Comments on the Shared Savings Rate for the 2010-2012 EE Program Cycle

Among those filing comments on my August 30, 2011 ruling, the Natural Resources Defense Council (NRDC) was the only party to provide actual numerical calculations to derive a shared savings rate for an incentive formula for of energy efficiency savings for the 2010-2012 portfolio. NRDC calculated equivalent supply-side equivalent savings of $532 million for all three utilities based on assumed gross energy savings of 8,706 Gigawatthours (GWh) estimated for 2010-2012 program cycle (as derived from D.09-09-047).

NRDC calculated the $532 million based on the ratio of 8706 GWh/7371 GWh multiplied by the assumed $450 million supply-side savings for the 2006-2008 cycle (before any adjustments to reflect earnings adjustments for reduced risk). NRDC does not update any of the underlying assumptions used to derive the original $450 million supply-side savings, however, but merely applies a simple ratio of the difference in GWh savings to calculate the $532 million figure. The NRDC calculation of $532 million, likewise, does not incorporate the updated impacts on 2010-2012 energy efficiency savings resulting from the IOUs' portfolio design changes consistent with the Commission-adopted ex-ante measures in D.11-07-030.

Among the utilities, Pacific Gas and Electric Company (PG&E) was the only one to provide a numerical response as to the applicable shared savings rate for the 2010-2012 program cycle. In its comments, PG&E makes the general observation that "the PEB resource savings for the 2010-2012 portfolio cycle are estimated to be lower than the previous cycle due to ex-ante values approved in D.09-09-047 and D.11-07-030." However, PG&E does not provide any specific calculations necessary to ascertain what the lower shared savings rate for PG&E

actually is. PG&E simply states "we would anticipate a comparable shared savings rate of at least 12% for this portfolio cycle." While I commend both NRDC's and PG&E's attempts at generating a record, I am not satisfied that the record is robust enough to make a full analysis of the complex issues at hand.

Directions for Calculating the Shared Savings Rate

I direct each of the IOUs to provide the relevant calculations and supporting assumptions applicable to the calculation of a shared savings rate for the 2010-2012 cycle, applying each of the steps outlined below. I also ask them to reply how these calculations (and the assumptions underlying the RRIM formulas and input values) would or should change, if at all, for the 2013-2014 time horizon.

Other parties are welcome to provide input as well on the appropriate manner in which to make the applicable calculations, and the appropriate assumptions and rationale for them. Again, I seek parties' input for both the current 2010-2012 program cycle and the proposed 2013-2014 period. For any party providing comments, please include in your response supporting calculations and explanatory rationale where relevant.

For the 2010-2012 program period, the calculations shall be provided in the following steps:

Step 1. Identify the energy savings in GWh associated with the 2010-2012 portfolio, as modified or updated to reflect any program design changes made based upon the ex-ante values approved in D.09-09-047 (as modified by D.10-12-054), and as updated, augmented or modified by D.11-07-030. For purposes of this calculation, I feel that the most recent numbers are the most appropriate to use. Therefore, I direct that the IOUs should use estimates based on their rebalanced portfolios provided in their pending advice letters filed in response to the revised ex-ante values adopted in D.11-07-030, even though these advice letters are not yet adopted. Without pre-judging the outcome, I anticipate that those advice letters will be disposed of prior to the issuance of a decision in

this proceeding. In the case of natural gas utility savings for the 2010-2012 portfolio, identify the relevant natural gas therm savings based on the applicable corresponding ex-ante values. Identify the applicable savings based upon achievement of (a) 100% of adopted savings goals and (b) 125% of adopted savings goals.

Step 2. Provide the calculation of the Performance Earnings Basis (PEB) that corresponds to the energy or natural gas savings for 2010-2012 calculated in Step 1 above. Since custom measures are expected to provide a significant share of total net benefits, the calculation should disclose what assumptions are made regarding the amount of 2010-2012 energy savings from custom measures. The custom measure savings should assume the 90% gross realization rate adopted in D.11-07-030.

The PEB calculations should be broken out separately in three annual components for 2010, 2011, and 2012, respectively. To the extent that the IOUs modified their portfolios (and expected savings) as a result of D.11-07-030, the calculations should delineate the portion of the PEB that applies to the period before and after the portfolios and ex-ante savings were modified pursuant to D.11-07-030.

Step 3. Calculate 2010-2012 earnings associated with supply-side resources avoided by energy efficiency. Provide the updated calculation of the equivalent supply-side earnings that the IOU would realize for the 2010-2012 cycle, assuming such supply-side resources were utilized (instead of energy efficiency savings) to meet the load demand identified in Step 1 above. This calculation is simply intended to update the corresponding 2006-2008 RRIM calculations previously adopted in D.07-09-043. For purposes of the calculations here, make no separate adjustment for the effects of reduced earnings risk. The risk-related adjustment to the shared savings rate will be addressed separately in Step 5 below.

As a context for updating this calculation for 2010-2012, refer to D.07-09-043, Section 6.3.3 "Supply-Side Comparability Benchmark: Adopted Range of Values" (pp. 92-102). As explained in this section of D.07-09-043, the Commission determined supply-side equivalent earnings associated with steel-in-the-ground investments that would otherwise be acquired to meet load if not satisfied by energy efficiency savings from the 2006-2008 portfolio.

For purposes of supporting the calculated supply-side earnings, the formula and calculations should be provided. Since a single set of uniform assumptions were applied in D.07-09-043 for purposes of calculating the supply-side equivalent values for 2006-2008, for purposes of this updated calculation, the IOUs should likewise seek to develop a consensus among themselves on a uniform set of assumptions, rather than using different company-specific assumptions.

Updates in the key underlying assumptions should be specified particularly with respect to (a) the average life of energy efficiency measures, (b) the percentage of supply-side resource needs met by utility-owned facilities (rather than by contract power), (c) whether or how debt equivalence should be imputed for power purchases in the utilities' comparable earnings calculations, and (d) the most current estimates of avoided cost of generation capacity.

Any additional material changes in the relevant assumptions of 2010-2012 supply-side equivalent resources since the calculation made in D.07-09-043 should also be recognized in providing the updated calculation in compliance with this ruling. For example, to the extent that the lead time needed to build more generation to meet new peak load has been extended further than was assumed in D.07-09-043, the IOUs should update this assumption in their calculations. In addition, the IOUs should use expected useful lives that were developed based on D.11-07-030 and relevant assumptions reflected in 2008 DEER values. Relevant updates to the forward natural gas cost curves embedded in the PEB should also be used to the extent that these have changed since 2007.

Step 4. Calculate the RRIM shared-savings percentage rate required to yield the supply-side equivalent earnings calculated in Step 3 above, before any adjustments to reflect reduced risk associated with RRIM earnings relative to the corresponding supply-side earnings. The formula for this shared savings percentage calculation is:

Equivalent Supply Side Earnings (as determined in Step 3 above)
Divided by:
Performance Earnings Basis (as determined in Step 2 above)

Step 5. Adjust the shared savings percentage rate as appropriate to reflect the reduced risk associated with earnings received as incentives for energy efficiency compared with rate-of-return earnings from supply side equivalent resources. This calculation should explicitly identify the relevant numerical

adjustment to the shared savings rate calculated in Step 4 in order to recognize the differences between the risk/reward associated with supply-side earnings versus corresponding incentive earnings.

Parties should not simply assume the 7% shared savings rate applied in D.10-12-049 is the relevant starting point for calculating incremental changes in the shared savings rate for 2010-2012. I ask that the parties independently evaluate all relevant comparisons between the financial risks and rewards associated with earnings from supply-side resources versus earnings from the RRIM formula, as applied in D.10-12-049, based upon 2010-2012 ex-ante values. The shared savings rate should be designed to yield supply-side equivalent earnings, with elimination of per-unit penalties, but retention of the cost-effectiveness guarantee. Among other things, the shared savings rate adjustment should incorporate the difference in risk between supply-side resources financed through external debt and equity capital markets versus RRIM awards simply collected from ratepayers with no capital market risk.

As mentioned above, after completing Steps 1-5 above for the 2010-2012 program period, I direct parties to separately comment on how the above assumptions or results would change, if at all, for the proposed 2013-2014 time frame.

IT IS RULED that:

1. Each of the investor-owned utilities, i.e., Southern California Edison Company (SCE), Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), and Pacific Gas and Electric Company (PG&E) is directed to provide a calculation of the applicable shared savings rate for purposes of awarding energy efficiency incentives for the 2010-2012 cycle, utilizing the assumptions and following the steps outlined above.

2. SCE, SoCalGas, SDG&E, and PG&E shall also reply how the results would change, if at all, for the 2013-2014 program cycle.

3. Other parties may provide their own alternative calculations, or comment upon the merits or appropriateness of the calculations presented by the utilities

for both the current 2010-2012 program cycle and the proposed 2013-2014 program cycle.

4. Opening comments shall be due by January 16, 2012 and reply comments shall be due by January 30, 2012.

5. Further direction will be provided as to the next steps in resolving this phase of the proceeding after receipt of the opening and reply comments responding to this ruling.

Dated December 16, 2011, at San Francisco, California.

/s/ MARK J. FERRON
Mark J. Ferron
Assigned Commissioner