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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)

APPLICATION FOR REHEARING
OF DECISION 10-12-049

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APPLICATION FOR REHEARING
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I. INTRODUCTION

On December 27, 2010, the Commission issued its "Decision Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008," Decision (D.) 10-12-049 (Decision). The Division of Ratepayer Advocates (DRA) and The Utility Reform Network (TURN) submit this Application for Rehearing of the Decision pursuant to Rule 16.1 of the Commission's Rules of Practice and Procedure. This Application for Rehearing is timely filed within 30 days of the date of the Decision's issuance.

The Decision purportedly resolved the third and final of the Risk/Reward Incentive Mechanism (RRIM) proceedings for the 2006-2008 energy cycle by awarding incentives for "savings achieved"[1] through the ratepayer-funded energy efficiency programs that Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas)[2] administer. The evaluation, measurement and verification (EM&V) studies overseen by the Commission's Energy Division demonstrated that the "savings achieved" fell far short of the Commission's energy savings goals and were therefore not entitled to further incentives, yet the Commission revised the incentive mechanism for the third time in three years in order to award the Utilities an additional $68,158,522.

The Decision claimed that it revised the incentive mechanism in order to "motivat[e] the [U]tilities to embrace energy efficiency as a core part of their business."[3] It is not specified how revising the incentive mechanism nearly three years after the programs ended and paying incentives for "savings achieved" that exist only when measured using out-of-date-metrics will motivate the Utilities to design and administer effective programs to save energy, the fundamental purpose of the incentive mechanism.

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[1] D.10-12-049, p. 2.

[2] DRA and TURN's Application for Rehearing refers collectively to PG&E, SCE, SDG&E and SoCalGas as "Utilities."

[3] D.10-22-049, p. 6.

The Decision awarded additional incentives based on its conclusion that it was "unreasonable" to expect the Utilities to modify their portfolios in response to changing market conditions "given the timing of information available regarding these changes, the substantial controversy regarding their accuracy, and their magnitude."[4] The conclusion that the Utilities had insufficient information or notice to revise their portfolios is contradicted by the record. Moreover, in approving payment of $68.2 million in incentives in addition to the $143.7 million the Utilities already received, notwithstanding the Energy Decision's Verification Report[5] showing that SoCalGas's portfolio was not cost-effective, and information showing that the cost of incentives rendered SDG&E's portfolio not cost-effective, the Commission disregarded its "legal duty …to ensure cost-effectiveness and reasonable use of ratepayer monies."[6]

For these reasons, the Decision represents an abuse of the Commission's discretion and should be reversed. DRA and TURN respectfully request that the Commission grant this Application for Rehearing and revise the Decision to award no additional incentives to the Utilities for their 2006-2008 energy efficiency programs, to include the cost of incentives in the calculation of the performance earnings basis, (PEB), and to require any award of incentives for the 2009 program year be based on the Energy Division's Verification Report,[7] consistent with D.07-09-043 as modified by D.08-01-042 and D.08-12-059.

II. BACKGROUND

A. Decision 07-09-043 adopted a shareholder incentive mechanism that awarded incentives for independently verified energy savings.

D.07-09-043 recognized the importance of energy efficiency as a resource for meeting California's energy needs by adopting a risk/reward mechanism designed to align

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[4] D.10-22-049, p. 7.

[5] 2006-2008 Energy Efficiency Evaluation Report, July 2010. Available at ftp://ftp.cpuc.ca.gov/gopher-data/energy%20efficiency/2006-2008%20Energy%20Efficiency%20Evaluation%20Report%20-%20Full.pdf

[6] D.09-09-047, p. 6; *see also* Public Utilities Code Section 451.

[7] Energy Efficiency Evaluation Report for the 2009 Bridge Funding Period, January 14, 2011. Available at http://www.cpuc.ca.gov/PUC/energy/Energy+Efficiency/EM+and+V/2009_Energy_Efficiency_Evaluation_Report.htm.

the interests of shareholders and ratepayers in pursuing energy efficiency. The mechanism included features designed to promote energy efficiency as a resource, while at the same time balancing the interests of shareholders and ratepayers:

> "[E]arnings begin to accrue <u>only</u> as the utilities <u>reach to meet and surpass</u> the Commission's kWh, kW and therm <u>savings goals</u>."
>
> "Earnings are greatest when performance is superior, not just 'expected.'"
>
> "All calculations of the net benefits and kW, kWh and therm achievements are <u>independently verified</u> by the Commission's Energy Division and its evaluation, measurement and verification (EM&V) contractors, based on adopted EM&V protocols."[8]

D.07-09-043 provided that shareholders would begin earning incentives when energy efficiency program savings reached the "minimum performance standard" (MPS), or 80-85% of the goals established in D.04-09-060.[9] Utility shareholders would receive 9% of the energy efficiency net benefits for program savings that reached the MPS, and 12% of the net benefits for program savings that reached or exceeded 100% of the Commission's energy efficiency goals. For energy savings between 65% and 80-85% of the goals, the incentive mechanism contained a deadband in which neither rewards nor penalties would accrue. The incentive mechanism was designed to penalize performance below 65% of the relevant goals.[10]

Decision 07-09-043 recognized that an effective incentive mechanism must include provisions for earnings (or penalties) at interim points during the three-year program cycle.[11] To provide timely feedback to the Utilities for their performance in achieving energy efficiency saving, and to "produce a stream of earnings during and at the

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[8] D.07-09-043, p. 4. These three aspects of the shareholder incentive mechanism were among nine that the Commission adopted (emphasis in original).

[9] The Commission established three types of goals: kilowatts (kW), kilowatt hours (kWh), and therms. Utilities with more than one goal would need to reach an average of 85% for each of their applicable metrics, with no single metric falling below 80%. SoCalGas would only have one goal to meet, so it would need to achieve at least 80% of the therms goal established by the Commission. D.07-09-043, p. 28.

[10] D.07-09-043, pp. 5-6.

[11] D.07-09-043, p. 122 and Conclusion of Law 7, at p. 212.

end of the program to provide ongoing incentives to the utilities,"[12] the RRIM included two interim incentive payouts as well as "one final true-up claim after the program cycle is completed."[13]

D.07-09-043 provided that the interim incentive payments would be calculated using verified measure installations and costs, but *ex ante* forecasted demand reduction and energy impacts parameters. The interim payments would be adjusted or "trued-up" after Energy Division's *ex post* evaluation to determine actual demand reduction and energy savings consistent with established EM&V protocols. To guard against the possibility that actual savings might be lower than forecasted, the incentive mechanism included a 30% hold back of incentives and provided that interim overpayments to the Utilities could be deducted from future claims.[14]

D.07-09-043 recognized that the final true-up process would help ensure that ratepayers pay incentives only for savings that were real and verified, and that energy efficiency produced "sizable GWh [gigawatt hour], MW [megawatt], and Mtherm [megatherm or Mth] savings that resource planners can depend upon now and in the future."[15] Thus, D.07-09-043 designed an incentive mechanism to promote energy efficiency as the resource of choice by striking a balance between shareholder and ratepayer interests.

B. Decision 08-01-042 eroded the original mechanism by allowing Utilities to keep incentives even if the final true-up showed the verified savings felt short of the requirements for earning incentives

Shortly after the adoption of D.07-09-043, the Utilities filed their first petition for modification,[16] which sought to restrict the final true-up so that achievement of the MPS would be calculated using verified measure installations and costs, but ex *ante* planning

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[12] D.07-09-043, p. 122.

[13] D.07-09-043, p. 12.

[14] D.07-09-043, Finding of Facts 110 and 112, p. 200.

[15] D.07-09-043, p. 119.

[16] Petition for Modification of Decision 07-09-043 By Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company and Southern California Gas Company, filed October 31, 2007 and amended November 7, 2007.

estimates of load impacts.[17] The Utilities requested that if final verified energy savings showed that their performance fell in the "deadband," between 65% and 85% of the Commission's adopted savings goals, they would nevertheless retain interim incentives and continue earning at the established share rate of 9%. The Utilities claimed that their requested changes were necessary in order to provide sufficient certainty to investors that energy efficiency earnings could be booked "'on a regular basis for accounting purposes in a manner that can be expected and anticipated by the investment community'" so that energy efficiency resources would be "'on par with generation resources in the minds of investors.'"[18]

The Commission was persuaded that effectiveness of the incentive mechanism would be undermined if the Utilities could not book authorized earnings because the final true-up might require the return of incentive payments.[19] It therefore modified the incentive mechanism to limit the final true-up process so that

> "if a utility meets the MPS for the interim claim based on verified measure installations and costs, and the *ex ante* savings assumptions, but falls within the 65 to 85% of energy savings goals as a result of the final *ex post* true-up of load impacts…the utility will continue to earn at the 9% shared savings rate, applied to the ex post PEB. In addition, as long as a utility continues to exceed the 65% of savings goal threshold for each individual metric on an *ex post* basis, it will not be required to pay back any interim incentives payments earned."[20]

D.08-01-042 further revised the incentive mechanism to mitigate the risk of large swings in earnings and decrease the risk of overpayment, including "[u]pdating *ex ante* load impacts using the DEER[21] database prior to payout of interim claims in 2008 and

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[17] Petition for Modification of Decision 07-09-043 By Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company and Southern California Gas Company, filed October 31, 2007 and amended November 7, 2007, p. 3.

[18] D.08-01-042, p. 9, quoting Petition for Modification of Decision 07-09-043 By Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company And Southern California Gas Company, filed October 31, 2007 and amended November 7, 2007 at p.13.

[19] D.08-01-042, p. 10.

[20] D.08-01-042, Ordering Paragraph 2, p. 25.

[21] DEER is a database developed jointed by the Commission and the California Energy

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2009"[22] and requiring that 35% of the interim payment be held back.[23] While restricting the final true-up removed the "incentive for utility managers and staff to support the most accurate estimate of energy savings"[24] and worked against the interest of ratepayers in sharing the net benefits with shareholders "at precisely the adopted share rate,"[25] use of updated DEERnumbers to calculate interim claims and increasing the hold back decreased the possibility that shareholders would retain incentives for mediocre performance. The Commission explained that "[a] combination of updated *ex ante* values combined with a larger hold-back will substantially mitigate ratepayer risk brought upon by the changes we adopt to the true-up mechanism."[26]

C. D.08-12-059 modified the incentive mechanism to award incentives based on the Utilities' self-reported data even when the Draft Energy Efficiency 2006-2007 Verification Report showed that three of the four Utilities were not entitled to incentives.

The process of measuring energy saved by the Utilities' 2006-2008 portfolios encountered delays, caused in part by D.08-01-042's requirement (in conjunction with the removal of the obligation that Utilities repay interim incentives if *ex post* studies reveal they were overpaid) that interim claims be calculated using updated *ex ante* parameters. This significantly increased the complexity of preparing the first Energy Division Verification Report that would form the basis for the interim claim.

The Utilities filed a second petition for modification[27] that sought immediate payment of $152 million interim incentives for 2006-2007 using their self-reported

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Commission and funded by ratepayers that provides standardized energy saving parameters, including unit energy savings for various energy efficiency measures. D.08-01.042, p. 16.

[22] D.08-01-042, Finding of Fact 15, p. 21.

[23] D.08-01-042, Finding of Fact 13, p. 21

[24] D.07-09-043, p. 123.

[25] D.07-09-043, Finding of Fact 111, p. 204.

[26] D.08-01-042, Finding of Fact 11, p. 20.

[27] Petition for Modification of Decisions 07-09-043 and 08-01-042 by Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company and Southern California Gas Company, filed August 15, 2008 (Second PFM).

savings and the same *ex ante* parameters used when they filed their portfolio, (i.e., violating D.08-01-042's requirement that interim earnings claims be based on updated DEER estimates).[28]

On November 18, 2008, rather than in August as originally planned, the Energy Division issued its "Energy Efficiency 2006-2007 Verification Report, Review Draft" (Draft Verification Report).[29] The Draft Verification Report showed that SoCalGas would earn a 2008 interim incentive payment of $3.6 million, but that the other Utilities were not entitled to incentives.[30] The Energy Division's Draft Verification Report demonstrated that the importance of using independently verified data is not hypothetical: the report revealed significant differences between the Utilities' self-reported savings and the savings calculated through the process of independent verification.

Notwithstanding the Draft Verification Report that showed three of the four Utilities would not be entitled to incentives, D. 08-12-059 authorized payment of interim incentives of $82 million to the Utilities based only on their self-reported energy savings results. While D.08-12-059 increased the holdback of interim claims payments from 35% to 65%, if the Utilities were not entitled to incentive payments, then no holdback, short of 100%, would protect ratepayers from the risk of paying non-refundable incentives. Similarly, while the D.08-12-059 claimed to reinstate the dead band for purposes of conducting the *ex post* true-up for the 2006-2008 program cycle, it only provided that no "additional" incentives will be awarded.[31] Since D.08-12-059 did not otherwise change the non-refundability of incentive overpayments, it did not truly reinstate the deadband as established by D.07-09-043. Thus, it remains true that "payment of awards to utility shareholders for incentive-based savings is a one-way street."[32]

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[28] Second PFM, pp. 4, 6. The Second PFM also sought calculation of interim incentives payments based on self-reported measure savings and cost estimates in the event that Energy Division's EM&V reports were delayed (Second PFM, pp. 3-4) and the opportunity for Commission review earnings-related issues raised in evaluation, measurement, and verification reports, outside of the current advice letter process. Second PFM, p. 4.

[29] The Draft Verification Report and accompanying appendices consist of more than 150 pages of detailed analysis explaining the savings parameters used and the rationale for the results.

[31] D.08-12-059, Ordering Paragraph 4, p.28.

[32] D.08-12-059, dissent, p. DMG-2.

DRA and TURN filed an Application for Rehearing of D.08-12-059 on February 2, 2009[33] that the Commission has not yet resolved.

D. Decision 09-12-045 awarded incentives using a sharing rate that ignored the results of the Energy Division's Second Interim Verification Report.

Decision 09-12-045 considered the Utilities' claims for second interim incentive payments. Rather than awarding incentives based solely on the Utilities' self-reported energy savings as it had in D.08-12-059, the Commission used the Energy Division's Second Interim Verification Report[34] to calculate the awards, except for purposes of determining whether the Utilities had met the MPS. While D.09-12-045 acknowledged that "ratepayers are best served by using updated assumptions and independently verified results to determine the amount of actual energy savings, and the value of those savings, to be shared between utilities and ratepayers,"[35] it observed that "using relatively unmodified *ex ante* assumptions to compare the results of their programs with the Commission's goals would result in each utility meeting a high enough percentage of those goals to qualify for a 12% shared savings rate"[36] and concluded that "[r]ather than using the shared savings rate calculated using the verification report data, we will use a 12% shared savings rate and apply it to the [performance earnings basis] PEB as calculated by the Energy Division Verification Report as modified herein."[37]

D.09-12-045's award of incentives using 12% share rate ignored the detailed analysis in the Verification Report, and directly contradicted D.09-12-045's recognition that the Second Interim Verification Report was the appropriate basis for determining the second interim claim.

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[33] Application for Rehearing of Decision 08-12-059, filed by DRA and TURN in R.06-04-010 on February 2, 2009.

[34] The Second Interim Verification Report was issued in draft in August 2009, and then issued in final form by Commission Resolution E-4272 on October 15, 2009. It is available at http://docs.cpuc.ca.gov/word_pdf/FINAL_RESOLUTION/108628.pdf.

[35] D.09-12-045, p. 68.

[36] D.09-12-045, p. 68-69.

[37] D.09-12-045, p. 69.

TURN filed an Application for Rehearing of D.09-12-045 on January 28, 2010 that remains pending.

E. D.10-12-049 modified the incentive mechanism to allow the calculation of awards using outdated savings parameters from the early 2000's

The Decision purportedly resolved the final true-up payment for energy efficiency incentives by once again revising the incentive mechanism to allow shareholders to receive incentives, rather than ensuring that:

> "[r]atepayers will only be required to share net benefits with shareholders to the extent that those net benefits actually materialize, based on Energy Division's EM&V results."[38]

While D.07-09-043 provided that shareholders would share net benefits based on the verified results of the EM&V studies completed under the supervision of the Energy Division, the Decision determined:

> "rather than assessing the performance of the utilities' energy efficiency programs based on updated parameters, as was our original intent, we modify the mechanism such that the performance against the goals, as well as the total savings attributed to the utility programs for purposes of determining incentives are calculated using the parameters that were in place at the time the Commission approved the utility energy efficiency portfolios."[39]

Although the Decision opted not to "rely solely on the results contained in the Energy Division report" for purposes of the final true-up, it acknowledged that the information in the report is "valuable and useful for a variety of purposes" and did not purport to change the results of the report.[40] The 2006-2008 portfolios contained hundreds of energy efficiency measures, and for each measure, there were parameters designed to estimate the energy saved. For compact florescent lamps (CFLs), the energy saving measure that was received a lion's share of ratepayer funding, the parameters included hours of operation, the installation rate (to take into account the fact that

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[38] D.07-09-043, p. 12.

[39] D.10-12-049, p.3.

[40] D.10-12-049, p.30.

customers may buy bulbs that are not immediately installed) and whether customers would have purchased the bulbs in the absence of the energy efficiency programs. The *ex ante* savings parameters that were in place when the Utilities filed their portfolios in 2005 were based on studies completed before 2005 or on default values derived from studies completed in the 1990's.[41] Member of the Peer Review Group, including TURN and the Office of Ratepayer Advocates argued that some of those parameters were likely to overstate the energy savings that the portfolios would actually deliver.[42] The concern that savings would likely be overstated using the Utilities' *ex ante* savings parameters was well-founded.[43]

The Energy Division issued its 2006-2008 Energy Efficiency Evaluation Report in final form on July 9, 2010, the product of almost three years of field-based energy efficiency research completed at a cost of $97 million by leading evaluation professionals under the direction of the Commission's Energy Division.[44] The 2006-2008 Energy Efficiency Evaluation Report measured the Utilities' energy savings (but did not calculate incentive earnings) and found they were substantially less than forecasted using *ex ante* parameters.

Table 24 of the 2006-2008 Energy Efficiency Evaluation Report "Comparative of Program Cycle 2006-2008 Evaluated Results to Goal" presents the sobering truth of the Utilities' energy efficiency savings. PG&E met only 60% of its MW goal and 63% of its MMTh goals. SCE met only 64% of its MW goals. SDG&E met only 37% of its MMth

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[41] Details about the development of the *ex ante* savings parameters were provided in the "Comments of TURN on the Merits of Scenarios and Assumptions for Calculating Energy Efficiency Program Results," May 18, 2010, p. 18-20; and "Reply Comments of TURN on Proposed Scenarios and Assumptions for Calculating 2006-2008 Energy Efficiency Program Results," June 11, 2010, p. 2-13.

[42] D.05-09-043, p. 54.

[43] For example, 2005 DEER contained installation rates of 0.9 for residential CFLs and 0.92 for nonresidential CFLs from 2005 DEER, which was based on results from early 2000. Yet 2006-2008 Upstream Lighting Evaluation recommended that installation rates of between 0.67 and 0.77 be used for residential CFLs and 0.76 for nonresidential CFLs. Final Evaluation Report: Upstream Lighting Program, Volume 1, KEMA, February 8, 2010, page 43-44. http://www.calmac.org/publications/FinalUpstreamLightingEvaluationReport_Vol1_CALMAC_3.pdf

[44] D.10-12-049, p. 29.

goals. SoCalGas achieved 67% of its MMTh goals. Independently verified numbers demonstrated that the Utilities' energy savings were well under the MPS of 80-85% that D.07-09-043 established to justify the award of incentives.

Faced with these dismal results, the Decision elected to revise the incentive mechanism to award incentives based on *ex ante* estimates rather than acknowledge the disappointing performance of the Utilities in achieving the Commission's energy efficiency goals. While the Decision lowered the sharing rate from a range of 9-12% to 7%, that sharing rate still exceeded that recommended by ratepayer advocates in the original incentive proceeding.[45]

The Decision justified its revision of the incentive mechanism by contending that

> "[t]he changes to the mechanism are appropriate in light of ongoing concerns about substantial, controversial, and unanticipated swings in a number of the key parameters in Energy Division's recent evaluation studies."[46]

While the changes to the parameters may have been controversial and substantial, the record does not support the claim they were unanticipated. In fact, as explained at pages 16-17 below, the information about the decrease in energy savings as a result of changes in the market and the evolving operation of energy efficiency devices, in particular CFLs, was available to stakeholders, including the Utilities.

III. STANDARD OF REVIEW

Rule 16.1(c) requires an application for rehearing to "set forth specifically the grounds on which the applicant considers the order or decision of the Commission to be unlawful or erroneous," making specific references to the record or law. When a reviewing court examines the validity of a Commission decision pursuant to Section 1757 of the Public Utilities Code, it determines whether the decision is supported by the findings and whether the findings in the decision are supported by "substantial evidence in light of the whole record."[47] The reviewing court also examines, among other things,

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[45] D.07-09-043, p.42.

[46] D.10-12-049, p. 4.

[47] Public Utilities Code §§ 1757(a)(3)-(4). Section 1756 of the Public Utilities Code provides that a party may petition for a writ of review in the court of appeal or the Supreme Court so that the court can determine the lawfulness of a Commission order. Section 1757(a) provides that in a

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whether the Commission has proceeded in manner required by law, and whether the decision is an abuse of discretion.

IV. The Omission of Uncontested Material Evidence in the Record Violates the Substantial Evidence Standard of Public Utilities Code Section 1757

A. The Final Decision Ignores Material and Uncontested Evidence and Explicitly Deletes Reference to Relevant Evidence that Contradicts the Policy Basis for Awarding Incentives

The Decision adopted a new incentive mechanism to supplement the RRIM for 2006-2008 adopted in D.07-09-043 and modified in D.08-01-042 and D.08-12-059. The Decision makes two fundamental changes. It eliminated the use of *ex post* data to true-up performance, and it instituted a lower 7% sharing rate to compensate for reduced utility risk. The effect was to award the Utilities a combined additional \$68.2 million, in addition to the \$143.7 million already awarded in interim payments.

These changes were based on one fundamental policy conclusion. The Decision concluded that the long line of previous decisions reiterating the Commission's commitment to "true-up" energy efficiency performance results based on evaluated *ex post* numbers was "unfair" to the Utilities because they could not have made any changes in program activities based on those updated numbers. The Decision explains the policy reversal to use *ex ante* values for critical parameters at length in Section 5.3:

> "The IOUs argue that the NTG updates in the Energy Division Verification Report are fundamentally flawed, and, even if correct, occurred too late in the 2006-2008 cycle to enable the IOUs to make meaningful mid-course adjustments in program funding in response to the updated NTG ratio. By way of example, for PG&E's programs,

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complaint or enforcement proceeding, or in a ratemaking or licensing decision of specific application that is addressed to particular parties, the court's review is limited to determining whether, on the basis of the entire record, whether any of the following errors occurred: "(1) The commission acted without, or in excess of, its powers or jurisdiction. (2) The commission has not proceeded in the manner required by law. (3) The decision of the commission is not supported by the findings. (4) The findings in the decision of the commission are not supported by substantial evidence in light of the whole record. (5) The order or decision of the commission was procured by fraud or was an abuse of discretion. (6) The order or decision of the commission violates any right of the petitioner under the Constitution of the United States or the California Constitution."

allocations of incentives to upstream lighting manufacturers/distributors must be made at least 120 days prior to the movement of the products into the marketplace. Therefore, the IOUs argue, the October 2007 report, even were they to accept them as accurate, allowed little time for adjustments to program delivery and implementation to take hold during the 2006-2008. They further argue that it is inappropriate to apply these NTG values to the entire 2006-2008 program cycle for purposes of awarding incentives. We agree.

Until the review process has run its course and numbers are adopted as final, we do not think it is reasonable to, in effect, require the utilities to modify their portfolios as if preliminary assessments are, in fact, final. To do so undermines the purpose of the review, and it essentially prejudges the outcome of that process. A more reasonable approach and expectation is for the utilities to modify their portfolios based on assumptions available to them at the time they are developing and implementing their portfolios. We do not believe the changes to the parameters, and the magnitude thereof, that result in the dramatic swing in earnings under the incentive mechanism, as adopted, were available in a manner that would have allowed the utilities to react in a timely manner.[48]

…

The forgoing review establishes that one of the fundamental premises on which the incentive mechanism adopted in D.07-09-043 was based was fundamentally flawed. Specifically, it was/is unreasonable to expect the utilities to anticipate the very substantial changes in a number of the key parameters over the three year cycle that drive their energy efficiency program results. Furthermore, given the after-the-fact timing of Energy Division's updates to these parameters, we find that the IOUs did not have the opportunity to modify their portfolios on the basis of this updated information in a way that would allow them to substantially avoid the adverse impacts of those updated assumptions on estimated program performance. Irrespective of the accuracy of the updates adopted by Energy Division, we find that the incentive mechanism as implemented was/is unfair to the utilities, in that it bases its results on assumptions the utilities cannot be reasonably

[48] D.10-12-049, 36-37.

> expected to anticipate; and further, when those changed assumptions come to light, cannot be reasonably expected to respond to in a way that enables them to substantially avoid the adverse impacts on the estimated performance of their programs."[49]

The Decision concludes that the Utilities did not have sufficient warning to change their programs based on the review of the historical facts concerning when changes to parameter values were available to the utility administrators, and when the Utilities should have *acted* based on these data. This review includes a consideration of known historical facts.

D.10-12-049 first summarizes the long history in which the Commission repeatedly stressed the importance of updating parameter values to perform a true-up with *ex post* data, as reflected in Decisions 05-04-051, 07-09-043, 08-01-042, 08-12-059 and 09-12-045.[50] D.10-12-049 then concludes that such a true-up of parameter values based on actual evaluation results is warranted for purposes of resource planning and program design. However, D.10-12-049 significantly departs from precedent by concluding capriciously that the *ex post* updating is not reasonable for purposes of the final incentive calculation:

> "However, in the context of the incentive framework, as explained below, our experience with the mechanism over the past three years, establishes that the reliance on *ex post* updating creates an unreasonable amount of risk for the utilities because it results in an imposition of unrealistic expectations regarding their ability to anticipate and respond to changes in thousands of parameters that influence program performance."[51]

The Decision then explains the bases for its conclusion that an *ex post* updating creates "unrealistic expectations" that the Utilities could modify programs in response to newly emerging data showing changes in the values of the parameters that measure energy savings.[52] The Decision first posits that assessing the changing dynamics of energy

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49 D.10-12-049, 40-41. This policy conclusion is summarized in Finding of Fact 16 at p.69.

50 See, generally, D.10-12-049, at 31-34.

51 D.10-12-049, p. 34.

52 The Decision frames this issue as the key question: "The efficacy and legitimacy of the

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efficiency markets is profoundly difficult. It then directly addresses the notion that "the utilities had ample information available to them regarding changes in some of the key underlying assumptions."[53] The Decision rejects this notion by focusing on one key date – the October 2007 release of the Itron Report 2004/2005 Statewide Residential Retrofit Single-Family Energy Efficiency Rebate Evaluation Report, which documented the significantly lower net to gross values of upstream lighting programs. The Decision rejects the notion that the Utilities could have acted based on the availability of draft EM&V studies of the 2004-2006 energy efficiency programs. The Decision concludes that October 2007 was too late for the Utilities to modify programs for 2006-2008.[54]

The Decision next addresses the fact that concern about the accuracy of *ex ante* net to gross ratios was already expressed in Decision 05-09-043, which authorized the 2006-2008 programs. But D.10-12-049 concludes that these "concerns are expressed only in qualitative terms" and thus "provided an insufficient basis for the utilities to act."[55] Most significantly, the Decision repeatedly claims that the data available prior to October 2007 was of a "preliminary nature,"[56] and thus neither the Utilities nor the Commission could reasonably have anticipated the significant changes in parameter values.[57] The Decision concludes that:

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incentive mechanism hinges fundamentally on the ability of the utilities to modify their programs and portfolios adjust their portfolios over the course of the 2006-2008 program cycle in response to changes in the various parameters that influence measure savings and attribution." D.10-12-049, p. 35.

[53] D.10-12-049, p. 36.

[54] The Decision gives as an example PG&E's explanation that allocations of incentives to upstream lighting manufacturers/distributors must be made at least 120 days prior to product movement, so numbers released in October 2007 provided too little time to adjust program delivery and implementation for the 2006-2008 cycle. D.10-12-049, pp. 36-37.

[55] D.10-12-049, p. 38.

[56] "Given the preliminary nature of the information available to the utilities over the 2006-2008 period regarding changes to key parameters, the expectation that they should have dramatically modified their portfolios in a manner sufficient to avoid the adverse consequences under the incentive framework is unreasonable." D.10-12-049, p. 38-39.

[57] The Decision argues that the fact that the Commission adopted a hold-back of only 30% in D.07-09-043, at almost the same time as the release of the Itron Report, demonstrates that even the Commission could not have foreseen the changes in parameter values. Such an analysis ignores the fact that the original mechanism included a "clawback" provision that required shareholders to repay interim incentives in excess of the final amount justified by Energy Division's *ex post*

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> "The forgoing review establishes that one of the fundamental premises on which the incentive mechanism adopted in D.07-09-043 was based was fundamentally flawed. Specifically, it was/is unreasonable to expect the utilities to anticipate the very substantial changes in a number of the key parameters over the three year cycle that drive their energy efficiency program results."[58]

On the surface the analysis and conclusions reached in Section 5.3 of D.10-12-049 appear plausible. Superficially, there is no obvious error in numbers or analysis. But the conclusions in D.10-12-049 suffer from a fault that is as real and egregious as inaccurate numbers or flawed reasoning– selective history. The conclusions appear reasonable only because the Decision chooses to ignore *relevant and uncontested* historical facts that are contained in the record.

Some of these facts are discussed in the "Dissent of Commissioner Dian M. Grueneich," which is attached in its entirety at Attachment C to this application. The dissent references an Assigned Commissioner's Ruling issued on October 5, 2007 in R.06-04-010, the predecessor rulemaking addressing energy efficiency policy issues. In that Ruling, Assigned Commissioner Grueneich detailed the history of Commission policy concerning parameter true-up. The Ruling described the contents of a Joint Case Management Statement, filed by PG&E on July 18, 2005:

> The CMS noted that PRG members were frustrated that the utilities used NTG values for a variety of strategies that were outdated, inaccurate, and probably too high (page 6). The PRG requested that PG&E reduce its reliance on lighting measures, particularly residential lighting, to which PG&E responded that it would 'adjust its 2006 portfolio lighting savings to reflect more realistic and updated assumptions on NTG ratios." (pages 17-18).[59]

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evaluation so that there was little concern that ratepayers would be harmed by too small a holdback. The Commission increased the "holdback" to 35% when it eliminated the "clawback" provision in D.08-01-042, but declined to increase it to 50% as proposed by intervenors. D.08-01-042, pp.11-12. The Commission listened to the arguments of the Utilities, who obviously wanted a holdback as low as possible once the clawback was eliminated.

[58] D.10-12-049, p. 406.

[59] Assigned Commissioner Ruling, October 5, 2007 in R.06-04-010, Attachment A, p. 8.

Commissioner Grueneich's dissent explains that the Decision explicitly deleted the footnote and text of the Proposed Decision[60] that referenced this Ruling. In other words, the Decision deleted any mention of historical facts that conflict with the thesis presented in D.10-12-049.

The record evidence also shows that the *ex ante* net to gross ratios were adopted as a default temporary number in September of 2000, in response to direction from D.00-07-017.[61] The historical facts were included in at least two filings submitted by TURN in this proceeding.[62] Based on information and belief, it appears that no party disputed the historical facts as presented in those filings.

The 0.80 default NTG ratio was an average of 1994-1999 results. None of those programs included an "upstream incentives" program. The CALMAC report authorized use of this default because no historical programs were similar to the upstream program. But the CALMAC report explicitly warned that the default value was likely to be inaccurate for the market transformation programs such as an upstream manufacturer rebate:

> "The main challenge to using historical NTGRs estimated for information and rebate programs **targeted to individual customers** is that PY2001 programs are designed as **market transformation programs** targeted to a variety of market actors (e.g., manufacturers, distributors, retailers, etc.) in a particular market (e.g., commercial HVAC).[63]

The primary issue in contention for the 2006-2008 true-up was precisely the use of the 0.80 number, derived from "resource programs" in 1994-1999, for the residential

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[60] Proposed Decision of ALJ Pulsifer Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, September 28, 2010, p. 53, footnote 39.

[61] A fairly comprehensive history of the default 0.80 NTG ratio, adopted in the September 25, 2000 CALMAC report, was provided in the "Reply Comments of TURN on Proposed Scenarios and Assumptions for Calculating 2006-2008 Energy Efficiency Program Results," filed in R.09-01-019 on June 11, 2010, at pages 3-13.

[62] *See* "Comments of TURN on the Merits of Scenarios and Assumptions for Calculating Energy Efficiency Program Results," May 18, 2010, p. 18-20; and "Reply Comments of TURN on Proposed Scenarios and Assumptions for Calculating 2006-2008 Energy Efficiency Program Results," June 11, 2010, p. 2-13.

[63] CALMAC Workshop Report, September 25, 2000, p. 27 (emphasis added). Referenced in TURN's Reply Comments on Scenarios and Assumptions, June 11, 2010, p. 8.

upstream manufacturer rebate program. As early as 2000, all parties were on notice that this default number was likely to be inapplicable to the upstream rebate program and should be changed as soon as more relevant data became available.

Concern over the Utilities' use of a high default value of 0.80 was one of the main issues in contention throughout a series of workshops and meetings held in 2004-2006. The Decision is technically correct that updated NTG numbers based on the evaluations of 2004-2005 programs were not "finalized" until October 2007. However, the Decision ignores history by implying that no warning was available to the Utilities until draft EM&V studies of the 2004-2005 programs were released. The Utilities were on notice since 2000 that the 0.80 default NTG value should be replaced. The Utilities were repeatedly warned in 2004-2005 that this value should be adjusted downward, culminating in the Case Management Statement of July 21, 2005. The Commission reiterated these warnings in D.05-09-043.

The Decision now concludes that these warnings were too preliminary to warrant significant program modifications. Yet in January of 2005 President Peevey warned the Utilities that they should do exactly what they eventually failed to do:

> "In order to meet their goals, the utilities absolutely <u>must</u> 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."[64]

The Commission now concludes that the expectations in January of 2005 were unrealistic. But the expectations in January of 2005, fully a year before the 2006-2008 programs were started, were based on a realistic understanding of the history of EM&V and the weakness of the *ex ante* parameters. The Commission's conclusion now, about six years later, excuses the Utilities by deciding to overlook the significant information about the changing market and use of energy efficiency products that was already known to parties in early 2005. Focusing only on the fact that data were *finalized* in October 2007 provides an excuse only by ignoring historical reality.

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[64] Peevey Concurrence to D.05-01-055, January 27, 2005 (emphasis in original).

B. The Omission of Material Evidence that Contradicts the Fundamental Assumption of the Decision Violates the Substantial Evidence Standard of § 1757

The Commission's policy findings in the D.10-12-049 are not supported by substantial evidence in the record, as the Decision both ignores relevant and uncontested material evidence as well as explicitly deleted reference to such evidence from the final decision.

The Commission has recognized the requirement that its decisions meet the substantial evidence standard. For example, the Commission correctly points out that it can draw "reasonable evidentiary inferences" based on facts collected during the course of a proceeding.[65] In making such inferences, however, the Commission has noted that it must consider all relevant factors:

> "The Commission views the facts through the lens of the agency with regulatory responsibility for implementing the state's pro-competitive telecommunications policy, and not from the viewpoint of a competitor who may stand to gain or lose from the outcome of the Decision. <u>In construing substantial evidence, the Commission considers all factors that may have a bearing on our goal of achieving open competition</u> in the California telecommunications market. This is consistent with the California Supreme Court, which holds that courts "must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute."[66]

The California Supreme Court has defined "substantial evidence" to mean evidence of "ponderable legal significance ... reasonable in nature, credible, and of solid value."[67] It is not synonymous with "any evidence." Thus, an agency decision will not be upheld if it relies on evidence which is inherently improbable[68] or contrary to facts which

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[65] D.99-12-022, 1999 Cal. PUC LEXIS 782, *4-5; see also, D.00-03-025, 2000 Cal. PUC LEXIS 142.

[66] D.99-12-022 at *7-8, emphasis added, quoting *California Hotel & Motel Association v. Industrial Welfare Commission* (1979) 25 Cal. 3d 200, 212, fn. omitted.

[67] *People v. Basset,* 69 Cal.2d 122, 138-39 (1968).

[68] *Hongsathavij v. Queen of Angels/Hollywood Presbyterian Medical Center,* 62 Cal. App. 4th 1123 (1998).

are universally accepted as true.[69] Nor will an agency finding which relies solely on uncorroborated hearsay meet the substantial evidence test.[70]

In determining whether there is "substantial evidence," the court may not consider the evidence which supports the agency's findings in isolation.[71] Rather, it must consider *all* the relevant evidence in the case, including evidence that contradicts the agency's findings.[72] The court's responsibility to consider all of the relevant evidence necessarily "involves some weighing of the evidence to fairly estimate its worth."[73]

Decision 10-12-049 fails to satisfy the substantial evidence standard by ignoring relevant and material evidence that contradicts its primary conclusion. In this regard, the Decision also constitutes an abuse of discretion.

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[69] *Larson v. State Personnel Bd.*, 60 Cal. App.3d 58, 68 (1968).

[70] *See, e.g.*, *Layton v. Merit Sys. Comm'n of the City of Pomona*, 60 Cal. App. 3d 58, 68 (1976), *citing Walker v. Superior Court*, 20 Cal. 2d 879 (1945). For the rule in proceedings governed by the California Administrative Procedure Act, *see* Cal. Gov't Code Section 11513(d) (West Supp. 1999).

[71] The substantial evidence test "is not a toothless standard which calls for a court merely to rubber stamp an agency's findings if there is 'any evidence' to support them. *The reviewing court is empowered and obliged by the substantial evidence test to reverse an agency decision that seems unresponsive to the evidence or unfair*. Asimow, "The Scope of Judicial Review of Decisions of California Administrative Agencies," 42 UCLA Law Review 1157, 1178, June 1995 (emphasis added, internal footnotes omitted).

[72] *Bixby v. Pierno,* 4 Cal. 3d 130, 143 (1971) (substantial evidence test requires the trial court to review the entire record) *citing Universal Camera Corp. v. NLRB*, 340 US 474 (1951) (judgment in favor of respondent was vacated and remanded where the appellate court erroneously believed that when determining the substantiality of evidence supporting respondent's decision, the appellate court was limited to reviewing only evidence that justified that decision); *Newman v. State Personnel Bd*., 10 Cal. App. 4th 41 (1992) (affirming trial court's determination that employee's termination of employment by the State Personnel Board's was not supported by substantial evidence when the record contained conflicting medical opinions regarding the employee's ability to work)

[73] *County of San Diego v. Assessment Appeals Bd. No. 2*, 148 Cal. App. 3d 548, 555 (1983) (Assessment Board erred in determining the correct method of valuation to be the market value approach and then subsequently ignoring all competent evidence presented on market value, making its own determination of value based upon speculation and conjecture.)

V. THE DECISION VIOLATES STATUTORY REQUIREMENTS OF COST-EFFECTIVENESS BY EXCLUDING INTERIM PAYMENTS FROM THE PEB CALCULATION

Section 381(b)(1) of the Public Utilities Code requires that a portion of the money collected from the system benefits charge (a non-bypassable bill component) be allocated to "cost effective energy efficiency and conservation activities." TURN argued that the requirement for "cost-effectiveness" is violated by not including previously paid incentives in the calculation of the Performance Earnings Basis.[74]

The Decision rejects TURN's argument.[75] The Decision agrees that the already paid incentives are "a true economic cost of the program" and represent "sunk economic costs," but capriciously concludes that these facts do not require inclusion of the incentives in the calculation of the PEB.

The Commission has long held that incentives represent a true economic cost that should be included in cost-effectiveness calculations.[76] The Energy Efficiency Policy Manual adopted in December 2007 explicitly specified that incentives should be included in the calculation of portfolio cost effectiveness. But this version of the Energy Efficiency Policy Manual *excluded* incentives from the calculation of the PEB.[77] The rationale was based directly from the holding in D.07-09-043 that incentives should not be included in the calculation because:

> "The whole purpose of the PEB is to establish the level of portfolio net benefits <u>before shareholder incentives are paid out</u>, so we can determine what those incentive levels should be. To subtract forecasted incentives out <u>before</u> applying the sharing rate is a circular proposition."[78]

However, this entire rationale hinged on the existence of the "clawback" provision, which made the final incentive payout unknown until the PEB was determined. This

[74] Comments of The Utility Reform Network on Proposed Decision of Commissioner Peevey Regarding the Energy Efficiency Incentive True-Up For 2006-2008, December 6, 2010, p. 6.

[75] See, D.10-12-049, Section 8, at p. 66.

[76] See, for example, D.07-09-043, Section 10.1, for a discussion of this issue.

[77] Energy Efficiency Policy Manual, December 2007, Section VIII.3.d.

[78] D.07-09-043, Section 10.1, p. 134 (emphasis in original).

mathematical result changed completely once D.08-01-042 removed the clawback provision. However, the Commission never modified the language in the Policy Manual to comport with this change. The result is an illegal exclusion of known, quantifiable and undisputed costs from the PEB calculation.

The Legislature has clearly directed that the Commission authorize funding for "cost-effective" energy efficiency.[79] The Commission has broad latitude in establishing cost-effectiveness methodologies, and has directed the Utilities to ensure that energy efficiency activities are cost-effective on a portfolio-wide basis.[80] Incentives apply to the results of the entire portfolio rather than the results of individual program.[81] Not including known incentive payments in the final PEB calculation violates the requirements of §381(b)(1), Section 454.5, and Section 890 to fund and approve cost-effective energy efficiency programs.

VI. DECISION 10-12-049'S AWARD OF INCENTIVES FOR PORTFOLIOS THAT ARE NOT COST-EFFECTIVE RESULTS IN RATES THAT ARE NOT JUST AND REASONABLE.

The Decision awarded SoCalGas a final payment of $9.882 million in incentives for a total award of $17.193 million.[82] The Decision awarded additional incentives to SoCalGas even though its energy efficiency portfolio was not cost effective,[83] i.e. the cost of the portfolio as measured by the Total Resources Cost (TRC) test exceeded the benefits it produced. It awarded SDG&E a final payment of $5.069 million incentives for a total of award $16.170 million.[84] The Decision awarded additional incentives to SDG&E even

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[79] Section 381(b)(1) of the Public Utilities Code states the Commission must require electrical corporations such as SDG&E to include within their rates funds for "[c]ost-effective energy efficiency and conservation." Section 890 of the Public Utilities Code requires the Commission to "establish a [natural gas] surcharge to fund …cost-effective energy efficiency and conservation activities…"

[80] *See* D.09-09-047, discussed in Section VI *supra.*

[81] D.09-09-047, p.68.

[82] D.10-12-049, Third Earnings Claim (PY 2006-2008), p. 48, and Table 1, Interim 2006-2008 RRIM Earnings Previously Awarded, p. 15.

[83] The TRC for SoCalGas's 2006-2008 portfolio was 0.9. 2006-2008 Energy Efficiency Evaluation Report July 2010, Table 32, page 126.

[84] D.10-12-049, Third Earnings Claim (PY 2006-2008), p. 48, and Table 1, Interim 2006-2008

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including the interim incentive payments SDG&E received resulted in a portfolio that was not cost-effective as measured by the TRC.[85] Revising the incentive mechanism to allow the award of incentives for portfolios with costs that exceed their benefits contravenes two of the Commission's fundamental obligations: to approve cost-effective energy efficiency portfolios, and to ensure just and reasonable rates.

Utilities' Benefit-to Cost Ratios with Interim and Final RRIM Payments

Benefit-to-Cost Ratios			
Utility	**Excluding Interim RRIM Payments(1)**	**Net of Interim RRIM Payments(1)**	**Net of Interim and Final RRIM Payments(2)**
PG&E	1.17	1.09	1.07
SCE	1.19	1.12	1.10
SDG&E	1.02	0.98	0.96
SoCalGas	0.90	0.86	0.83
Statewide Average	1.14	1.07	1.05

Sources

(1) Proposed Decision of ALJ Pulsifer Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, September 28, 2010, p. 26; Proposed Revised Alternate Decision of Commissioner Bohn Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, October 19, 2010, p. 23.

(2) DRA and TURN calculation using Interim and Final RRIM Payments and Cost Effectiveness of the 2006-2008 Energy Efficiency Evaluation Report July 2010, Table 32, page 126.

The Commission recognized its obligation to require cost-effective energy efficiency portfolios in D.09-09-047[86] when it reviewed the Utilities' 2010-2012 portfolios and required revisions to improve their cost-effectiveness.

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RRIM Earnings Previously Awarded, p. 15.

[85] The TRC for SDG&E's 2006-2008 portfolio was 1.02. Energy Efficiency Evaluation Report July 2010, Table 32, page 126. When its interim incentives are included in the calculation, the TRC drops to 0.98. See Attachment A to this Application for Rehearing.

[86] D.09-09-047's focus on approving cost-effective portfolios is consistent with California policy as reflected in the Energy Action Plan and the Public Utilities Code. California's Energy Action plan states that "cost-effective energy efficiency is the resource of first choice for meeting California's energy needs."California Energy Action Plan II, September 21, 2005, p. 3, reiterating California's policy since 2005, (emphasis added). The 2008 update to the Energy Action plan did not change that policy but noted at page 6 that "[r]equirements for building codes, appliance

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> "We are required by Public Utilities Code Section 454.5(b)(9)(c) to approve energy efficiency expenditures that are cost-effective; that is, the overall ratepayer or societal benefits must exceed the overall costs…"[87]

D.09-09-047 explained that:

> "As stated in the Rule II.1 of the Energy Efficiency Policy Manual, the Commission's overriding goal for energy efficiency efforts is to 'pursue all cost-effective energy efficiency opportunities over both the short- and long-term.' Therefore, the Policy Rules establish a threshold cost-effectiveness condition for the utilities' energy efficiency portfolios. Cost-effectiveness is measured using two different tests: 1) the Total Resource Cost (or 'TRC') whereby the value of the energy savings is greater than the total cost of installed measures and all program costs; and 2) Program Administrator Cost (or 'PAC') whereby the value of energy savings outweighs the cost of utility financial incentives to customers and all other program costs.[88] These tests are expressed as ratios of costs and benefits; the higher the ratio, the higher the benefits to the ratepayers for each dollar spent."

In evaluating cost effectiveness, D.09-09-047 reiterated the Commission's long-standing policy that the cost of shareholder incentives must be included in the calculation of costs:

> "[S]hareholder incentives represent a true economic cost in the production of utility programs and should be included as a direct cost in the various Standard Practice Manual tests of

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standards, and utility energy efficiency investments must be cost-effective.

Section 381.2 of the Public Utilities Code requires the Commission to establish procedures by which any party, "may apply to become administrators for cost-effective energy efficiency and conservation programs established pursuant to Section 381" and that in determining whether to approve a party's application to become an administrator, the Commission must consider whether the application advances "the public interest in maximizing cost-effective electricity savings and benefits." See also Public Utilities Code Sections 381(b)1 and 890, summarized in footnote 79.

[87] Cost effectiveness is judged on the basis of the entire portfolio, rather than individual programs: "Our policy, as articulated in Rule IV.6 of the Energy Efficiency Policy Manual, is to evaluate the entire portfolio for cost-effectiveness, and not to require each individual program element to meet this test. For example, several elements of our Strategic Plan may not be cost-effective in the timeframe of this portfolio, but should be cost-effective over a longer period. We remain committed to finding all cost-effective energy efficiency opportunities over time." D.09-09-047, p.68.

[88] See Energy Efficiency Policy Rules IV.1-IV.3.

> cost-effectiveness, including the TRC test and the predecessor of the PAC test, the 'Utility Cost' test."[89]

The Utilities filed 2010-2012 portfolios that contained "imperfections" likely to lower their cost-effectiveness ratios, so the Commission required adjustments to the portfolio costs in order to increase the cost-effectiveness ratios.

> "In order to meet the requirement of Public Utilities Code Section 454.5(b)(9)(c) to approve cost-effective energy efficiency programs, and to set just and reasonable rates, it is prudent policy to adopt a margin of safety for the calculation of cost-effectiveness."[90]

D.09-09-047 recognized the Commission's obligation to approve energy efficiency portfolios that were cost-effective at the outset and likely to remain so over the course of the energy efficiency program cycle.[91] Yet the Decision altered the incentive mechanism to allow the award of incentives to portfolios that were not cost-effective.

The Proposed Decision of Judge Pulsifer[92] and the Revised Alternate Proposed Decision of Commissioner Bohn[93] each contained a "Benefit-to-Cost Ratios" table illustrating the impact of awarding additional incentives to all four Utilities.[94] That table shows that SoCalGas's Total Resource Cost (TRC) ratio is .090 excluding the cost of interim incentives and 0.86 including the cost of interim incentives. The table shows that SDG&E's TRC is 1.02 without the cost of interim incentives and 0.98 including the cost of interim incentives. Thus, for both SoCalGas and SDG&E, any final true-up payment drives the cost-effectiveness ratios using the TRC method further below 1.0, a result

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89 D.09-90-047, p. 66-67, citing D.07-09-043 and D.94-10-059.

90 D.09-09-047, Conclusion of Law 1 at p. 353.

91 D.09-09-047, Conclusion of Law 2 at p. 353.(requiring "cost-effectiveness ratios using the TRC method are above 1.0 in order to meet the statutory obligation of Public Utilities Code Section 454.5(b)(9)(c).")

92 Proposed Decision of ALJ Pulsifer Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, September 28, 2010, p. 26;

93 Proposed Revised Alternate Decision of Commissioner Bohn Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, October 19, 2010, p. 23.

94 Proposed Decision of ALJ Pulsifer Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, September 28, 2010, p. 26; Proposed Revised Alternate Decision of Commissioner Bohn Regarding the Risk/Reward Incentive Mechanism Earnings True-Up for 2006-2008, October 19, 2010, p. 22. The Tables are appended to this document as Attachment B.

inconsistent with the Commission's obligation to ensure cost-effective energy efficiency programs.

The Table illustrating cost-effectiveness and the impact of further incentive payments is absent from the Decision, but its absence does not obscure the fact that the Decision awarded a final true-up payment incentives for portfolios that were not cost-effective, and that each additional incentive dollar awarded pushed the cost-effectiveness ratios of SoCalGas and SDG&E further below the required TRC ratio of no less than 1.

Paying incentives for programs that deliver less than one dollar of benefits for every dollar invested disregards the requirement that the Commission approve cost-effective energy efficiency portfolios.[95] Although Section 454.5(b)(9)(c) speaks of the Commission's prospective obligation to approve cost-effective portfolios, it makes little sense to require portfolios to be cost-effective at the outset, yet allow the award of incentives that render the portfolios not cost-effective.[96] Moreover, awarding incentives for portfolios that are not cost-effective also contravenes the requirement for just and reasonable rates. Section 451 of the Public Utilities Code requires that:

> "All charges demanded or received by any public utility, . . . for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful."

The obligation to ensure just and reasonable rates has been characterized as the Commission's "'oldest and most basic responsibility.'"[97] Exercising that responsibility requires that the Commission "assure the public that the prices they pay for electric and gas distribution service are in fact just and reasonable, and reasonably related to costs

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[95] Public Utilities' Code 454.5(b)(9)(c).

[96] SoCalGas's portfolio was not cost-effective even before the award of incentives, but SDG&E's portfolio was cost-effective with a TRC of 1.02 prior to the award of interim incentives.

[97] D.07-12-052, Appendix C, p. 12 (summarizing intervenor positions on Utilities' Long Term Procurement Plans; the California Large Energy Consumers Association requested that in reviewing the utility procurement plans that the Commission "to keep in mind its oldest and most basic responsibility—that embedded in Public Utilities Code Section 451—which is to assure ratepayers that they pay rates which are just and reasonable, and just and reasonable rates are those based on the cost to serve."

prudently incurred by efficient, conscientious managers to provide the quality of service we expect."[98] It is neither just nor reasonable to require SoCalGas and SDG&E ratepayers to pay shareholder incentives for energy efficiency portfolios with total costs that exceed their benefits. Yet the Decision requires SoCalGas ratepayers to pay shareholder incentives for an energy efficiency portfolio that lost 17 cents for every dollar spent, while SDG&E ratepayers' must pay incentives for a portfolio that lost 4 cents for every dollar spent.

Less than four years ago, the Commission envisioned an energy efficiency incentive mechanism in which "earnings to shareholders would accrue <u>only</u> when utility portfolio managers <u>produce positive net benefits</u> (savings minus costs) for ratepayers"[99] and that would "[c]reat[e] meaningful and sustainable shareholder value for <u>superior</u> achievement in achieving cost-effectiveness and verified GWh, MW and MTherm savings levels…"[100] The Decision awards incentives to SoCalGas and SDG&E for portfolios with performance that is not superior, and in fact, fail to meet the fundamental requirement of cost-effectiveness. The Commission should grant rehearing and at a minimum, reverse the award of incentives to programs that are not cost-effective using the TRC test, the costs and benefits shown in the 2006-2008 Energy Efficiency Evaluation Report and the interim incentives awarded in D.08-12-059 and D.09-12-045.

VII. DECISION 10-12-049 REFLECTS AN ABUSE OF THE COMMISSION'S DISCRETION.

An abuse of discretion is established if: (1) an agency does not proceed in the manner required by law; (2) an order or decision is not supported by the findings; or (3) the findings are not supported by the record.[101] The Decision contravenes the Commission's obligation to approve cost-effective energy efficiency portfolios pursuant to Public Utilities Code Section 454.5(b)(9)(c) and to ensure rates that are just and reasonable pursuant to Public Utilities Code Section 451. The Decision's conclusion that

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[98] D.04-10-034, p.6.

[99] D.07-09-043, p. 4 (emphasis in original).

[100] D.07-09-043, Finding of Fact 98, p.197

[101] *Davis v. Civil Service Commission,* 55 Cal.App.4th 677, 686-687 (1997); *Sierra Club v. State*

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the Utilities had insufficient notice to adjust their programs in response based on evaluated *ex post* numbers was "unfair" to the Utilities because they could not have made any changes in program activities based on those updated numbers is not supported by substantial evidence. The Decision awarding incentives based on *ex ante* energy savings parameters therefore constitutes an abuse of discretion.

VIII. CONCLUSION

The Commission announced its intent in D.07-09-043 to adopt a risk/reward mechanism that would provide utility shareholders "a meaningful opportunity to earn"[102] incentives. Through the Commission's subsequent decisions the "meaningful opportunity" has devolved into an entitlement to payouts that bears little relation to the energy savings achieved or progress toward the Commission's energy efficiency goals.

The Commission should grant rehearing of the Decision and reverse the final incentive award consistent with D.07-09-043 as modified by D.08-01-042 and D.08-12-059, because the conclusion that the Utilities had insufficient information or notice to revise their portfolios is unsupported by the record. Alternatively, the conclusion that the Utilities were unable to change their portfolios based on the information available speaks to the need for a new structure to administer energy efficiency.

At a minimum, the Commission should grant rehearing of the Decision because it awards incentives to two portfolios that were not cost-effective, which disregards the Commission's obligations to approve and oversee cost-effective energy efficiency portfolios and to ensure just and reasonable rates. Any incentives awarded should be included in the PEB, consistent with the Commission's obligations to ensure cost-effective portfolios. Finally, any incentives awarded for the 2009 program year should be based on the energy savings results verified in the Energy Division's 2009 Energy Efficiency Evaluation Report consistent with D.07-09-043 as modified by D.08-01-042 and D.08-12-059.

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Board of Forestry, 7 Cal.4th 1215, 1236-1237 (1994); see also Code of Civ. Proc., §1094.5.

[102] D.07-09-043, p. 4 (emphasis deleted.).

Respectfully submitted,

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January 26, 2011

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **"APPLICATION FOR REHEARING OF DECISION 10-12-049"** in **R.09-01-019**. by using the following service:

[**X**] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

[ ] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on **January 26, 2011** at San Francisco, California.

/s/ IMELDA EUSEBIO

Imelda Eusebio

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.