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Decision **PROPOSED ALTERNATE DECISION OF COMMISSIONER BOHN**
(Mailed 9/28/2010)

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)

**DECISION REGARDING THE RISK/REWARD INCENTIVE MECHANISM
EARNINGS TRUE-UP FOR 2006-2008**

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**DECISION REGARDING THE RISK/REWARD INCENTIVE MECHANISM
EARNINGS TRUE-UP FOR 2006-2008****1. Introduction**

This decision resolves the final true-up of Risk/Reward Incentive Mechanism (RRIM) earnings for the 2006-2008 cycle for savings achieved due to energy efficiency programs administered by Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company (the IOUs). As adopted in Decision (D.) 07-09-043, RRIM offers financial incentives or penalties as a function of utility success in achieving and surpassing adopted energy savings goals.

In this decision, we complete the true-up of these interim awards, and determine if additional incentive earnings are due, or if penalties apply. The IOUs have already been awarded interim incentive earnings for the 2006-2008 cycle totaling \$143.7 million.¹ These amounts were awarded as incentives based on interim review of the IOUs' achievements of energy efficiency savings during 2006-2008. We determine that the IOUs' should receive additional incentive payments totaling \$77.3 million, equal to the holdover amounts specified in D. 09-12-045.

We make this determination although it is a deviation from the original incentive mechanism process. The RRIM earnings claims process was originally expected to be ministerial. However, that has turned out not to be the case. We

¹ A first interim installment was awarded in D.08-12-059, and a second installment was awarded in D.09-12-045. Together, these interim payments total \$143.7 million.

opened this rulemaking, recognizing the contentious nature of the prior proceeding to determining incentive earnings.² This controversy has continued unabated. When applied, the RRIM methodologies for assessing incentive earnings have proven to involve complexities that are not as easily or as timely resolved as was originally contemplated.

In this proceeding, we sought to develop a new framework for the determination of 2006-2008 energy efficiency incentives.³ We have repeatedly encouraged parties to pursue settlement discussions of these protracted issues, but the resulting efforts to seek resolution have not been successful. We have also explored possible alternative policy assumptions to streamline the derivation of incentive amounts while maintaining the integrity of the process.

Parties have been unable to agree upon any such means to improve or streamline the existing process, and thus we are again faced with contentious, conflicting proposals for the final true-up of the 2006-2008 incentive payments. In consideration of the complexities, uncertainties, potential procedural changes and the sensitivity of the incentive calculations to each of these factors, we conclude that changes to the incentive amounts identified in D. 09-12-045 are not warranted and in fact would undermine our goal of encouraging utility support and advancement of our energy efficiency goals. The primary purpose of the incentive mechanism is to spur utility management and investors to support and

² This rulemaking is the successor to Rulemaking (R.) 06-04-010, our inquiry into post-2005 energy efficiency policies, programs, evaluation, measurement and verification (EM&V), and related issues. We issued a number of decisions in R.06-04-010 on topics ranging from energy efficiency goals (e.g., D.08-07-047) to the RRIM.

³ Order Instituting Rulemaking (OIR) 09-01-019 at 5.

expand energy efficiency programs and savings by providing a reasonable level of profits related to their efforts. This goal is better met by keeping in place the adopted holdover amounts rather than continuing to attempt to implement a problematic mechanism with potentially perverse results. The final true-up payments of \$40.3 million for PG&E, \$27.1 million for SCE, \$6 million for SDG&E and \$3.9 million for SoCal Gas are well within the range of values proposed by parties in this proceeding.

The incentive mechanism reinforces our strong commitment to the goal of declining overall future per capita electricity consumption in California for the IOUs. Moreover, we do not address herein what incentives earnings may be awarded for energy efficiency achievements accomplished during 2009, or how incentives earnings may apply for the 2010-2012 program cycle. We defer those matters to a subsequent decision in this proceeding, recognizing the need for timely resolution of those issues. We continue to believe that the Commission should pursue reforms to the existing mechanism to design incentives to help achieve the Commission's energy efficiency goals through approaches designed to avoid the protracted controversy over technical methodologies that have characterized the RRIM process. We intend to address needed reforms in the prospective redesign of the RRIM in the next phase of this proceeding.

2. Procedural Background

This phase of the proceeding finalizes the true-up of incentives (or penalties) for achievements in energy efficiency savings for the 2006-2008 cycle. Previous interim incentive earnings for the 2006-2008 cycle were awarded in Decision (D.) 08-12-059 and D.09-12-045, respectively. Parties participating in the

proceeding, in addition to the Investor-owned Utilities (IOUs),⁴ were the Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), Natural Resources Defense Council (NRDC), and Women's Energy Matters (WEM). The record developed for this phase of the proceeding consists of written comments by parties, together with work products produced by the Commission's Energy Division, namely, the Energy Efficiency Evaluation Report and the Scenario Analysis Report. The record also includes the scenario analysis presented by the IOUs in filed comments. The IOUs filed supporting calculations on July 16, 2010, identifying assumptions utilized in their scenario.

As discussed in D.07-09-043, the RRIM earnings claims process was originally expected to be ministerial. Incentive earnings were to be awarded based on the Energy Division's independent evaluation of savings accomplishments. Substantive earnings claim issues were to be resolved through adopted procedures for vetting of the Energy Division Evaluation, Measurement, and Verification (EM&V) Reports. Under circumstances where disposition of EM&V issues might require more than ministerial action under General Order 96-B, Energy Division was to prepare a Commission resolution. In D.08-12-059, the Commission revised this procedure stating that:

Beginning with the draft verification report that was issued on November 18, 2008 and going forward, we will require that Energy Division issue these 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. This

⁴ The IOUs are Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), and Southern California Gas Company (SoCalGas or SCG).

direction applies to both the verification reports used to assess interim claims as well as those used for the final true-up. These resolutions should include detailed information regarding the underlying assumptions used and supporting documentation that provides the basis for those assumptions. (D.08-12-059 at 21.)

Pursuant to the schedule for the true-up phase of this proceeding set in D.09-12-045, the Energy Division issued its 2006-2008 draft Energy Efficiency Evaluation Report on April 15, 2010, culminating nearly three years of field-based evaluation research. The Report was issued in final form on July 9, 2010, incorporating corrections and responses to parties' comments.

The Final Energy Division Evaluation Report identified the IOUs' energy efficiency savings, but did not address the calculation of RRIM earnings. Accordingly, since RRIM earnings were not addressed, no resolution was issued in connection with the Report's issuance. We have considered the Energy Division's evaluated results, however, within the record of this proceeding, incorporating parties' comments on the process and results of the Energy Division Report.

On April 8, 2010, an Assigned Commissioner's Ruling (ACR) outlined a process to develop the record for this true-up of incentive earnings using the Evaluation Reporting Tools/Database (ERT). Parties filed comments in response to the ACR on April 20, 2010. A subsequent ACR, issued on May 4, 2010, provided for comments on the Energy Division Scenario Analysis Report which set forth incentive earnings and/or penalties calculations under a range of scenario assumptions. Parties filed comments in response to this ACR on May 18, 2010, and reply comments on June 11, 2010. The IOUs presented a separate scenario analysis in their comments and filed supporting calculations underlying their scenario proposal on July 16, 2010. DRA filed comments on

these supporting calculations on July 26, 2010. The IOUs filed a response on August 2, 2010.

In D.09-12-045, the Commission also directed parties to convene a settlement conference “to enter into further settlement discussions to seek agreement on a 2010 final true-up of incentive earnings for each utility that reasonably ties incentives to actual performance consistent with the policies adopted in [D.09-12-045].”

In this regard, the Commission stated that:

...while the Final Performance Report may provide a context for settlement discussions, we encourage parties to explore the possibility of a 2010 true-up settlement based upon simplified assumptions or metrics not necessarily tied to the detailed and minute level of calculations embodied in the Final Performance Basis Report for the 2006-2008 cycle. In this manner, the schedule for comments and adoption of the Final Performance Basis Report may proceed on a separate, but related track to the schedule for a settlement, or related dispute resolution processes to determine the final 2010 true-up of incentive amounts for each utility.
(D.09-12-045 at 72.)

A settlement conference was convened on June 27, 2010, but no settlement was reached. The parties filed a further round of comments on July 9, 2010 with reply comments on July 23, 2010. The record in this proceeding thus establishes a basis for consideration of data in the Energy Division Report, along with the various RRIM earnings scenario analyses, and parties’ comments in evaluating how to resolve the RRIM earnings true-up.

3. Principles Governing the RRIM True-Up Process

As a basis for finalizing the incentive true-up, we apply the principles that have been adopted in designing the RRIM. As adopted in D.07-09-043, the RRIM offers incentives to encourage the IOUs to meet and exceed Commission

goals for energy efficiency savings, and to extend California's commitment to making energy efficiency the highest energy resource priority. Incentives are earned as a function of the IOU's success in achieving adopted energy savings goals. Conversely, if the IOU fails to achieve at least minimally acceptable energy efficiency savings, the IOU receives no RRIM earnings, and may incur a penalty.

Incentives are earned as a shared percentage of the net cost savings achieved due to deployment of energy efficiency measures, designated as the performance earnings basis (PEB). The shared savings rate varies depending upon the extent of success in meeting or exceeding adopted goals. Maximum limits on incentive earnings and penalties for all IOUs were capped at \$450 million for the 2006-2008 cycle.

In D.07-09-043, we prescribed a process to update, and verify the *ex ante* (pre-installation) assumptions of energy efficiency savings⁵ as programs are implemented during three-year program cycles. First, the utilities report the number and type of measures installed and services rendered, along with associated program costs. This reporting was to occur during the first quarter of each year covering the prior year's accomplishments.

Next, Energy Division and its contractors review this information, conduct field research, and release reports evaluating the costs of installations and

⁵ *Ex ante* refers to assumed energy savings associated with a particular energy efficiency measure or equipment prior to installation. Thus, *ex ante* refers to using program metric assumptions based on past program performance. *Ex ante* measurement relies on engineering estimates or the results of *ex post* savings measurement (e.g., load impact studies) from previous program years or other program experience. (See D.05-04-051 at 35.)

estimate related savings achieved. Program costs were validated through an audit conducted by the Commission Audit Division. Verification reports were to be released annually during the month of August following the end of each calendar year.⁶

At the end of the program cycle, the Energy Division evaluation results were to be used to true-up the *ex ante* estimates of savings with respect to the number and type of measures installed, and with the associated program costs. Other parameters that were evaluated with respect to measure savings include: (1) per-unit energy savings and peak demand reductions, (2) expected useful lives for installed measures/equipment and (3) net-to-gross (NTG) ratios.⁷

Energy Division and its consultants evaluate these parameters on an *ex post* (post- installation) basis with a variety of field research methods. A true-up of portfolio savings and PEB for the full program cycle was to be based on the parameters evaluated by Energy Division.

⁶ See *ALJ Ruling Adopting Protocols for Process and Review of Post-2005 EM&V activities*, January 11, 2006. Energy Division's Verification Report schedule was modified by Administrative Law Judge (ALJ) ruling on January 2, 2007. For the 2006-2008 program cycle, verification of 2006 installations and program costs were combined with the report on 2007 accomplishments. Both were released concurrently.

⁷ NTG ratios are used to discount savings associated with program to reflect the existence of "free riders," that is, customers who would have installed the energy efficiency measure or equipment without the utility's financial incentive (e.g., rebate). NTG ratios are estimated at the start of program implementation, and EM&V studies are designed to evaluate those ratios on an *ex post* (post-installation) basis, using control groups and statistical regression analyses, among other approaches.

The RRIM provides opportunities for earnings (or risk of penalties) at interim points for each three-year program cycle.⁸ Under the adopted process,⁹ each IOU is eligible for two interim incentive installments, and a final true-up. Interim RRIM earnings were based on savings achievements measured using *ex ante* assumptions subject to a holdback of a portion of the claim, pending *ex post* true-up.

In December 2008, the IOUs received a first installment of RRIM earnings for 2006-2007 mid-cycle performance. In D.09-12-045, the IOUs received a second installment for the 2006-2008 program cycle. The total interim incentive payments totaled \$143.7 million, as set forth below:

Interim 2006-2008 RRIM Earnings Previously Awarded

| Utility | First Installment (Authorized in D.08-12-059) [A] | Earnings Rate Used For Second Installment | Maximum Earnings (PEB * Earnings Rate) [B] | Maximum Earnings less 35% holdback [C] | 2nd Installment of Interim Earnings [C]-[A] | Holdback Amount Subject to Final True-Up [B] - [C] |
|---------|---|---|--|--|---|--|
| PG&E | \$41,500,000 | 12% | \$115,277,868 | \$74,930,614 | \$33,430,614 | \$40,347,254 |
| SCE | \$24,700,000 | 12% | \$77,465,151 | \$50,352,348 | \$25,652,348 | \$27,112,803 |
| SDG&E | \$10,800,000 | 12% | \$17,077,803 | \$11,100,572 | \$300,572 | \$5,977,231 |
| SCG | \$5,200,000 | 12% | \$11,247,724 | \$7,311,021 | \$2,111,021 | \$3,936,703 |

The interim EM&V reports produced by Energy Division have been the subject of considerable controversy. Due to delays associated with the first interim report, the first installment of RRIM incentives was based on IOU self-reported results subject to a 65% hold back. Although we utilized self-reported

⁸ D.08-01-042, citing D.07-09-043 Conclusion of Law 7 at 212.

⁹ See D.07-09-043, Conclusion of Law 7 at 212, and Attachments 6 and 7.

utility claims, we did so only because the First Verification Report was not available in time. The holdback of 65% reflected increased uncertainties associated with self-reported claims.

The Commission upheld the validity of the Energy Division Second Interim Verification Report in D.09-12-045 in determining the dollar value of energy savings subject to the RRIM calculation for the second interim claim. The Commission formally adopted the Energy Division Second Verification Report by resolution on October 15, 2009. The resolution incorporated reference to Verification Report's extensive log of corrections to modeling tools and inputs¹⁰ and itemized responses to criticisms or comments posed by stakeholders.¹¹

The second installment of incentive earnings was based on net benefits measured by the Energy Division Verification Report, with additional adjustments for following factors:

- (1) Both positive and negative interactive savings effects were applied;
- (2) The cumulative effects of 2004-2005 savings goals were excluded;
- (3) Savings goals were adjusted for interactive effects that were not originally considered in setting 2006-2008 goals;
- (4) A shared savings rate of 12% was used by applying the IOUs' original unmodified *ex ante* assumptions in comparing the IOUs' reported savings achievements relative to Commission goals;

¹⁰ See Second Verification Report, Section 8.2.

¹¹ *Id.*, Section 9.2.

(5) The NTG ratio applied for savings attributable to SCE's residential lighting program was adjusted to reflect SCE's specific implementation approach to this program; and

(6) The realization rate applied to SDG&E's Energy Savings BID program and SoCalGas' Local Business Energy Efficiency program was adjusted to reflect the unique nature of those programs as compared to more generic statewide programs.

4. Framing of the Issues for the True-Up

As a framework for determining the true-up of incentive earnings for the 2006-2008 cycle, parties raise two fundamental disputes: (1) the amount of assumed net dollar benefits subject to the incentive calculation, and (2) the applicable percentage allocation of those benefits to be shared between ratepayers and shareholders. Based on these differences, parties disagree as to whether the IOUs are entitled to additional incentive earnings, or whether penalties apply.

The assigned Commissioner circulated a range of incentive earnings scenarios as set forth in the Energy Division "Scenario Analysis Report" (provided by ACR dated May 4, 2010).

This Report illustrated the sensitivity of RRIM earnings over a range of different policy assumptions calculated utilizing the ERT.¹² Each scenario incorporated variations showing incentive impacts assuming:

¹² The ERT is a combination of tools and processes that work in concert to calculate 2006-2008 energy efficiency portfolio performance results.

The ERT core features were used to compile and evaluate alternative scenarios and resulting RRIM earnings based upon changes to key parameters. The ERT aggregates and reports efficiency savings performance at the level of measure group, program, and

Footnote continued on next page

- a) shared savings rate of 9%;
- b) shared savings rate of 12%;
- c) results compared to 2006-2008 goals;
- d) reduced therm goals by 22% for SDG&E and 26% for PG&E;
- e) recognition of 100% of savings from Codes and Standards (C&S) Advocacy accomplishments; and
- f) Inclusion of interim RRIM awards as additional program costs.

These assumptions were highlighted to illustrate the effects of various policy disputes previously at issue in interim incentive proceedings. The scenarios drew data from different sources utilizing the ERT as a template, including Energy Division evaluation findings, along with the IOUs' self-reported data.

The RRIM earnings calculated under these scenarios range from less than \$1 million to almost \$400 million. The scenarios can be grouped into the following general categories:

(1) Scenarios S2 and S3 -- "Utility Reported Net Savings"

These scenarios apply *ex ante* values for all key parameters and exclude updating based on EM&V evaluation studies. These scenarios result in total earnings of either about \$400 million (all S2 results) or around \$300 million (S3 results with updated installation rates). Scenario S2 calculates the results using IOU-reported net savings based on their 4th quarter tracking database, with IOU-reported net-to-gross ratios without updating for evaluation field research. Scenario S3 utilizes a similar data set as

total portfolio. Based on specified parameter assumptions, the ERT generated scenario runs showing corresponding RRIM earnings.

Scenario S2, but with IOU-reported quantities adjusted based on evaluated installation rates.

(2) Scenarios S4 and S5 -- "Evaluated Gross Savings"

These scenarios use key parameters updated based on Energy Division's evaluation studies of installation rates and energy savings, but exclude Energy Division's evaluated NTG ratios. These scenarios result in total earnings around \$200 million, though the two sub-scenarios using a 12% sharing rate result in earnings of about \$250 million.

(3) Scenarios 6 through 9 -- "Evaluated Net Savings"

These scenarios apply *ex post* savings as evaluated by the Energy Division yielding total shareholder incentive earnings of about \$29 million for all the utilities for the 2006-2008 cycle. These scenarios replace *ex ante* utility parameter values with evaluated *ex post* results based on the most recent studies conducted under the EM&V protocols. None of these scenarios result in earnings higher than about \$85 million. The sub-scenarios that use a 9% rate result in total incentives of about \$30 million, while the use of the 12% sharing rate results in earnings of about \$80 million. Scenario 7 shows incentive earnings for all three utilities as \$29,101,924. Since the Commission has already authorized \$143.7 million in interim RRIM payments, and since there is no claw back provision, no further RRIM awards would be due. However, Scenario 7 calculates that PG&E accomplished less than 65% of its demand savings goal, which would place PG&E into the penalty zone, resulting in the refund of previous incentive payments of \$74 million.¹³

¹³ In its July 9, 2010 comments, DRA claims that the Energy Division penalty calculations for PG&E are understated, and offers corrected values. DRA points out that the PG&E penalty amount calculated by the Energy Division only includes repayment of the interim incentives, rather than the per unit penalty established in D.07-09-043 where energy utility savings are less than 65%. Energy Division calculated that PG&E only achieved 60% of its megawatt (MW) Goal. Applying the penalty of

Footnote continued on next page

TURN, DRA, and WEM argue that the incentive true-up should be determined utilizing the Energy Division evaluation of net savings. The IOUs and NRDC, however, oppose the Energy Division findings as the basis for measuring energy efficiency savings. They criticize the Energy Division Report and the measurement studies that formed the basis for its findings on evaluated savings.

The IOUs and NRDC argue that the net savings used in the true-up should instead simply carry forward the *ex ante* assumptions previously used in the 2005 Database for Energy Efficiency Resources (DEER) at least for key parameters. The IOUs also argue that incentives should apply using a 12% shared savings rate, while TURN, DRA, and WEM support the use of a 9% shared savings rate, as calculated by the Energy Division based on the RRIM formula.

DRA and TURN contend that the Energy Division Verification Report utilizes the most up-to-date and independently verified parameters of energy efficiency savings achievements. DRA argues that ignoring these results or engaging in after-the-fact lowering of goals defeats the purpose of the incentive

\$25,000/MW to PG&E's deficit of 32 MW yields a penalty of more than \$800,000. Energy Division also calculates that PG&E achieved only 63% of its MMtherm (MMTh) goal. Applying the per-unit penalty would result in a penalty of \$450,000. DRA argues that these goal shortfalls should result in additional penalties of \$1.25 million.

Moreover, on Table 23, page 96, the Energy Efficiency Draft 2006-2008 Report calculates that SCE also fell short of its MW Goal at 64%. Using the per unit penalty formula established in D.07-09-043, a penalty of \$175,000 would result. DRA notes that SDG&E is calculated as achieving only 37% of its MMTh Goal. At this level D.07-09-043 requires a dollar-for-dollar payback of negative net benefits. Thus, DRA argues that all three energy utilities should repay their interim incentive payments and be subject to penalties as well.

mechanism to align the interest of shareholders and ratepayers by rewarding innovative and effective performance in achieving the Commission's goals. If the IOUs are rewarded for results that do not achieve the Commission's energy efficiency goals, DRA argues the incentive mechanism loses its value to promote optimal performance. DRA and TURN thus support use of the Energy Division's adjusted results in the Evaluation Report for calculating incentives for 2006-2008. DRA and TURN point out that the Energy Division, unlike the IOUs, has no financial interest in the outcome of the incentives calculation and is therefore the most unbiased source of information. DRA argues that if other assumptions are used to calculate incentives, the shared savings rate established in D.07-09-043 should be lowered to reflect the decreased risk shareholders face by using lowered goals or less accurate parameter measures.

On the basis of the Evaluation Report data, Energy Division made the following calculation of RRIM earnings for the 2006-2008 cycle (identified as: "Scenario 7" in the Scenario Analysis Report:¹⁴

| Utility | Performance Earnings Basis | Earnings % Rate | RRIM Total Earnings | (Penalties) |
|----------------|-----------------------------------|------------------------|----------------------------|--------------------|
| PG&E | | | | (\$74,930,614) |
| SCE | \$299,294,334 | 9% | \$26,936,490 | |
| SDG&E | \$28,365,487 | 9% | \$2,552,894 | |
| SoCalGas | \$8,423,204 | 9% | \$758,088 | |

The Energy Division evaluation results show positive earnings for SCE, SDG&E, and SoCalGas. Since the interim incentives previously awarded for each of these IOUs exceed the final totals, however, no additional incentive earnings would be due. For PG&E, the Energy Division findings indicate a penalty of \$74.9 million was incurred because evaluated PG&E MW savings fell below the 65% minimum performance standard (MPS) threshold level.

The IOUs claim that reliance on the Energy Division Evaluation Report as the basis for RRIM earnings would diverge from adopted EM&V protocols. The IOUs claim that the Energy Division Report results are not independently verified based on adopted EM&V protocols and are not consistent with the Commission policy of independent verification.

¹⁴ Although Scenario 7 applied a 9% shared savings rate in completing incentive earnings, a 0% rate should have been applied based upon the achieved percentages of savings goals assumed. Scenario 7 calculates that each IOU achieved less than 85% of its savings goals. Pursuant to D.08-12-059, Ordering Paragraph 4, a 0% rate applies under this assumption.

The IOUs claim that the Energy Division evaluation has many technical deficiencies and cannot be relied upon to assess IOU achievements for the 2006-2008 cycle. Among the claimed shortcomings, the IOUs complain of inappropriate sample sizes, low confidence intervals, self-reported NTG ratios, and generally poor measurement execution.¹⁵

The IOUs propose that instead of the Energy Division *ex post* evaluations for certain specified measures at least, incentive earnings should be quantified by applying the *ex ante* values, that were assumed at the time that the 2006-2008 program cycle funding was initially established, as reflected in the 2005 DEER. The IOUs claim that the 2005 DEER values are the only ones that have been properly vetted and accepted. The IOUs nonetheless propose the use of updated data, however, for computing avoided costs and greenhouse gas (GHG) adders.

The IOUs and NRDC argue that the Energy Division evaluation studies completed in 2008 and 2009 are not reliable sources of certain key parameters, such as NTG ratios. In the interests of compromise, however, the IOUs accept certain assumptions in the Energy Division Report except as detailed below. The IOUs seek a final installment of RRIM earnings based upon their own proposed calculation scenario, arguing that their calculation produces an appropriate outcome given the current policy and intent of the Commission. The IOUs' calculation scenario uses the Energy Division's Final Evaluation Report as a foundation, but applies different assumptions for factors that the Joint IOUs consider to be errors in the Energy Division Report. The Joint IOU Scenario thus:

¹⁵ The Energy Division's responses to claimed technical deficiencies are discussed in Section 5.2 below.

- applies a 12% shared savings rate in accordance with D.09-12-045 (citation included above);
- does not compare energy savings against 2004-2008 cumulative goals;
- includes 100% of the savings from 2006-2008 C&S activities; and
- applies *ex ante* values for NTG ratios, Expected Useful Life (EUL), In-Service Rates (ISR) for upstream-delivered Compact Fluorescent Light bulbs (CFLs), and Interactive Effects as found in the 2005 DEER.¹⁶

Based on these assumptions, the Joint IOUs seek an additional \$112.3 million in RRIM earnings. When added to the \$143.7 million previously awarded, the IOU proposal for an additional \$112.3 million would result in cumulative RRIM awards for 2006-2008 totaling \$256 million, summarized as follows:

| <u>(Dollars in Millions)</u> | | | | | |
|------------------------------|------------|-------------------|-----------------------------------|------------------------------|------------------------------|
| <u>Utility</u> | <u>PEB</u> | <u>Earnings %</u> | <u>Total 2006 – 2008 Earnings</u> | <u>Interim RRIM Earnings</u> | <u>Final True-Up Payment</u> |
| PG&E | \$1,146.7 | 12% | \$137.6 | \$75 | \$62.6 |
| SCE | 752.5 | 12% | 90.3 | 50.4 | 39.9 |
| SDG&E | 128.3 | 12% | 15.4 | 11.1 | 4.3 |
| SoCalGas | 106.7 | 12% | 12.8 | 7.3 | 5.5 |
| Totals | | | \$256.1 | \$143.7 | \$112.3 |

¹⁶ The IOU Scenario accepts the Energy Division evaluated results for remaining parameters including (1) Unit Energy Savings (UES), (2) Installation rates (except for upstream CFLs), (3) Incremental Measure Costs (IMC), (4) Load Shapes, (5) Residential/Non-Residential split for upstream CFLs, (6) Realization Rates, (7) Program Costs, (8) Makeup of PEB: TRC/PAC split, and (9) Goals.

Because the Joint IOU Scenario was not pre-defined within the ERT, the IOUs customized the ERT to run their scenario. The ERT allows users to run some aspects of the IOU scenario, including *ex ante* NTG ratios, *ex ante* effective useful lives, and *ex post* unit energy savings. However, to include *ex ante* in-service rates for upstream delivered CFLs, the IOUs modified the ERT Input Sheets to reflect the *ex ante* values, while retaining the *ex post* installation rate values for all other measures. Similar customization was required to address *ex ante* interactive effects.

PG&E attempted to modify the ERT to include these interactive effects in calculating earnings under the IOU scenario. As an electric utility, therm interactive effects were not included in SCE's *ex ante* estimates, therefore SCE ran its "with interactive effects" scenario and removed all therm benefits from the ERT. Upon running the scenario through the ERT, the IOUs applied an average factor to the net resource benefits to estimate the affect of increasing the GHG adder to \$30 a ton.

5. Discussion

5.1. Summary Findings Regarding the True-Up of Incentive Earnings

In finalizing the 2006-2008 true-up, we are guided by the following fundamental principles:

1. Promotion of the Commission's energy efficiency goals;
2. Incentive methodologies should be applied in a fair, transparent, and conceptually consistent manner; and
3. Ratepayers should pay incentives only for real and verifiable energy efficiency savings.

4. Encourage utility investors and managers to view energy efficiency as a core part of the utility's regulated operations that can generate meaningful earnings for its shareholders.

Accordingly, we evaluate the parties' disputes in terms of the Commission's adopted goals and principles for administering the 2006-2008 energy efficiency program portfolios and the related RRIM earnings. Our task is to true-up the interim calculations of incentive earnings for the 2006-2008 cycle, and thereby determine whether additional earnings are due, or whether penalties apply. Since parties could not reach consensus on a reasonable basis to simplify the calculation of energy savings achievements, we rely upon the record that has been developed to assess a reasonable outcome consistent with adopted Commission goals and policies.

As discussed below, we cannot rely solely upon the outdated *ex ante* assumptions from the 2005 DEER, as proposed by the IOUs and NRDC, as a performance basis for the true-up of energy cost savings achieved. The Commission has repeatedly stated that these *ex ante* estimates are too outdated to be used as final determinants of energy efficiency accomplishments justifying incentive awards. Instead, the Commission intended that *ex ante* assumptions would be trued up with updated *ex post* evaluations that are designed to determine the savings achieved in the program period. The EM&V process is the vehicle established by the Commission for measuring success (or failure) in achieving energy efficiency accomplishments and cost savings for purposes of incentive awards. However, it was originally assumed, incorrectly, to be a non-controversial, ministerial task.

We appreciate that the Energy Division evaluation process has been extremely contentious, resulting in considerable disagreement over estimates of

energy savings achievements, and the resulting incentive payments due. Unlike expenditures for energy resources that are measured through arms-length transactions, energy savings cannot be easily quantified. To calculate cost savings associated with energy efficiency measures, it is necessary to develop assumptions as to relevant parameters based on surveys, sampling, and extrapolation of estimates over extremely large volumes of data points. Because of the sensitivity of the assumptions to performance results as applied in the incentive formula, we carefully consider the process used to assess energy savings achievements for purposes of the incentive true-up. While the IOUs continue to disagree with multiple minute details of data points underlying various Energy Division figures, we conclude that the overall Energy Division evaluation was produced with professional care.

In addition to evaluation of the program results, a number of changes to the original incentive calculation process have also been proposed such as incorporating 100% of the savings from pre-2006 Codes and Standards Advocacy Programs, adjusting savings goals for interactive effects with associated reductions in therm goals (as approved for interim payments in D.09-05-037) , inclusion of some or all of 2004-2005 data in assessing cumulative goals, and updating assumptions of avoided costs.

The Energy Division presented an evaluation of the 2006-2008 programs' cost effectiveness, excluding the costs of funding shareholder incentive payments. The 2006-2008 cost-effectiveness program results for each IOU, as evaluated by the Energy Division, are summarized below, expressed as in terms

of benefit-to-cost (B/C) ratios.¹⁷ The summary below demonstrates how the B/C ratio is impacted by the payment of the \$143.7 million interim incentives previously awarded and how the B/C ratio would be further impacted by additional incentive payments of \$112.3 million, as the IOUs propose.

| <u>Utility</u> | <u>Benefit-to-Cost Ratios</u> | | |
|----------------|--|---------------------------------------|---|
| | <u>(Excluding Interim RRIM Payments)</u> | <u>(Net of Interim RRIM Payments)</u> | <u>Net of Interim and IOU-Proposed Payments</u> |
| PG&E | 1.17 | 1.09 | 1.03 |
| SCE | 1.19 | 1.12 | 1.09 |
| SDG&E | 1.02 | 0.981 | 0.96 |
| SoCalGas | 0.90 | 0.86 | 0.84 |
| Statewide | | | |
| Average | 1.14 | 1.07 | 1.03 |

As summarized above, the Energy Division calculated an overall statewide B/C ratio of 1.14, representing an additional 14 cents of benefits for every dollar of ratepayer investment. The payment of additional incentives in addition to previous interim payments would reduce the overall statewide B/C ratio to 1.03. Consequently, even in this “worst case” scenario using Energy Division’s results of savings while providing the utilities with their requested amount of incentive payments, the energy efficiency programs would still be cost-effective for ratepayers statewide.

¹⁷ See the Final Energy Division Evaluation Report, Table 32 at 126. The Energy Division benefit-to-cost ratios measured benefits in terms of the net present value of avoided costs of supply-side resources avoided, and measured costs as the net present value of the costs of the programs to participants plus non-rebate costs incurred by program administrators.

5.2. Role of the Energy Division Evaluation in the True-Up

The Energy Division Final Evaluation Report of 2006-2008 energy efficiency savings performance was finalized in accordance with adopted Commission processes. The Report found that California ratepayers' \$2.1 billion investment in energy efficiency resulted in over 6,000 Gigawatthours (GWh), 80 million therms, and over 1100 MW in annual energy savings over the 2006-2008 cycle. These accumulated savings represent approximately 3.2% of electricity and 1% of the natural gas sold in 2008. The reported savings were evaluated through field work to verify energy efficient technologies installed and the related savings attributable to the programs. In total, the evaluations for any given parameter directly assessed the majority of the *ex ante* claimed savings. Evaluations of measure installations accounted for 77% of kilowatt-hour (kWh) savings. Evaluations of unit energy savings accounted for 86% of kWh savings. Evaluations of load shapes covered 80% of kW savings and evaluations of NTG ratios covered 90% of kWh savings.

Energy Division focused limited evaluation resources on measuring gross savings from the end-use measures or technologies that dominated portfolio savings, i.e., high-impact measures (HIM), and on estimating net savings attributable to programs with the highest savings from installed technologies. The IOUs claim that HIM methodology developed point estimates for certain measures and then applied them to similar measures across the portfolio. They further claim that the shift in methodology to evaluation of HIMs represents an untested divergence from longstanding and commonly accepted EM&V protocols without the opportunity for public review. In addition, the IOUs claim that the evaluated results were not properly translated into earnings projections,

as the ERT itself was systematically flawed such that it produced earnings estimates with no statistical confidence.

We conclude that the Energy Division's HIM focus was reasonable, and allowed for a more efficient use of Energy Division resources, allowing for approximately 85% of the reported kWh, kW and therms to be included in the direct evaluation of gross savings. The claim that values from the HIM evaluations were applied without respect to program design, customer, or delivery strategies is inaccurate as illustrated in Energy Division's report.¹⁸ The HIM approach went beyond a program-by-program evaluation by ensuring that the majority of the portfolio savings were subject to evaluation review. The error bound for the net savings estimates for GWh, MW, and MMTherms were added to Energy Division's final evaluation report, Section 4.3. Across the IOUs, the error bounds are $\pm 6\%$ for electricity, $\pm 4\%$ for peak, and $\pm 11\%$ for natural gas at the 90% confidence interval. Results are specific to each IOU and category.¹⁹

The IOUs claim that the findings in the Energy Division Report are unreliable, lack transparency, and have not been subject to an adequate public review process. PG&E, for example, claims that given the breadth of the evaluation, the time provided for review and comment on EM&V evaluations was too short. PG&E claims that critical data needed to conduct a comprehensive review was not made available in a timely fashion, which

¹⁸ Section 3.4 of the Energy Division Report states that less than 1% of any parameter estimate received an update that was not directly evaluated and in cases where they were, the program design, customer, and delivery strategies were considered by professional evaluators.

¹⁹ See Energy Division Report, Table 19 at 88.

foreclosed the possibility of robust analysis. Consequently, PG&E believes the process did not provide for the free exchange among stakeholders as contemplated by the Commission in D.07-09-043.

We disagree with IOUs' allegations that the work product and review process to produce the Energy Division report was not reasonably vetted. We conclude that stakeholders have had a fair opportunity to review and comment on the Energy Division Report and underlying assumptions. PG&E complains that the deadlines for public review imposed by the Energy Division were too short. Yet, the schedule incorporated the deadlines that the Commission had set in D.09-12-045 for completion of the true-up. No party pursued remedies within this proceeding to extend the schedule to address claimed inadequacies in the review process.

The Energy Division Report necessarily encompasses review of a large number of records that reflect considerable technical complexity and detail. The Commission established a process by which evaluation studies must be posted for public comment prior to finalizing the results. Energy Division followed protocols for vetting adopted in D.07-09-043, characterized as:

...a specific and adequate process by which parties can submit questions, concerns and comments to both Energy Division and evaluation contractors. Conferences and the submission of written comments based on conferences, allow parties to participate in the process by raising and discussing issues. This takes place in formulating the several reports before they are finalized: the draft Verification Report, the draft final evaluation reports, and the draft Final Performance Basis Report. Our belief is that any concerns the parties may have can be resolved through such a process. (See D.07-09-043 at 129.)

We find that Commission-adopted protocols for stakeholder input and vetting have been followed.²⁰ Energy Division circulated requests for technical participation from parties, provided draft materials, held several meetings to discuss technical issues, provided opportunities for comments, and responded in writing, explaining how assumptions were applied in developing and measuring performance results.²¹ Energy Division changed or updated numbers where comments were found to have merit.

The Energy Division contractors provided updates to installation rates (how many technologies were installed and operating), unit energy savings (savings for any given technology), and NTG ratios (a factor used to adjust savings to account for the influence of the program) where evaluation updates were available. Several parameters, primarily cost data, were part of the data set but were not updated with evaluation results.²²

The Energy Division adhered to strict timelines and a rigorous public review process. Stakeholders were provided opportunities to comment on the evaluation plans. Consultant reports were published at different times in 2007 and 2008, and the Energy Division's final report was released for public comment in December 2009. Results from the impact evaluations were posted

²⁰ See e.g., ALJ Ruling on process protocols dated January 11, 2006, in R.01-08-028 and January 2, 2007, in R.06-04-010.

²¹ See e.g., Evaluation Report, Appendix O for a compilation of comments and responses.

²² The updates applied, the source of the update, and the justification of the values were provided by each group, and presented in Appendix C of the Energy Division Report.

for public review and comment in December 2009 in detailed technical reports, and were also presented in public webinars. The Energy Division Report included voluminous and detailed point-by-point responses to stakeholders' questions and claimed errors. The public comment period generated approximately 1,700 comments, all of which were addressed by the Energy Division and its evaluation contractors. The reports were finalized in February 2010. Summaries of these report findings are included in the Energy Division report, and the final reports were posted on the California Measurement and Advisory Council (CALMAC) website. The IOUs claim the Energy Division results are non-transparent and utilize values without references to sources, and that methodologies lack actual documentation. The IOUs claim various technical errors in the processes utilized by the Energy Division in evaluations of savings.

The claimed errors involve various technical details often involving minute and arcane details as to how the Energy Division consultants conducted surveys, extrapolated samples, and used data in calculating the various savings measures. We recognize that there is room for debate about judgments made in conducting surveys and extrapolating results to estimate *ex post* measures. We find, however, Energy Division's work product reflects professional standards of care and there is no justification for the IOUs' dismissal of the Energy Division work product.

The Energy Division managed a budget of \$97 million, representing one of the largest energy efficiency impact evaluations in the world, which was implemented by leading evaluation professionals. The focus of its studies was to verify IOU self-reported energy savings and identify energy savings that would not have likely occurred in the absence of the program. The Energy Division report adopts the findings of numerous individual EM&V studies of the

performance of various individual energy efficiency programs in the IOUs' portfolios for the 2006-2008 cycle. The studies form the foundation for updates to the utility *ex ante* savings assumptions used to estimate portfolio and program savings and cost effectiveness, and provide information for program improvements and future estimates.

The Energy Division Report synthesizes three years of program implementation and evaluation and presents the final outcomes of multiple billions of dollars in ratepayer investments. The Energy Division Report incorporates multiple attachments of data and tools that allowed for detailed review by stakeholders. Most pieces (i.e., Contractor Reports, Decision Framework and ERT) have been introduced to the public in advance of the Energy Division report release. The largest and most complex portion of the data (over 4 million tracking records) was provided by the IOUs and standardized in collaboration with Energy Division consultants over the course of a three-year period.

5.3. Use of *Ex Ante* versus *Ex Post* Measures for Measuring Savings

The 2006-2008 energy efficiency cost savings used to determine final incentive earnings varies significantly depending on how key parameters are quantified. Parties disagree, in particular, concerning the appropriate values for the NTG ratio, expected useful lives, and in-service installation rates. The IOUs and NRDC advocate using *ex ante* values from the 2005 DEER. The Energy Division Report calculated updated *ex post* values for these measures. A key factor contributing to the differences between *ex ante* and *ex post* savings is the much lower than expected impact of interior screw lighting measures, as they made up a significant portions of the portfolio, adjustments to NTG ratios,

installation rates, and unit energy savings based on the Energy Division evaluation all contributed to these impacts.

As noted by Energy Division, the goals for the last two program cycles (i.e., 2004-2005 and 2006-2008), were developed from analyses conducted in 2002-2004. As a result, significant variances exist between the savings estimates from the Energy Division *ex post* evaluation and the assumptions underlying the original *ex ante* assumptions used to develop the Commission's efficiency goals. In the aggregate, utility self-reported energy savings during 2006-2008 were claimed at the level of 151% of the adopted goals. By contrast, the Energy Division evaluation found that energy savings equal to only 62% of the adopted goals. Similarly, utility self-reported demand savings for 2006-2008 were claimed to be 122% of the goals, but the Energy Division evaluation found demand savings amounting to only 55% of goals.

The *ex post* savings were to be independently evaluated by the Commission's Energy Division.²³ In D.05-01-055, we mandated that the Energy Division take responsibility for managing and contracting for all EM&V studies. This mandate marked a shift in the responsibility from the utilities to Commission staff and helped ensure unbiased results by having a neutral party overseeing the EM&V process. This process ensures that incentives are awarded based on independently evaluated, real savings, and that customers fund incentives only for real and verifiable savings. Energy Division has access to the experience and expertise of evaluation contractors throughout the processes for developing the research and data to estimate interim and final earnings claims.

²³ D.07-09-043 at 4.

Yet the proposal of the IOUs would disregard independent *ex post* evaluations by simply applying outdated *ex ante* assumptions to savings calculations. The Commission has previously recognized the importance of independent verification in ensuring that ratepayers get value commensurate with their energy efficiency investment, that programs are well designed, and that energy efficiency is considered a reliable resource comparable to supply side resources.²⁴ The Energy Division Report is the only source in the record that offers an independent assessment of performance-based earnings from a neutral perspective.

We previously rejected requests by the IOUs to remove the requirement for updates of key parameters in assessing RRIM earnings. In denying the IOUs' earlier request to retreat from the updating of parameters, we explained in D.08-12-059:

At this point we do not think it would be reasonable to remove, in part or in whole, the requirement that the *ex ante* assumptions used to assess interim claims be updated. This updating is part and parcel of the balance that was struck in D.08-01-042 between providing utilities the ability to book interim rewards without the uncertainty that they would have to return these interim amounts after the fact, and limiting the risk to ratepayers of overpayment. (D.08-12-059 at 19.)

We reiterated the importance of this principle in D.09-12-045 where we relied upon updated assumptions in the Energy Division verification studies as the basis for the cost savings used to allocate incentive awards. By not updating *ex ante* assumptions, we are left with an outdated basis for measuring cost

²⁴ D.05-01-055 at 112.

savings and associated incentive payments. We have previously stated that the earnings true-up would reflect updated assumptions in the DEER, as noted in D.08-01-042:

Updating measure load impacts using the DEER database prior to the payout of interim claims in 2008 and 2009 should help to mitigate the risk of extremely large swings in earnings (positive or negative) at the final earnings true-up, which serves the interests of both utility shareholders and ratepayers. (D.08-01-042 at 17.)

Accordingly, the use of *ex post* updates of key parameters is in accordance with Commission policy and produces the most reasonable basis for the true-up. As discussed further below, we address more specifically the issues raised concerning *ex post* updates in the context of the shared savings rate and the specific key parameters in dispute. We conclude that the IOUs proposal to measure cost savings based solely on *ex ante* assumptions from the 2005 DEER for key parameters is unsupported.

5.4. Shared Savings Percentage Rate for the True-Up

We approve a 12% shared saving rate in calculating the true-up of 2006-2008 RRIM earnings. The RRIM formula applies different shared savings percentages depending on the extent that adopted savings goals are met or exceeded. Parties disagree as to the shared savings percentage that applies for allocating savings for the true-up. The IOUs and NRDC believe a 12% shared savings rate applies for computing the earnings true-up, and claim that use of a lower shared savings rate contradicts Commission policy.

TURN and DRA argue, however, that the shared savings rate should be based on the evaluated results of the Energy Division Report. The Energy

Division evaluation computes that the IOUs did not achieve 100% of their goals, and consequently Energy Division's calculations apply a 9% rate.²⁵

If the Commission rejects the Energy Division's Report in favor of awarding incentives using *ex ante* assumptions, DRA and TURN argue that the shared savings rate established in D.07-09-043 should be lowered. They argue in favor of reducing the shared savings rate in the event that unverified parameters or lowered goals are applied to maintain the risk/reward balance established when the 9%/12% percentages were originally adopted. They argue that a reduced percentage allocated to investors would compensate for the modified expectations that programs would be independently verified.

We applied a 12% rate for the interim installment of earnings in D.09-12-045 stating that the program results goals should be compared with the goals for true-up purposes based on the same assumptions used to develop the goals. In other words, since the goals are derived based on *ex ante* assumptions, it is reasonable to use *ex ante* assumptions when comparing utility results with those goals in order to have an apples to apples comparison. In this decision, we apply that principle based upon a consideration of all of the relevant assumptions adopted by the Commission regarding the purpose and use of *ex ante* values.

As shown in Scenario 2 of Energy Division's analysis, the results using *ex ante* assumptions would result in a 12% shared savings rate for each utility. Thus, consistent with our approach adopted in D. 09-12-045, we approve a 12% shared savings rate for the final true up.

²⁵ As noted above, DRA calculates additional penalties under the RRIM formula beyond those Energy Division calculates. Also, although the energy Division assumed a 9% rate, the RRIM formula calls for a 0% rate under the MPS values computed.

5.5. Specific Policy Assumptions Used to Calculate the True-Up

5.5.1. Updates to NTG Ratios

In the context of energy efficiency programs, the NTG ratio measures the effects of “free riders,” i.e., participants who would have undertaken an energy efficiency activity even absent a utility program.²⁶ While the NTG ratio does not change the measurement of gross savings from all energy efficiency investments, the savings attribution does impact the cost-effectiveness calculations, and the basis for allocating the gross savings between the utility programs and other impacts.

In D.07-09-043, we designed the RRIM to limit incentive awards only to savings that directly result from utility programs, and excluding savings attributable to “free riders.” Applying the NTG adjustment to program savings, in turn, motivates the utilities to direct energy efficiency dollars to achieve results that would not otherwise have occurred as a factor in determining what energy efficiency programs to pursue. Likewise, ratepayers only pay incentives for savings that were achieved as a direct result of funded programs.

Parties’ disagreements concerning the NTG ratio constitutes a major difference in RRIM earnings results. There are two separate disputes regarding the use of the NTG ratio: (1) whether the NTG ratio should be updated at all during the 2006-2008 cycle, and (2) if so, what updated figures should apply.

The IOUs argue that there should be no updating of the NTG numbers. They contend that the Commission should use *ex ante* utility data from the

2005 DEER. The *ex ante* figure are based on self-reported numbers generally dating back from the 1990's (Scenarios S2 and S3). Another possible alternative would be to simply use gross savings and forgo the whole issue of attribution altogether (Scenarios S4 and S5).

The IOUs argue that the RRIM calculation should apply the utility-reported *ex ante* NTG values. The IOUs argue that both the rationale and methodology behind the updated NTG values in the Energy Division Report are not supportable.

The Commission's policy has been to calculate incentives with updated NTG ratios, stating that utilities will be *encouraged* to pursue more cost effective programs. However, the IOUs disagree that basing incentives on updated NTG ratios encourages pursuit of cost-effective programs. The utilities complain that the updated NTG numbers are 1) untimely, 2) unreliable, and 3) send the wrong incentive to the utility. They argue that NTG ratios have been updated *after* the programs have been implemented, thereby eliminating the opportunity for utilities to change their approach to maximize energy savings attributable to their programs. Rather than being a tool to encourage cost-effective investments in energy efficiency programs, they argue, the application of *ex post* NTG ratios in incentive calculations has become contentious, with parties arguing after-the-fact whether customers were motivated by utility programs to install energy efficiency measures.

²⁶ For example, an NTG ratio of 0.80 indicates that 80% of total participants are not free riders.

PG&E claims that in the final performance evaluation, many of the NTG ratios were estimated based upon inadequate sample size, insufficient survey response levels, and excessive delays in surveying customers regarding their motivation for participation in energy efficiency programs.

We recognize that judgments may differ in estimating the effects of free ridership, and acknowledge that any measure of the NTG can at best only be an approximation. Yet, by simply advocating perpetuation of the 2005 DEER assumptions, the IOUs fail to offer any better approximation of NTG values compared to the Energy Division report. The IOUs have not justified perpetuating outdated 2005 DEER NTG ratio assumptions for the true-up of incentive earnings.

Measurement of NTG ratios has caused particular controversy both because evaluation methods depend on customer behavior survey results and because positive impacts in market transformation – for example, greater consumer awareness of the benefits of CFLs – will reduce utility savings eligible for incentive earnings.²⁷ We have previously recognized that measuring NTG ratios is inherently difficult. For example, we acknowledged in D.08-12-059 the utilities’

...concerns expressed regarding the robustness of assumptions and updates thereof used to assess utility performance under the incentive mechanism. For example, the net-to-gross ratio has

²⁷ The NTG for CFLs is one of the key parameters that has changed, as consumer demand for CFLs has increased due to the combined impacts of utility rebate programs, supply growth and price declines from large retailers such as WalMart, and greater public awareness of the impact of climate change and its relation to electricity production.

engendered substantial controversy throughout this proceeding. This can be largely attributed to the inherent difficulty in developing a robust number that quantifies the level of energy efficiency measure deployment that would have occurred in the absence of utility programs. Unlike many of the other parameters used in assessing program performance, which lend themselves to sampling methodologies and direct measurement, estimates of the net-to-gross ratio rely on surveys in which upstream and downstream program participants are asked to assess the impact of utility programs on their behavior or that of their customers. (D.08-12-059 at 20-21.)

Studies that evaluate NTG ratios ask customers deploying energy efficiency measures to recall whether their decision to adopt such measures, sometimes more than a year before, was directly attributable to utility programs. The fact that NTG ratios are difficult to measure, however, does not justify ignoring NTG effects in calculating savings used to determine incentive awards. The importance of NTG measurement in relation to incentives for performance should not be minimized merely because NTG measurement is not an exact science and is difficult to measure.

The IOUs argue that requiring *ex post* true-up of NTG ratios could skew program designs by unduly emphasizing utility performance instead of broader energy efficiency goals irrespective of utility attribution.

The IOUs note that the 2004/2005 Statewide Residential Retrofit Single-Family Energy Efficiency Rebate Evaluation (Itron Report), which provided NTG values for upstream lighting measures was published October 2, 2007. The Itron Report showed that NTG numbers for lighting were closer to 0.62, rather than the 0.80 assumed by IOUs. The IOUs argue that the NTG updates in the Energy Division Verification Report 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 programs, 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 that the October 2007 report allowed little time for adjustments to program delivery and implementation to take hold during the 2006-2008. They argue therefore, it is inappropriate to apply these NTG values to the entire 2006-2008 program cycle for purposes of awarding incentives.

We disagree that program administrators were unable to adapt programs during the 2006-2008 cycle as a result of the timing of the release of the Energy Division findings in October 2007. The preliminary results of the EM&V studies of the 2004-2005 programs were well-known to the IOUs throughout the 2006-2008 period, as there were numerous stakeholder meetings and discussions before the evaluation report was finalized in October of 2007. One of the reasons that the results of these studies were delayed was the continued opposition of the IOUs to the preliminary results. However, we note that the values specified by Energy Division for NTG in this final true-up differ significantly than those specified in October 2007, and were not available to the utilities until 2010, years after the utility programs were enacted.

The IOUs also criticize the reliance on self-reporting as a survey tool to estimate NTG ratios. As explained by Energy Division, however, the self reporting approach implemented in the evaluations to estimate NTG ratios is a widely-used and well-established means of measuring attribution and has in fact been implemented on numerous occasions by the IOUs. Energy Division's "Net to Gross Working Group" was convened early in the evaluation process to ensure consistency in survey methods and design and scoring algorithms.

Additionally, Energy Division technical advisors drafted NTG supporting documents that provide detailed explanation of the use of the self reporting approach in these evaluations and address questions of potential bias.

Thus, we find the NTG ratios estimated by the Energy Division to be the best available information at this time, while recognizing that measurement and evaluation of NTG is difficult and imprecise, and that utilities had little ability to ascertain what the final values of the NTG would be when implementing their programs. We find no reliable basis to accept the NTG ratio in the 2005 DEER as the sole basis for calculating the PEB for the true-up of incentives.

5.5.2. Effective Useful Life Estimates

The effective useful life (EUL) is an “estimate of the median number of years that the measures installed under the program are still in place and operable.”²⁸ The IOUs’ proposed scenario would exclude the EUL from the 2008 DEER update of energy savings measures, but instead use 2005 *ex ante* EUL values for calculating RRIM earnings for 2006-2008 performance. The IOUs propose not to update the EUL either for the final true-up.

The IOUs claim that the Energy Division report produces faulty results by calculating savings based upon updated estimates for EULs. The IOUs argue that because the updated EUL estimates were not released until late 2008, they had no opportunity to modify their 2006-2008 program design. The IOUs further claim that the updated EUL estimates were technically flawed and did not rely upon EM&V studies or best practices, but instead were based on new, un-vetted, and nontransparent engineering simulation models. The IOUs claim that the

²⁸ The California Evaluation Framework, TecMarket Works, June 2004 at 418.

EUL estimate for residential CFLs was modified based on insufficient sample sizes. The IOUs claim that Energy Division did not specifically study EULs in their 2006-08 evaluation, and thus cannot corroborate the DEER 2008 updates.

D.08-01-042 mandated updates to DEER parameters, including EULs, to limit the risk of overpayment of IOUs' interim claims. The Energy Division thus incorporated updates to EULs, accepted comments from parties and made adjustments as appropriate. Prior to the DEER update, the EUL for residential indoor CFLs failed to reflect usage patterns associated with those CFLs and led to shorter lamp life than the rated life.²⁹ After considering available studies and other evidence, the Energy Division adjusted the EUL for indoor residential CFLs to reflect usage patterns associated with indoor residential CFLs.

We find the Energy Division process in preparing EUL updates to conform to Commission protocols and to be reasonably justified for purposes of the earnings true-up. These estimates are superior to the 2005 DEER estimates supported by the IOUs and NRDC.

5.5.3. Upstream CFL In-Service Rates (ISR)

The IOUs argue that the Commission should apply the 2005 DEER *ex ante* ISR values for CFLs delivered upstream for purposes of measuring final performance-based RRM earnings. The IOUs argue that the utilization of an *ex ante* ISR value is appropriate as it resembles how the program was operated. Since CFLs are often sold (and rebated) in multi-packs, there may be instances where customers do not install all of the purchased CFLs right away, but

²⁹ See October 10, 2008 Energy Division EUL Comments and Response to posted at <http://www.energydataweb.com/cpuc/> at 2.

eventually install all of the purchased CFLs. Since utility programs incurred the CFL costs within the 2006-2008 program cycle, the IOUs believe it is appropriate to provide the PEB credit in the 2006-2008 true-up (consistent with where the program costs were incurred) and provide MPS credit in the year where those CFLs are eventually installed. Conversely, the IOUs believe they should receive MPS credit in 2006-2008 for those CFLs that were purchased as a result of the 2004-2005 program, but not installed until 2006. The IOUs claim this approach is consistent with the Commission's stated intent to use CFLs to fill the cumulative goal gap created from CFLs dying faster than the EUL assumption used to set the goals.

The Energy Division approach applies a first-year installation rate to upstream CFLs, giving the utilities no credit for bulbs *purchased* in 2006 or 2007, but *installed* in 2008. The IOUs complain that the Energy Division report thus ignores the effects of deferred installation of stored bulbs after the bulbs in place burned out. The IOUs claim that measures like CFLs need a dynamic model for installation rate determination to identify the full effects of the program. They argue that the Energy Division approach is not in conformance with EM&V best practices, and should not be used for incentive earnings purposes.

NRDC likewise recommends that the Commission "take a close look at the final upstream lighting evaluation report," and suggests that "there are significant issues with the evaluation of this program." (NRDC at 4.)

We conclude that the Energy Division ISR measurement methodology is consistent with Commission policy. However, we recognize that failing to account for savings from CFLs purchased in 2006-2007 but not installed until

2008 may understate the benefits obtained by ratepayers from the 2006-2008 programs.

PG&E also claims that the CFL residential ISRs modeled in the Upstream Lighting Program are unreasonably low. PG&E disagrees with the updating of the assumptions regarding the split between residential versus nonresidential usage of upstream CFLs. The Energy Division Report updated the assumed usage from 90% residential and 10% nonresidential to 94% residential and 6% nonresidential. This adjustment reduced the total assumed kW and KWh savings derived from upstream CFLs given the higher peak and total use intensity for nonresidential CFLs. PG&E claims that more research is needed as a basis to ascertain a more reliable split between residential and nonresidential CFLs.

As previously discussed in D.09-12-045, we can not validate the claim of 90%/10% installation split assumption for upstream CFLs sold, for the following reasons:³⁰

- a. There are likely to be significant differences between the 1994 programs, lighting products, and purchasing patterns compared to 2006-2008.
- b. The extent to which the 1994 consumer mail-in survey data contains possible self-selection bias is not known.
- c. Whether or not the 1994 consumer mail-in survey data were drawn from a random and representative sample of customers cannot be ascertained.

³⁰ See Second Verification Report at 72-73.

- d. Customer survey data collected between 2004 and 2007 as part of the upstream lighting program evaluations suggest that the proportion of commercial customer purchases is likely to be between 3% and 7%.
- e. Preliminary data from 2006-2007 in-store intercept surveys suggest that the volume of CFLs purchased by nonresidential customers from retail channels is about 2%, but the data do not appear representative and conclusive at this time.
- f. Surveys of recipients of CFLs given away at the events organized by IOUs in 2006-2007 show that 1-2% of CFLs given away are installed in nonresidential premises.³¹
- g. The number of commercial building sockets which can receive CFLs (data available from the Commercial End Use Survey database) combined with the fraction of likely upstream commercial purchasers (in D above) does not appear to support more than 2-5% of the 2006-2007 upstream CFLs volume (>50,000,000 bulbs) being installed in non-residential buildings.

According to the Energy Division report, the relevant data sources strongly suggest that nonresidential installations of CFLs sold through upstream programs are less than 10%. We rely upon the Evaluation Report's assumed split between residential and commercial CFL usage rather than the 90/10 split which is based on a 1994 mail-in survey of customers. The 90/10 split assumed by utilities has not been justified given: (1) the potentially significant differences between programs, lighting products and purchasing patterns in 1994 as compared to 2006-2007; and (2) more recent customer survey data indicating that

³¹ See Appendix A5.

the percentage of nonresidential CFL purchases, and information about the number of commercial sockets available for CFL installation.³² The more recent information reviewed by Energy Division regarding the likely distribution of CFLs between the residential and nonresidential sector is more reliable than a 15-year-old study that supports a 90/10 assumption. However, we recognize that some uncertainty exists regarding the accuracy and precision of this new estimate.

5.5.4. Treatment of 2004-2005 Cumulative Goals

The Energy Division Scenario Analysis Report calculates incentive earnings based on cumulative goals starting from 2004, compared with alternative impacts from excluding cumulative 2004-2005 goals. The direction provided in D.07-09-043, Ordering Paragraph 4(b) called for interim incentive claims to be evaluated on a “cumulative-to-date” basis. As further explained in D.07-10-037:

For any given year, cumulative savings represents the savings in that year from all previous measure installations (and reflecting any persistence decay that has occurred since the measures were installed) plus the first-year savings of the measures installed in that program year. (D.07-10-037 at 77.)

Our rules on cumulative savings goals were first developed in D.04-09-060 to ensure the IOUs focus on long-term savings, as opposed to those with short-term payback and short expected useful lives. We elaborated on this principle in D.07-10-037, which stated:

³² CPUC Energy Efficiency 2006-2007 Final Verification Report at 58-59.

Under the risk/reward mechanism's MPS, the utilities are further motivated to avoid excessive reliance on short-lived measures. Therefore, it does not work to the utilities' advantage to focus exclusively on measures with short lives (or low persistence of savings over time) because doing so creates the savings shortfall illustrated above, making it harder to meet the MPS. For example, if an energy efficient light with an expected life of five years was installed in 2004, it will remain in service producing savings throughout 2006-2008, after which it will reach the end of its life and need to be replaced with like-savings in 2009. (D.07-10-037 at 77.)

The IOUs, however, take issue with the inclusion of 2004-2005 data in measuring cumulative goals in deriving incentive earnings for the 2006-2008 cycle. In D.09-05-037, the Commission found that 2004-2005 data is not directly reconcilable with 2006-2008 evaluation results. Consequently, cumulative savings for purposes of the prospective program cycle were defined to exclude the 2004-2005 data. (D.09-05-037 at 57.)

The Commission likewise concluded in D.09-12-045 that "[f]or the purposes of measuring interim incentive earnings for the 2006-2008 cycle, we agree that it is appropriate to exclude the effects of cumulative goals starting from 2004, as reflected in the Verification Report." (D.09-12-045 at 66.) The IOUs argue that the same principle of excluding the cumulative effects of the 2004-2005 program cycle should apply for determining incentive earnings in the final 2006-2008 true-up.

As explained in D.09-05-037, although we excluded 2004-2005 data in the calculation of cumulative savings for the 2010-2012 cycle, we did not reverse our policy of comparing results against cumulative goals. As stated in D.09-05-037, cumulative savings are a critical element of our overall strategy to create long-term, lasting savings through ratepayer investments. Without the cumulative

savings goals, we cannot ensure that energy efficiency programs will produce benefits comparable to investments in power plants.

Although we excluded 2004-2005 data in measuring cumulative goals for the 2010-2012 cycle, we did not decide how 2004-2005 data should be treated in defining the cumulative savings for the final 2006-2008 true-up. The treatment of 2004-2005 data for the 2006-2008 true-up likewise does not set any precedent as to the treatment of cumulative goals on a prospective basis as previously addressed in D.09-05-037.

For purposes of RRIM earnings formula, the recognition of 2004-2005 data in cumulative goal measurement has an effect on the MPS, which determines the applicable shared savings rate, or whether earnings penalties apply. If the MPS drops to 65% or less, a penalty applies.

In contrast to this anomaly, a more stable measure of RRIM earnings results by measuring cumulative savings with at least some recognition of 2004-2005 data. For example, even if we define cumulative goals to include as little as 10% of the effects of 2004-2005 goals and savings, the MPS for SDG&E increases to 66%, which is outside the penalty zone. Inclusion of more than 10% of 2004-2005 goals and savings in calculating cumulative results would further increase the MPS for SDG&E. The effects for SDG&E of including differing percentages of 2004-2005 therm goals and savings are illustrated below:

| Percent of 2004-2005 Goal and Savings data included | 0% | 1% | 5% | 10% | 15% | 20% | 25% | 30% | 35% | 40% | 45% | 50% |
|---|-----|-----|-----|------|-----|-----|-----|-----|-----|-----|-----|-----|
| SDGE Therm MPS | 62% | 63% | 64% | 66% | 67% | 68% | 70% | 71% | 72% | 73% | 74% | 75% |
| MMTherm Goal | 7.1 | 7.2 | 7.3 | 7.49 | 7.7 | 7.8 | 8.0 | 8.2 | 8.4 | 8.6 | 8.7 | 8.9 |
| MMTherm Savings | 4.4 | 4.5 | 4.7 | 4.9 | 5.1 | 5.4 | 5.6 | 5.8 | 6.0 | 6.3 | 6.5 | 6.7 |

Even though the 2004-2005 data is not directly comparable to 2006-2008 data, including some recognition of 2004-2005 data in measuring cumulative goals is not unreasonable. To the extent the RRIM earnings calculation does not change over a range of MPS values, however, it is not necessary to identify an exact amount of 2004-2005 data to recognize in the calculation of cumulative goals. We note that including differing levels of 2004-2005 data may impact the PEB calculations and resulting incentive payments and that the record does not indicate a “correct” level of 2004-2005 data to incorporate for purposes of the final true-up.

5.5.5. Savings From Codes and Standards (C&S) Advocacy Programs

The IOUs argue that the Commission’s policy rules for energy efficiency state that 100% of verified savings from pre-2006 C&S Advocacy Programs shall count towards the energy savings goals, minimum performance standards and performance earnings basis for the 2006-2008 and 2009-2011 program cycles.

The ERT assumptions utilized by the Energy Division, however, did not reflect any net benefits associated with any C&S activity initiated within the 2006-2008 program cycle.

In D.09-12-045, the Commission accepted the non-inclusion of such C&S benefits for interim claims because information was not yet available for incorporation into the savings calculations. The Commission thus concluded that “since the requisite data will be incorporated for purposes of the 2010 true-up, the utilities will be made whole for the effects of any updated data that may change the incentive earnings amount.” (D.09-12-045 at 64-65.)

The IOUs claim that omission of this information in the Energy Division’s calculations systematically undercounts the benefits associated with the utility

2006-2008 programs. In accordance with the Commission's directive, the IOUs argue that the savings used to compute RRIM earnings should include 100% of the efficiency savings and net benefits from the aforementioned C&S.

In D.10-04-029, the Commission determined that it is appropriate to count 100% of these savings toward achievement of the 2010-2012 cumulative goals. This determination was based on the finding that: "...better technical data about savings is now available as compared to when the original 50% determination was made in D.05-09-043, including Evaluation Protocols and elimination of concerns about double-counting and base case forecasts." (D.10-04-029 at 46.) While D.10-04-029 was issued in the context of the 2010-2012 program cycle, the rationale expressed therein supports counting 100% of all C&S savings toward 2006-2008 goals as well. This is especially true since the 2006-2008 savings will likely be used to measure progress towards the 2010-2012 cumulative savings goals. Inclusion of 100% of the savings is consistent with our statement in D.09-12-045 that the IOUs would be made whole in the true-up for recognition of all C&S savings.

5.5.6. Assumptions Regarding Avoided Costs and GHG Reductions

The calculation of net cost savings from energy efficiency measures includes recognition of the reduction in GHG emissions. The Energy Division report included recognition of the avoided cost benefits due to GHG reductions at the rate of \$12 per ton averaged over time.

The IOUs propose instead that the avoided cost benefits for GHG reductions should be valued at \$30 per ton. In the EM&V Decision, the Commission directed Energy Division to update the avoided cost GHG adder to \$30 per ton. The updated avoided costs that were approved by the Commission

were based on the 2008 Market Price Referent (MPR). The IOUs argue that since the 2008 MPR represented the best available information on GHG prices as of 2008, the \$30 per ton figure should be used to evaluate the benefits associated with the utilities' 2006-2008 energy efficiency portfolios. The IOUs believe this update would represent the most appropriate estimation of program benefits and should be utilized for RRIM earnings purposes.

DRA points out, however, that D.10-04-029, which authorized the GHG value of \$30 per ton of CO₂, was issued April 8, 2010, more than a year after the 2006-2008 program cycle ended. Since the updated GHG number was intended to apply to the EM&V process for 2010-2012 energy efficiency portfolios, DRA argues that the updated value is not applicable to the measurement of 2006-2008 program results.

DRA calculates that the total GHG Adder amounts to \$32,008,464 for the four IOUs. DRA argues that there is no evidence that the Commission intended to reward the IOUs with such an unreasonably large amount of incentive dollars based solely on the revaluation of the GHG Adder. DRA notes that the change to a \$30 per ton value did not add a single GWH, MW or MMTh in savings to the energy efficiency results of the IOUs. DRA finds it inconsistent that the IOUs oppose updates for NTG, EUL, and support the use of *ex ante* interactive effects and *ex ante* installation rates for CFLs delivered via upstream channels, yet want to use an updated GHG value that does not apply to the 2006-2008 program cycle.

However, the opposite is also true, it appears inconsistent to support updating factors such as NTG and EUL, while ignoring updates to other factors such as the value of GHG reductions. While DRA is correct that the change to \$30/ton does not increase the amount of GWH, MW or MMTh saved, it does

affect the value of those savings, and thus, potentially the amount to be shared with utilities via incentives.

We also note that reductions in GWH consumed by customers reduce the amount of renewable generation that utilities are required to procure under California's renewable procurement standards. Between 20% and 33% of utility sales must be from renewable resources. Thus, the energy reductions from efficiency programs offset not just combined cycle generation (as reflected in the MPR prices) but also more expensive renewable generation. Updates to the avoided costs used to measure the value of energy efficiency savings do not reflect this potential additional benefit and thus may underestimate the value of the energy efficiency savings, and the appropriate level of incentive payments.

5.5.7. Treatment of Interactive Effects

Historically, the energy savings profile of a given efficiency measure has been considered in isolation. The impact of installing a single CFL, for instance, is estimated as the difference in its own energy consumption and that of the incandescent bulb it is assumed to replace. However, in some cases, measures have systems impacts, or "interactive effects," which are not captured by baseline comparisons along a single parameter. Some energy efficiency measures, for example, produce less heat than the measure they replace. Depending on factors, including where they are installed, certain energy efficiency measures may increase the need for heating or decrease the need for air conditioning.

The Energy Division reviewed available studies and produced scenario calculations to incorporate interactive effects for both residential and commercial measures for a number of lighting and appliance measures, resulting in negative therm impacts and positive kWh demand impacts for select measures. The data

underlying the Commission's currently adopted goals, however, do not reflect these assumptions regarding interactive effects. For comparison, the Scenario Analysis Report also showed the savings impacts assuming exclusion of all interactive effects.

In D.09-05-037, we affirmed that interactive effects affect net energy savings and are thus appropriate for incorporation into the DEER update, stating that:

It is of paramount importance to maintain the analytical rigor of our methodologies to count savings. Compromising the technical integrity of our counting methodologies is tantamount to compromising the reliability of energy efficiency as a resource. Given the priority energy efficiency holds in our loading order, we are duly committed to reflecting our best knowledge regarding savings in DEER. (D.09-05-037 at 21.)

We also recognized, however, how interactive effects can have a significant effect on assumed savings achievement, particularly for the dual-fuel utilities, PG&E and SDG&E. In D.09-05-037, we determined the adjustment that was appropriate to reduce 2009-2011 therm goals to recognize the applicable interactive effects, but we did not separately address in that proceeding how the utilities' therm goals for the 2006-2008 cycle should be adjusted for interactive effects. Because interactive effects, particularly those experienced by dual-fuel gas and electric utilities, had not been considered in previously adopted energy efficiency goals, we found it reasonable in D.09-05-037 to make adjustments to SDG&E and PG&E's goals for therm savings for purposes of their 2009-2011 gross savings goals. Drawing from the Energy Division Verification Report's analysis of 2006-2007 data, we thereby reduced the adopted 2009-2011 therm savings goals for PG&E by 26% and for SDG&E by 22%.

We concluded in D.09-12-045 that the issue of whether to apply the full 26% reduction to PG&E's 2006-2008 therm goals for purposes of computing 2006-2008 RRIM earnings would be addressed in this true-up. Consistent with the reduction in 2009-2011 therm goals, as adopted in D.09-05-037, it is reasonable to make a reduction in 2006-2008 goals to recognize interactive effects that were not reflected in the originally adopted goals. Accordingly, for purposes of evaluating the IOUs' achievements, we adjust the goals for therm savings by 38% for PG&E and 35% for SDG&E to recognize interactive effects not originally reflected in adopted goals.³³

6. Conclusion

The Commission is faced with widely varying proposals for the final true up incentive payments. Scenarios prepared by Energy Division show potential incentive payments ranging from the Commission imposed maximum of \$450 million for all utilities combined, to negative amounts reflecting penalties for some utilities. Similarly, parties proposals for final incentive payments, and for the assumptions and methodologies underlying those payments, differ significantly. While we conclude that relying solely on old ex ante assumptions to evaluate program performance is inappropriate, we also recognize that the ex post assumptions presented by Energy Division, while the best available information, have inherent uncertainty and imprecision. Many factors such as NTG ratios are difficult to measure and require application of judgement, as does determination of the split between residential and non-residential installation of CFLs. While the calculation of incentives was originally assumed

³³ The calculation of 38% and 25% goal reductions reflect the updated data calculations

Footnote continued on next page

to be ministerial, it has instead turned out to be extremely contentious, and requires much more discretion and interpretation by the Commission than originally intended.

Not only are there disagreements regarding the ex post estimates provided by Energy Division, there are also a number of process modifications that have been presented for Commission consideration that also could impact the results of the incentive calculations. These considerations are not ministerial nor are they solely in relation to determining actual, measurable energy efficiency savings. Instead, they raise issues such as the appropriate level of 2004-2005 data to include; whether or not to update GHG and avoided cost values; whether Energy Division's change to a High Impact Measure approach is appropriate, whether or not to include interactive effects not considered in the original incentive mechanism, whether to include savings from CFLs purchased in 2006-2007 but not installed till later and what level of savings from Codes and Standards are appropriate to include in the calculations.

All of these raise a concern regarding the reasonableness of using an incentive mechanism whose results can change dramatically due to relatively small changes in any of the above mentioned assumptions or processes. We conclude that we cannot simply blindly apply the approved mechanism without taking into consideration the uncertainty of the assumptions and the impact of potential changes to the process. What the record shows is that there is not a demonstrated single correct answer for the amount of incentives to be paid to the utilities. Given these concerns, it is reasonable to use the holdover amounts

in the Energy Division Report, Table 26.

specified in D.09-12-045 for the final true-up rather than making significant changes based on uncertain information. This also best meets our goal of providing utility investors and managers with an expectation of profits for pursuing energy efficiency as opposed to generation alternatives, which is the very reason why an incentive mechanism was first adopted by the Commission.

7. Assignment of Proceeding

John A. Bohn is the assigned Commissioner, and Thomas R. Pulsifer is the assigned ALJ for this proceeding.

8. Comments on Proposed Decision

The alternate proposed decision of Commissioner Bohn (Alternate Decision) in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on _____ and reply comments were filed on _____.

Findings of Fact

1. In D.07-09-043, the Commission adopted the RRIM to encourage achievement of Commission-adopted energy efficiency goals, and to extend California's commitment to making energy efficiency the highest energy resource priority.

2. The RRIM was designed to rely upon independent evaluation of energy savings by the Energy Division Reports which were to serve as the basis for interim and final incentive payments, as warranted.

3. The process established for utilities to qualify for incentive earnings to meet and exceed Commission-adopted energy efficiency savings goals has proven to be quite controversial, both because of disputes about methodologies used in calculating energy efficiency savings accomplishments and the

sensitivity of incentive earnings to differences in the savings calculation methodologies.

4. The IOUs have already been awarded two interim incentive payments for the 2006-2008 cycle, totaling \$143.7 million.

5. Outstanding disputes as to the final true-up amount of incentive payments relate to assumptions regarding (a) the total net cost savings subject to incentive earnings, and (b) the applicable percentage share of the net savings to be assigned as incentive earnings.

6. Although challenges have been raised regarding the transparency of the process for review and verification of data underlying the Energy Division evaluation of energy efficiency savings accomplishments, the Energy Division has followed Commission-established protocols for the vetting of the evaluated findings.

7. While the details of various measures used to estimate *ex post* parameters of savings measures may be subject to differences of professional judgment, no party has demonstrated that the overall evaluation produced by Energy Division should be disregarded.

8. The calculation of the 2006-2008 earnings true-up amounts vary significantly depending upon whether assumed energy savings are derived using unmodified *ex ante* values, versus updated *ex post* measures for key parameters.

9. The estimating processes used by Energy Division to derive the *ex post* update of relevant parameters requires professional judgment.

10. The use of unmodified *ex ante* parameters drawn from the 2005 DEER for purposes of deriving savings achievements subject to the 2006-2008 incentive

earnings true-up produces inaccurate measures of savings and incentives to the extent that more accurate updates are ignored.

11. The IOUs were not constrained from making adjustments in the administration of programs throughout the 2006-2008 cycle as a result of the timing of the Energy Division's finalization of updated NTG ratios.

12. While the Energy Division's *ex post* updates can be useful in planning the design of future energy efficiency portfolios, the timing of the publication of Energy Division updates did not constrain utility management from making appropriate adjustments in program priorities or funding throughout the 2006-2008 cycle.

13. Under the adopted RRIM formula, each IOU is eligible for a shared savings percentage that varies depending on the degree of success in achieving energy efficiency savings in relation to a "minimum performance standard."

14. Based solely on the use of the Energy Division *ex post* evaluated energy efficiency savings results for the 2006-2008 cycle, the resulting amounts of incentive earnings are zero or negative.

15. Based on the use of the 2005 DEER values for designated parameters as set forth in the IOUs' proposed scenario, and applying a 12% sharing rate, the resulting calculation of incentive earnings total \$256 million, which would represent \$112.3 million in additional true-up payments.

16. Consistent with D.09-12-045, a shared savings rate of 12% is appropriate based on an apples to apples comparison of results and goals.

17. Although in D.09-05-037 the Commission found that 2004-2005 data is not directly reconcilable with 2006-2008 results, it is still reasonable to include some amount of 2004-2005 cumulative savings for purposes of the earnings true-up, consistent with the Commission's policy of measuring cumulative goals.

18. Because interactive effects experienced by dual-fuel gas and electric utilities were not considered in previously adopted energy efficiency goals, in D.09-05-037, the Commission adjusted SDG&E and PG&E's goals for therm savings for purposes of 2009-2011 gross savings goals. A corresponding adjustment to 2006-2008 therm goals provides a consistent treatment for purposes of the true-up.

19. In D.10-04-029, the Commission determined that it is appropriate to count 100% of these savings toward achievement of the 2010-2012 cumulative goals. This determination was based on the finding that better technical data about savings is now available as compared to when the original 50% determination was made in D.05-09-043. That same determination supports the recognition of 100% of C&S advocacy savings for deriving the MPS for the 2006-2008 true-up.

20. The payment of incentive earnings constitutes a cost to ratepayers that reduces the overall cost-effectiveness of energy efficiency programs.

21. Any additional incentive payments would reduce the 2006-2008 programs' cost-effectiveness, reducing the overall statewide benefit-to-cost ratio to only 1.03, based upon Energy Division evaluated results.

22. The incentive earnings specified in D.09-12-045 provide a reasonable basis to determine whether any of the IOUs are due additional incentive payments for the 2006-2008 cycle, or whether penalties are owed.

Conclusions of Law

1. The final true-up of incentive earnings for the 2006-2008 cycle should be evaluated based upon consideration of the results of Energy Division's final evaluation, measurement and verification report, concerns regarding the report, underlying uncertainties, proposed and approved changes to the incentive calculation process and Commission policies.

2. Adopted Commission policy calls for finalizing the true-up of 2006-2008 incentive earnings based upon consideration of *ex post* updates of relevant parameter measures as evaluated by the Energy Division and its consultants.

3. The reliance solely on the *ex ante* assumptions for finalizing the calculation of net energy savings subject to the incentive calculation would not be consistent with express Commission policies that call for *ex post* updates to be applied in the true-up of incentive savings.

4. Ratepayers are only required to share net benefits with shareholders through the incentive mechanism to the extent that those net benefits actually materialize.

5. Parties have been provided a fair opportunity to participate in the public review of the Energy Division Evaluation Report.

6. Based on a reasonable approximation of IOU savings accomplishments for the 2006-2008 cycle, consideration of the uncertainties in the approximations and consideration of Commission goals and policies, the IOUs are eligible for additional incentive payments for the 2006-2008 equal to the hold back amounts specified in Decision 09-12-045.

7. The incentive earnings specified herein balance the goals of fostering energy efficiency achievements while protecting ratepayers from paying for incentives that have not been earned.

8. The 2006-2008 RRIM true-up should be finalized in accordance with the ordering paragraphs as adopted below.

O R D E R

IT IS ORDERED that:

1. The true-up of Risk/Reward Incentive Mechanism Savings for the 2006-2008 program cycle is hereby concluded. The previously awarded interim incentive earnings awarded in Decision (D.) 08-12-059 and D.09-12-045 including the holdover amounts specified therein constitute the final and complete resolution of payments due Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Edison Company, and Southern California Gas Company for the 2006-2008 cycle.

2. The Commission shall separately address in a subsequent decision in this proceeding whether, or subject to what conditions incentive payments and/or penalties may be due for 2009, 2010, or for future years.

3. This proceeding shall remain open for consideration of issues relating to prospective modifications to the Risk/Reward Incentive Mechanism.

This order is effective today.

Dated _____, at San Francisco, California.