STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

June 1, 2006

Advice Letter 2704-G/2786-E
Advice Letter 2704-G-A/2786-E-A

Mr. Brian Cherry
Director, Regulatory Relations
Pacific Gas and Electric Company
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, CA 94177

Subject: 2006-2008 Energy Efficiency Compliance Filing

Dear Mr. Cherry:

Advice Letter 2704-G/2786-E, including supplemental Advice Letter 2704-G-A/2786-E-A, is effective May 17, 2006. Enclosed for your records is a copy of Energy Division's disposition of the advice letter.

Sincerely,

S V Gallagher

Sean H. Gallagher, Director
Energy Division

Enclosure

235694

June 1, 2006

ENERGY DIVISION DISPOSITION OF PG&E'S AL 2704-G/2786-E AND AL 2704-G-A/2786-E-A

SUMMARY

In accordance with Rule 4.7 in Decision (D.) 05-01-032, dated January 13, 2005, Energy Division staff (Staff) prepares this Disposition approving Advice Letter 2704-G/2786-E and supplement Advice Letter 2704-G-A/2786-E-A, effective May 17, 2006 as requested.

Pacific Gas & Electric Company (PG&E) filed Advice Letter (AL) 2704-G/2786-E on February 17, 2006, and supplemental Advice Letter 2704-G-A/2786-E-A on April 17, 2006, in compliance with Commission (D.)05-09-043. Together, these comprise PG&E's compliance filing associated with its 2006-2008 energy efficiency program plans.

No parties protested PG&E's Advice Letter compliance filing. However, several parties filed comments and a response.[1] The comments urged the Commission to consider approval of California Preschool Energy Efficiency (CPEEP) proposal submitted by the Low Income Investment Fund (LIIF). While the response focused primarily on issues relating to the delays in contracting and implementing partnership programs. Staff believes that PG&E followed the criteria approved by the Commission in selecting competitively bid 3rd party programs. If LIIF wants to pursue submitting proposals in the PG&E territory, it can participate in future solicitations that will be conducted by PG&E. With regards to the partnership-related issues raised by the City of San Jose and TURN/DRA, Staff believes that these are legitimate and important issues that Staff recommends the Commission to address in Rulemaking (R.)06-04-010.

Staff suspended PG&E's Advice Letter 2704-G/2786-E on March 17, 2006, in order to give PG&E time to respond to comments and time for staff to consider responses and other issues. Staff reviewed the comments and response, PG&E's response to the issues raised in the comments and response, and information requested via data requests to PG&E. Staff is sufficiently satisfied with PG&E's responses to the comments and response to approve this advice letter including the supplement, thereby allowing the roll out of PG&E's 2006-2008 portfolio of energy efficiency programs.

Staff also identified two issues in the Advice Letter compliance filing that required clarification from PG&E: benefits-costs calculations and impact on bills. In general, Staff is satisfied with PG&E's clarifications. There remains, however, a difference between Staff's and PG&E's interpretation on the cost inputs to the Total Resource Cost (TRC) cost-effectiveness test in using the formula in the Standard Practice Manual (SPM). PG&E demonstrated to Staff that, under both interpretations of the TRC cost-effectiveness calculations, its 2006-2008 energy efficiency program portfolio is still cost effective.

PG&E has satisfied the requirements of D.05-09-043; therefore, the suspension of PG&E's AL 2704-G/2786-E is removed without prejudice. PG&E's Compliance Filing Advice Letter 2704-G/2786-E and supplemental Advice Letter 2704-G-A/2786-E-A are approved effective May 17, 2006, as PG&E requested.

BACKGROUND

PG&E filed advice letter compliance filing for its 2006-2008 energy efficiency program portfolio per D.05-09-043. Additionally, PG&E filed a Motion to bifurcate its compliance filing since it was still negotiating with its local government and statewide partnerships. The Administrative Law Judge granted the Motion on March 7, 2006 and ruled that PG&E serve and file the supplement compliance filing that focuses on partnership programs.

In D.05-09-043, the Commission adopted the energy efficiency portfolio and program funding levels for program cycle 2006-2008 for PG&E and other investor-owned utilities.[2] In that decision, the Commission authorized –on an interim basis– the utilities to begin

1 Per D.05-01-032, a response differs from a protest in that a response unconditionally supports the relief requested in the advice letter, and may provide useful information regarding the advice letter.

2 Namely: Southern California Edison Company, San Diego Gas and Electric Company and Southern California Gas Company.

implementing their non-competitive bid programs, effective January 1, 2006. This interim authorization remained in effect until the Commission approves the final program plans to be submitted during the compliance phase after the competitive bid solicitation process for third party programs is completed.[3]

In D.05-09-043, the Commission contemplated that the utility compliance filings would describe the competitive solicitation process and results for those components of the portfolio plans put out to bid, as well as the final integrated portfolio including utility-implemented programs, third-party programs (continuing and new) and the local government and statewide partnerships (partnership programs).

In February 2006, PG&E has not yet finalized its negotiations with the local government and statewide partnerships. As a result of the continuing negotiations, PG&E filed on February 17, 2006 a Motion and an Advice Letter. The Advice letter focused mainly on PG&E's competitively bid third-party programs, and the Motion sought an expedited Administrative Law Judge Ruling to bifurcate its 2006-2008 Energy Efficiency Portfolio Compliance Filing Ordered in D.05-09-043. The Administrative Law Judge granted the motion on March 7, 2007 and ruled that PG&E file and serve the supplemental compliance filing that focuses on partnership programs.[4]

Consistent with the requirements of Decisions 05-01-055[5] and 05-09-053, and the Administrative Law Judge Ruling dated March 7, 2006, PG&E filed a bifurcated compliance filing and submitted Advice Letter (AL) 2704-G/2786-E on February 17, 2006 and Advice Letter 2704-G-A/2786-E-A on April 17, 2006.[6]

The Commission described in D.05-09-043 (Ordering Paragraph 7) the requirements for the 2006-2008 energy efficiency portfolio compliance filing to be filed by utilities.

According to Ordering Paragraph 7 of D.05-09-043, the utilities' compliance filing shall include:

(a) The results of the competitive bid solicitations and the final program plans.

(b) Calculations of portfolio cost-effectiveness based on the final program plans, including scenario analysis around key input assumptions as directed by this decision.

(c) Projections of energy savings and demand reductions that will be achieved by the final portfolio plans, including the scenario analysis directed by this decision.

(d) Additional program detail to reflect the statewide coordination plans, and a report on the status of the statewide coordination efforts described in this decision. These efforts shall be guided by the following policy goals:

    (i) Ensure that all firms with a footprint or facilities in multiple service areas should have easy and consistent access to all statewide programs;

    (ii) Develop consistent rebate levels and participant rules for products promoted in statewide programs for use in negotiating with manufacturers and suppliers;

    (iii) Leverage private advertising dollars for more savings impact;

    (iv) Reinforce energy efficiency investments with positive statewide message; and

    (v) Protect the utilities' abilities to reduce the competition among utility service territories or among programs within the same service territory

---

3 The non-competitive bid programs comprise of approximately 80% of the portfolio while the third-party programs subject to bid comprise approximately 20% of the portfolio.

4 In a telephonic conversation with the Administrative Law Judge, PG&E received permission to file the supplement on April 17, 2006, instead of April 14, to include the Peer Review Group report and PG&E's response thereto.

5 In Decision 05-01-055, the Commission adopted the administrative structure for energy efficiency programs for post-2005 and returned to the utilities the functions of selecting the activities and implementers for the portfolio of energy efficiency programs. In Ordering Paragraph 9 of this decision, the Commission also ordered that utilities submit compliance filings for Commission approval of final programs and make public all winning bids.

6 Per Decision 05-09-043, the compliance filing may be submitted as an advice letter filing if the Peer Review Group and utility are in agreement on final program plans and bid selection.

(e) Estimates of the overall bill impacts expected from the portfolios, working with PRG members to develop a consistent estimating methodology across utilities.

(f) The assessments of the utilities' Peer Review Groups (PRGs)"

The discussion below addresses PG&E's compliance with the above requirements.

NOTICE

Notice of AL 2704-G/2786-E and AL 2704-G-A/2786-E-A was made by publication in the Commission's Daily Calendar. PG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

COMMENTS/RESPONSES

There were no protests on the compliance filing of PG&E (AL 2704-G/2786-E and supplemental AL 2704-G-A/2786-E-A). However, several parties submitted comments and letters on AL 2704-G/2786-E, and a response on supplemental AL 2704-G-A/2786-E-A was received.

The following parties filed comments on AL 2704-G/2786-E: the California Head Start Association on March 6, 2006, Alameda County Child Care Planning Council on March 9, 2006, and the City of San Jose on March 9, 2006.

The California Head Start Association[7] urged that PG&E fund the California Preschool Energy Efficiency Program (CPEEP) proposal submitted by the Low Income Investment Fund (LIIF) for the 2006-2008 program cycle. It stated that CPEEP has been approved by SCE and SDG&E in their service territories and that there are economies of scale in implementing the program statewide. The Alameda County Child Care Planning Council asked the Commission to direct PG&E to reconsider its decision to provide support to the CPEEP proposal.

Although LIIF did not submit comments or protests, it sent on February 26, 2006 letters of support for its CPEEP from Mark Leno, Assemblyman, 13th District, and Aaron Peskin, President of the San Francisco Board of Supervisors.

PG&E responded to the comments of Alameda County Child Care Planning Council and letters of support on March 16, 2006 and March 7, 2006, respectively. PG&E did not respond to the comments of the California Head Start Association. **In its response, PG&E stated that it fairly evaluated the CPEEP proposal in accordance with the Commission-approved bid evaluation criteria and that PG&E's proposal selection process was reviewed by its independent Peer Review Group.** Further, PG&E explained that Alameda County did not provide any basis to change the outcome of PG&E's third-party selection process. PG&E also stated that its selection criteria approved by the Commission differed from the selection criteria approved for SCE and SDG&E, that both selected CPEEP proposal. PG&E explained that CPEEP was not selected because other competing proposals were a better fit to optimize the energy savings targeted in PG&E's service territory. PG&E clarified that it will be issuing additional solicitation in the 2nd quarter of 2006 and has offered each bidder the opportunity to discuss, in private, how it can improve its bid for subsequent PG&E solicitations.

In its comments, the City of San Jose detailed its concerns and experience of the City of San Jose's Silicon Valley Energy Program (SVEP) in the development of PG&E's local government partnership programs. It is important to note that the advice letter filed by PG&E on February 17, 2006 was mainly focused on third-party programs although it contained placeholder budget information on partnerships. The City of San Jose pointed out the following concerns:
(1) Lack of PG&E programs' integration within the overall portfolio – the City of San Jose stated that PG&E failed to address the integration and coordination issues between the statewide activities, 3rd party offerings and partnerships in a timely manner.
(2) Consistent unresponsiveness of PG&E to local government partnership concerns – the City stated that it presented to PG&E the concept of clearly established geographical territories to prevent confusion and to address the perceived duplication of services between Silicon Valley Energy Program (SVEP) direct install services and those of continuing 3rd party programs. In reviewing the 3rd party programs filed by PG&E on February 17, 2006, the City noted that the issue of overlap/duplication has not been addressed by PG&E.
(3) Lack of clear process for development of programs, and
(4) Unilateral decision-making on behalf of PG&E for local government program design and budgets – the City stated that it based its SVEP on PG&E's proposed $20 million budget. Without input from the City –as to program design, proposed measures, geographic territory, oversight of contracts, quality control, and processing or marketing initiatives—PG&E reduced the budget to $6.6 million.

[7] Filed on behalf of 4,000 state licensed early care and early education centers in PG&E's service area.

In its March 16, 2006 response to the comments of the City of San Jose relating to PG&E's partnership development process, PG&E explained that the City of San Jose misunderstood the timeline for third-party and partnership contract development. PG&E explained that it could not provide the City of San Jose information on third-party programs until after completion of the competitive bid process and after announcement of those selections. Further, PG&E believed that it had worked diligently with the City of San Jose since April 2005 to define the partnership program elements, measure, budgets and goals. PG&E explained that it provided San Jose with specially designated maps to assist in identifying the city's customers and geographic areas to be targeted for direct installations, E3 calculator and access to E3 calculator's consultants, and weekly meetings to update the city on the development of third-party program issues. PG&E, however, acknowledged that it made some unilateral decisions in setting the initial budgets/cost-effectiveness targets and revising the partnership portfolio budget in response to the portfolio integration process. PG&E explained that it made these decisions in its role as the portfolio administrator responsible for the overall success of its energy efficiency portfolio.

PG&E added that it recognized the difficulties experienced in the partnership development process and that the lessons PG&E learned from that experience is now allowing PG&E and the City of San Jose to progress in the negotiations.

On May 8, 2006, The Utility Reform Network (TURN) and Division of Ratepayer Advocates (DRA) filed a joint response to PG&E's supplemental AL 2704-G-A/2786-G-A. According to TURN and DRA, they are recommending the following to ensure that PG&E's ratepayers receive the greatest value for their investment in energy efficiency during the 2006-2008 program cycle:

(1) Submittal of a report by PG&E documenting the start date, ramp-up and full-level operation for all partnerships and third-party programs once all programs have commenced. TURN and DRA stated that they are not confident when PG&E's partnership programs will start delivering energy savings. In its initial compliance filing (AL 2704-G/2786-E filed on February 17, 2006) and in its April 25, 2006 partnership workshop, PG&E indicated different completion dates for approving contracts. Furthermore, PG&E appears to not have considered the potential delays associated with the differences in government contracting processes, and TURN and DRA understand that the implementation of PG&E's competitively bid 3rd party programs depend upon the completion of contracts, which have unannounced start dates. Since the Commission cannot know when these programs will start, TURN and DRA recommend that the Commission require PG&E to keep it informed of PG&E's implementation progress on its 3rd party and partnership programs.

In its response, PG&E explained that statewide and local government partnerships have made significant progress in the last months. Although the process is not yet completed, PG&E continues to work with each partnership and with the new 3rd parties to ensure that its total portfolio meet the energy savings targets set by the Commission**. Since the Commission is currently requiring monthly and quarterly progress reports on achieving the energy goals, PG&E believes that additional reporting is unnecessary and merely increases administrative costs.** If however, the Commission would like additional reporting on this issue, PG&E stated that the Commission could consider this issue in Phase 4 of the ongoing energy efficiency R.06-04-010.

(2) Suspension of PG&E's fund shifting authority during 2006 for funds unspent due to program start-up delay. Although D.05-09-043 provision permitted fund shifting rules for 2006-2008 energy efficiency program budgets, TURN and DRA stated that PG&E should not be allowed to shift funds away from its partnership or 3rd party programs during 2006 for the sole reason that funds are available due to delays in program start-up.[8] It is because, TURN and DRA explained, permitting PG&E to shift funds in 2006 would penalize these partnership programs for start-up delays by reducing their opportunities to meet goals. Furthermore, TURN and DRA noted that the suspension of PG&E's fund shifting authority would help mitigate their concern on the use of the budget ($48 million) that was reduced from the partnerships during PG&E's budget integration; without suspension of the fund shifting authority, the $48 million would appear to be a slush fund for PG&E's core program rather than merit-based fund that partnerships and delayed third-party programs could hope to receive.[9] Thus, consistent with the D.05-09-043 provision that clarification to the fund shifting rules may be issued as appropriate, TURN and DRA recommend that the Commission issue a ruling suspending PG&E's funding shifting authority during 2006 for funds unspent due to program start-up delays in disposing of PG&E's advice letter compliance filing.

In its reply, PG&E indicated that unspent funds resulting from start-up delay are not yet a problem requiring attention and therefore does not warrant changes, which would be difficult and unnecessarily costly to implement. PG&E added that if the Commission decides to add additional restriction to one or more of the utilities, the Policy Rules already include a process to achieve this.

---

8 TURN and DRA, however, believe that program underperformance --not due to implementation delays-- would be consistent with D.05-09043 intent and rules on fund shifting.

9 In its advice letter compliance filing dated February 17, 2006, PG&E indicated that it removed $48 million from its initial partnership budgets during integration and planned to allocate these funds to programs within its portfolio that demonstrate early success in achieving energy savings.

(3) Limit PG&E's ability to carryover unspent 2006 funds to 2007 when surplus funds result from delayed programs. With the delays in implementing PG&E's partnership and 3rd party programs, TURN and DRA stated that they expect that PG&E will not spend all funds authorized for 2006, resulting in a positive balance.[10] Therefore, consistent with their recommendation above (Item #3), if funds remain in the balancing accounts due to program delays, TURN and DRA recommend that the Commission limit PG&E's authority to spend these surplus funds by either (a) requiring PG&E to use such surplus to offset 2007 incremental energy efficiency requirement resulting in a reduced 2006 budget, or (b) permitting PG&E to augment the 2007 budget. The latter method would preserve the overall 2006-2008 program budgets by increasing the 2007 budget by the 2006 unspent budget due to program delays. However, TURN and DRA noted that they take no position on the relative merits of each approach since there are currently no data available to determine the desirability of maintaining or reducing the 2006-2008 program budgets.

PG&E replied that it is expensive and time consuming process to differentiate some unspent funds (if any exist) from other unspent 2006 funds; it is also unclear if the recommendation offers any advantage over the three-year funding cycle and the present funding shifting flexibility. However, if the Commission wishes to change the fund shifting rules, it can establish a process to accomplish this.

(4) Require PG&E to track administrative expenses related to contract negotiations with partners as general portfolio administrative costs rather than as part of partnership budgets. Because of the delay in finalizing partnership contracts, according to TURN and DRA, the cost of partnership negotiations is continuing to accrue in the form of administrative costs that have no actual relationship to actual program implementation. TURN and DRA stated that these types of administrative costs if charged to actual partnership programs –though it is situation beyond the partners' control– will have a detrimental impact on the overall cost-effectiveness of partnership programs.

Thus, TURN and DRA recommend that the Commission direct PG&E to distinguish its allocation of administrative costs between planning and implementation budgets so that these types of administrative costs incurred during negotiations are not reflected in the determination of the actual program success. And since PG&E stated in its compliance filing dated February 17, 2006 that it would (a) complete "Prospective Partner Scopes of Work and Letters of Agreement" by March 17, 2006, and (b) provide prospective partners draft/sample Contract Language to support the contracting process by March 21, 2006, TURN and DRA further recommend that PG&E not assign to the partnerships any incremental planning administrative costs incurred by PG&E or the partnership from May 1, 2006 (this provides PG&E six additional weeks to incur partnership planning administrative costs).

PG&E stated that it is unclear why the contract negotiations with partnerships should be treated differently from those of other delivery channels, such as contract with 3rd parties or contracts within PG&E's offerings. PG&E explained that the recommendation would add administrative costs without clear benefit to ratepayers. If the Commission, however, chooses to consider this recommendation, the Commission could do so in Phase 4 of R.06-04-010.

(5) Clarification by the Commission of the intent of the energy efficiency policy rules regarding the relationship between PG&E and its partners and the role of partnerships in its portfolio. TURN and DRA stated that the Energy Efficiency Policy Manual (Policy Manual) Section II.5 directs that Program Administrators should manage their portfolio of programs to meet or exceed both short- and long-term savings goals established by the Commission to discourage cream-skimming designs or approaches that create lost opportunities. While Section VI.5 provides that future partnership program need to be developed in a way that places the Program Administrator and local government or private partner on more equal footing in terms of program design/planning, information sharing and program implementation. TURN and DRA further explained that PG&E in its June 2005 application seemed to understand the Commission's direction on partnerships; however, it did not yet determine its partnership programs at the time of filing its application. The delays in implementing partnership programs, according to TURN and DRA, could make these programs become non-comprehensive lighting programs that provide only short-run annual savings. TURN and DRA believe that partnerships should be used to pursue long-term energy efficiency goals and minimize lost opportunities and cream-skimming; however, there appears to be confusion on this issue and thus they seek Commission clarification on the policy rules relating to government partnership programs and how these programs are to be utilized in the context of the overall portfolio.

See discussion below for PG&E's response on this issue.

---

[10] PG&E tracks energy efficiency funds (gas public purpose funds, electric public goods charge funds, electric procurement energy efficiency funds) in one-way balancing accounts. As established by the Commission, PG&E annually requests to recover incremental revenue requirements associated with energy efficiency budgets. If there are unspent funds in the account, these unspent funds are credited to the next year's authorized budget, thus reducing the amounts to be collected from ratepayers.

(6) Modify the energy efficiency policy rules to better address partnership-related issues in R.06-04-010. Although the Commission provides some guidance as to the role of partnership programs in the portfolio, TURN and DRA stated that the messages might be somewhat ambiguous. It is because Rule VI.5 states:

> "Future partnership programs need to be developed in a manner that places the Program Administrator and local government (or private) on more equal footing, in terms of involvement in program design and planning, information sharing and program implementation…"
>
> "Arrangements should in no way diminish or dilute the responsibility and accountability of Program Administrators to meet the Commission-adopted savings goals."

Therefore, TURN and DRA recommend that via R. 06-04-010, the Commission resolve this ambiguity in expectations and process for government partnership programs to best utilize ratepayer funds in the energy efficiency portfolio design and implementation and so that future funding cycles will not experience the same contracting and implementation delays. TURN and DRA also clarified that they consider the improvement of the partnership process as a statewide issue that should be addressed on a statewide basis, through a Commission-facilitated process.

PG&E believes that the present Policy Rules provide adequate guidance and flexibility to all implementers to succeed in their efforts to meet the Commission's energy savings. PG&E will continue to work with its partners and anticipates that the issues raised by TURN and DRA will fail to become significant issues.

DISCUSSION

Staff reviewed PG&E's complete compliance filing in accordance with Ordering Paragraph 7 of D.05-09-043, and found that PG&E's filing conformed to the Decision.

In its Advice Letter compliance filing, PG&E submitted the results of its competitive bid solicitations and the final program plans, portfolio cost-effectiveness based on the final program plans--including the scenario analyses, and projections of energy savings and demand reductions that will be achieved by the final program plans—including scenario analyses. Additionally, PG&E included the PRG assessment report in its compliance filing. Overall, Staff found that PG&E submitted information described in Ordering Paragraph 7 of Decision 05-09-043. See discussion below on overall bill impacts expected from PG&E's portfolio.

Staff reviewed the comments, response, PG&E's replies to the concerns of parties, and information requested through data requests to PG&E. Although Staff is satisfied with PG&E's replies particularly to Staff's data requests, Staff is concerned about the issues raised with respect to PG&E's partnership programs, despite PG&E's responses. Staff believes these are important issues that go beyond the scope of Staff's disposition of the Advice Letter, but Staff strongly recommends the Commission to address more appropriately in R.06-04-010.

With regard to the comments on and letters of support for the California Preschool Energy Efficiency Program (CPEEP) proposal submitted by the Low Income Investment Fund (LIIF), Staff believes that PGE followed the selection criteria approved by the Commission. If LIIF is still interested in pursuing its proposal in the PG&E territory, it still has the opportunity to participate in the forthcoming 2nd quarter 2006 solicitation to be conducted by PG&E.

The City of San Jose and TURN/DRA raised the following partnership issues: lack of clear process, additional reporting, suspension of fund shifting authority, limitation to carryover unspent funds, tracking of administrative expenses, clarification on energy efficiency policy manual. The PRG raised similar concerns regarding PG&E's partnerships in its assessment reports submitted with PG&E's compliance advice letter filings. Staff believes these are important process and policy related issues that the Commission should address, but are beyond the scope of Staff's disposition of the Advice Letter compliance filing. Nevertheless, Staff intends to raise these issues with the Assigned Commissioner and the Assigned Administrative Law Judge, and would strongly recommend that they be addressed in R.06-04-010, as both PG&E and TURN/DRA have also suggested.

With respect to the statewide coordination, PG&E provided status updates on the utilities' statewide coordination efforts. In addition, the PRG made several recommendations with regards to statewide coordination, marketing and outreach, and local government partnerships.

To the extent possible, PG&E and its PRG will collaboratively address these issues with other PRGs and utilities. If needed, the Commission will address these issues and other issues as appropriate.

Staff identified two additional issues in the utility's Advice Letter compliance filings that required clarification from PG&E: impact on customers' bills of the 2006-2008 energy efficiency portfolio and cost-effectiveness calculation. In general, Staff is satisfied with the utility's clarifications with respect to these issues, although there still remains a difference in Staff's and PG&E's interpretation regarding the cost inputs to the Total Resource Cost (TRC) cost-effectiveness test following the formula in the Standard Practice Manual.

Staff and its consultant, TecMarket Works (TMW), reviewed PG&E's Advice Letter compliance filing. In its April 4, 2006 data request to PG&E, Staff asked clarification on the interpretation of the Standard Practice Manual in the calculation of cost effectiveness. On April 12, 2006, PG&E responded to these issues in Staff's data request.

Cost effectiveness: Staff's data request to PG&E noted that it was unclear in the Advice Letter compliance filing whether PG&E has properly implemented the Standard Practice Manual (SPM) in calculating cost-effectiveness using the TRC test.[11] Staff is concerned that the input values in PG&E's portfolio are not based on a methodology that the Commission ordered. As a result, in some cases, it would be possible for a program or measure that is not cost-effective to appear to be cost-effective.

PG&E responded that it applied the SPM TRC formula using the E3 calculator. According to PG&E, the TRC formula built in the E3 calculator is in accordance with the SPM, July 2002 version and that the gross incremental measure cost is multiplied by the net-to-gross (NTG) factor in the denominator of the TRC formula to calculate the net incremental measure costs (IMC).

Staff conducted an analysis of the calculation of costs in the TRC test to investigate a seeming difference between staff's interpretation of the TRC inputs per the SPM and that calculated by PG&E. Staff's interpretation of the SPM is that all costs incurred to make the activity happen must be fully counted – counted only once, but counted. This did not seem to be consistent with the TRC calculation that was incorporated in the PG&E advice letter compliance filing whereby the utility "netted out" the Incremental Cost. Staff's interpretation of the SPM does not allow for the costs to be "netted out" by multiplying costs by the NTG ratio. It is only appropriate to do so with the benefits, to accurately account for free-ridership. Staff believes that the utilities' calculation would make an expensive program with a high factor of free-ridership look very cost effective.

Staff informally raised the above concern regarding the TRC calculation with Administrative Law Judge Meg Gottstein. In the E3 Avoided Cost 2006 Update Workshop held on March 14 and 15, 2006, ALJ Gottstein instructed staff to conduct additional research. The Commission, as appropriate, will address this issue and the issue noted below, based on Staff's research.

Another issue related to the cost inputs used in the TRC test that has recently been brought to Staff's attention pertains to instances when financial incentives provided for certain measures exceed the gross incremental costs of those measures, as usually the case with direct-install type programs. Following the TRC formula in the SPM, the utilities' E3 calculator only captures the gross incremental costs multiplied by the NTG plus program administrative costs in the TRC cost denominator, but not the financial incentives. Thus, to the extent that higher financial incentives are provided relative to the incremental costs of particular measures in a given program, the TRC costs will be lower; hence, the TRC ratio higher than what it would have been if the differences of the financial incentives above gross incremental costs were factored into the TRC cost denominator.

Nevertheless, PG&E provided a cost-effectiveness analysis of its portfolio based on Staff's interpretation of not applying the NTG factor to the Incremental Cost and also adjusting for those instances when financial incentives exceed incremental costs in the TRC test.[12] The results of the analysis are attached as Appendix A. PG&E's scenarios show that the utility's energy efficiency program portfolio is still cost effective with these adjustments. Thus, for planning purposes, Staff is satisfied with the cost-effectiveness analysis.

---

[11] This potential problem was first raised by Tec Market Works in PG&E's June 1, 2005 application when the TRC test values were higher than the Program Administration Cost (PAC) test values and when the TRC costs were lower than the PAC costs for certain programs.

[12] PG&E's response dated April 19, 2006, to Energy Division's April 12, 2006, data request.

Impact on Bills: Staff indicated to PG&E that there is no description in its Advice Letter of the methodology used to calculate bill impacts and requested that PG&E provide a description of the costs used in the analysis, as well as the calculation methodology and how this methodology was applied, and the analysis conducted, for each rate class. In its response to Staff's data request, PG&E explained its methodology as described below, which Staff finds satisfactory.

In its response sent to Staff on May 8, 2006, PG&E explained that it used the E3 calculator –which produces a lifetime stream of costs and benefits-- for its bill impact analysis. PG&E summarized the net cost and benefits for its entire portfolio into a single set of dollar values for each year covered by the analysis. These were developed for both electric and gas program costs and energy savings. The total net impact of its energy efficiency portfolio was then treated like a rate and bill impact in a rate setting filing. Average rates and bills were set at the same levels as in PG&E's original filing (A.05-06-044) to maintain consistency of presentation. For each year, the impact of portfolio was allotted to customer classes and specific rate schedules for electric and gas. This was calculated in the same way that the revenue requirements for the original filing in A.05-06-044 were presented in June of 2005. Because the energy savings that result from the energy efficiency portfolio cause a reduction in costs on a net basis, the bill impacts were expressed as a reduction from base rates when appropriate.

Staff Conclusions

There are no protests filed on PG&E's compliance filing. In its review of comments to AL 2704-G/2786-E and AL 2704-G-A/2786-E-A, and PG&E's response to the comment issues, Staff is in general satisfied with PG&E's responses. However, Staff believes that parties, including the PRG, have raised legitimate and important process and policy-related issues pertaining to PG&E's partnership programs that go beyond the scope of Staff's disposition of this Advice Letter, but Staff strongly recommends the Commission to address in R.06-04-010.

PG&E has satisfied the requirements of D.05-09-043. The suspension of PG&E's AL 2704-G/2786-E, including the supplement, is removed without prejudice. PG&E's compliance filing advice letter is approved and effective May 17, 2006 as PG&E requested.

APPENDIX A

	Scenarios	Portfolio TRC Costs	Portfolio TRC Ratio	Portfolio PAC Costs	Portfolio PAC Ratio
Case 1	As initially submitted in compliance filing (no adjustments) - April 06 Filing	$1,226,277,084	1.61	$921,802,045	2.15
Case 2	Adjusted only for no NTG in TRC denominator (gross TRC)	$1,349,266,666	1.47	$921,802,045	2.15
Case 3	Adjusted only for sum of difference when incentive > gross IMC in TRC denominator	$1,273,798,405	1.55	$921,802,045	2.15
Case 4	Adjusted for both no NTG and sum of difference when incentive > gross IMC in TRC denominator	$1,396,787,987	1.42	$921,802,045	2.15