STATE OF CALIFORNIA GAVIN NEWSOM, Governor

PUBLIC UTILITIES COMMISSION

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TO PARTIES OF RECORD IN RULEMAKING 13-11-005

Enclosed is the Alternate Proposed Decision of Commissioner Liane M. Randolph to the Proposed Decision of Administrative Law Judge (ALJ) Julie Fitch previously mailed to you. This cover letter explains the comment and review period and provides a digest of the alternate decision.

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

Public Utilities Code Section 311(e) requires that an alternate to a proposed decision or to a decision subject to subdivision (g) be served on all parties, and be subject to public review and comment prior to a vote of the Commission.

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

Comments must be filed pursuant to Rule 1.13 and served in accordance with Rules 1.9 and 1.10. Electronic copies of comments should be sent to Commissioner Randolph's advisor Jason Ortego at Jason.Ortego@cpuc.ca.gov. The current service list for this proceeding is available on the Commission's website at www.cpuc.ca.gov.

/s/ ANNE E. SIMON
Anne E. Simon
Chief Administrative Law Judge

AES/gp2
Attachment

DIGEST OF DIFFERENCES

Pursuant to Public Utilities Code § 311(e), this is the digest of the substantive differences between the proposed decision of Administrative Law Judge Julie Fitch and the alternate proposed decision of Commissioner Liane Randolph.

The proposed decision maintains the status quo of the Efficiency Savings and Performance Incentive (ESPI) mechanism, allowing utility shareholders to have the potential to earn incentives based on the performance of the energy efficiency programs administered by the investor-owned utilities (IOUs). The Commission would commit to reevaluating and potentially modifying the structure of ESPI after the policy issues associated with the setting of energy efficiency potential and goals are resolved.

The alternate proposed decision places a moratorium on earnings associated with ESPI until such time as the Commission resolves the policy issues associated with energy efficiency potential and goal setting. The moratorium would also stay in effect during the transition period, currently underway, to a greater percentage of statewide and third-party programs as part of the energy efficiency portfolios administered by the IOUs.

While the proposed decision argues that the ESPI mechanism is part of a Commission regulatory regime designed to emphasize the importance of energy efficiency as a resource, the alternate argues that there is no evidence that the ESPI mechanism improves IOU administrator performance in the areas where they stand to earn ESPI incentives. Therefore, the alternate concludes that the ratepayers of the IOUs should not be required to continue funding ESPI payments until the portfolio transition is complete and the ESPI mechanism is further evaluated for re-design or permanent elimination.

Decision **ALTERNATE PROPOSED DECISION OF COMMISSIONER RANDOLPH (Mailed 10/2/2020)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Concerning Energy Efficiency Rolling Portfolios, Policies, Programs, Evaluation, and Related Issues.	Rulemaking 13-11-005

DECISION IMPOSING MORATORIUM ON EFFICIENCY SAVINGS AND PERFORMANCE INCENTIVE PROGRAM

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DECISION IMPOSING MORATORIUM ON EFFICIENCY SAVINGS AND PERFORMANCE INCENTIVE PROGRAM

Summary

With this decision, we impose a moratorium on award payments under the Efficiency Savings and Performance Incentive Mechanism (ESPI) beginning with 2021 program year advice letter earnings claims. The moratorium shall remain in effect pending subsequent action to assess whether, how, or when a new version of ESPI or a new incentive mechanism can be devised and implemented. Any new or revised incentive mechanism will apply only to activities performed on or after the date of implementation. No retroactive recovery of earnings will be allowed based on activities performed during periods prior to implementation of any new or revised incentive mechanism.

Consideration of ESPI reform, however, shall be deferred pending disposition of certain proposed changes relating to energy efficiency programs management and administration reform issues, as identified in the Assigned Commissioner's Scoping Ruling dated July 3, 2020 and detailed further in this order. In adopting this ESPI moratorium, our commitment remains undiminished to prioritize energy efficiency as the first cost-effective resource in the loading order to meet California's energy system needs.

1. Procedural Background

The issues addressed in this decision arise pursuant to the Public Advocates Office (Cal Advocates) Motion, filed December 27, 2019, in the instant Rulemaking (R.) 13-11-005. Cal Advocates asked the Commission to review, or preferably eliminate, the Electric Savings and Performance Incentive Mechanism (ESPI).

Responses to the Cal Advocates motion were filed January 13, 2020 by the investor-owned energy utilities (IOUs) (*i.e.,* Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company(SoCalGas)). Responses were also filed by the Natural Resources Defense Council (NRDC), the Joint Committee on Energy and Environmental Policy (JCEEP) and the International Brotherhood of Electrical Workers (IBEW). The National Electrical Contractors Association (NECA) Labor Management Cooperation Committee filed a response on January 14, 2020.

Cal Advocates replied to parties' responses on January 23, 2020.

On March 18, 2020, an Assigned Commissioner's and Administrative Law Judge's Ruling (ACR) granted Cal Advocates' motion, and formulated the scope of inquiry with a series of questions and issues for substantive comment. The ACR determined that any SoCalGas-specific issues related to their conduct in codes and standards advocacy activities (currently, or in the past) was to be considered only within the scope of the Order to Show Cause (OSC) portions of this proceeding.

As directed in the ACR, the IOUs each filed a separate response on April 15, 2020, reporting ESPI award amounts received or requested by award categories for the periods from 2015 to 2018. [1]

Interested parties filed and served comments on April 29, 2020, in response to the other questions posed in the ACR, with reply comments on May 15, 2020.

[1] The IOUs were each directed to calculate the reported Total Resource Cost (TRC) and Program Administrator Cost (PAC) test ratio of their portfolio, with and without ESPI costs. The TRC and PAC refer to Commission-prescribed methodologies used to assess cost effectiveness of program activity.

Comments were filed by the NRDC; California Efficiency +Demand Management Council (CEDMC)[2]; and PG&E, SDG&E, SCE, and SoCalGas (collectively the IOUs) filed opening comments on the ACR. The Utility Reform Network (TURN) filed only reply comments.

We have reviewed the comments of parties in response to the ACR and determine that they provide a sufficient basis for our decision as rendered herein.

2. Framing the Issues

The framework for this inquiry was formulated in the above-referenced ACR, granting Cal Advocates motion. The ACR framed the inquiry by soliciting comments on a series of questions. A threshold issue posed in the ACR was: "*Given the current management structure of energy efficiency programs, are shareholder incentives, in any form, necessary to ensure the achievement of energy savings? Should the Commission eliminate shareholder incentives for energy savings completely? Should individual ESPI award categories be eliminated? Why or why not?*"[3]

We affirm the framework of inquiry, as defined in the ACR. Based on the comments filed in response, we consider whether the burden of proof has been met to justify continued need for ratepayer funding of ESPI awards. We approach this inquiry in the context of the Commission's history of use of incentive tools to promote prioritizing energy efficiency (EE) resource savings consistent with Commission goals. We adopted the ESPI in 2013 after earlier versions of incentive mechanisms had been tried and replaced or discontinued. Our experiments with EE incentive mechanisms began in the 1990s. Early on, we adopted an incentive mechanism that shared EE savings between ratepayers and

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[2] The CEDMC is a statewide trade association of non-utility businesses that provide energy efficiency, demand response, and data analytics services and products in California.

[3] ACR at 16.

shareholders (as adopted in D.94-10-059). In 1998, we changed the basis for utility incentives by generally de-linking shareholder profits from the measurement of savings. We introduced performance milestones showing market transformation effects (*e.g.*, increased stocking of energy efficient appliances by retailers, etc.). Beginning with 2002, we effectively stopped offering utility EE shareholder incentives except for low income programs.[4] The IOUs continued to earn financial incentives on the implementation of low income energy efficiency programs.[5]

Between 2002 through 2006, although without a comprehensive EE shareholder incentive mechanism, we continued to make EE and demand response the IOUs' highest priority procurement resources.[6] We developed evaluation, measurement and verification (EM&V) protocols to hold the IOUs accountable for EE program results. For ratemaking purposes, we decoupled load reductions from utility earnings to neutralize disincentives for IOUs to promote reduced energy consumption.

In 2007, we resumed use of a shareholder incentive mechanism, adopting the Energy Efficiency Risk/Reward Incentive Mechanism (RRIM). We terminated the RRIM six years later, however, after determining that it did not perform according to expectations, but fostered extended controversy over

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[4] *See* D.05-10-041, at 7, referencing D.01-11-066, as confirmed in D.02-03-056.

[5] *See* D.02-03-056, p 54; *see also* D.03-10-057, at 12, referencing Attachment 2.

[6] *See* CPUC Energy Action Plan (EAP), adopted by the Commission in 2003 and updated in 2008, which established the loading order of energy resources and prioritization of EE to optimize energy conservation and resource efficiency and minimize the need for new generation. After cost-effective energy efficiency and demand response resources, we rely on renewable sources for power and distributed generation.

measurements of savings. We replaced the RRIM with the ESPI as adopted in D.13-09-023.

The ESPI mechanism differed from the RRIM in several respects, but offered shareholder EE incentive earnings in four categories:

1. *Energy Efficiency Resource Savings* award: based on net lifecycle resource program energy savings using (a) estimated (ex ante)"locked down" and (b) evaluated post-implementation (ex post verified) units of savings results. This element constituted about 70 percent of the total ESPI award earnings potential as originally set forth in D.13-09-023.
2. *Ex-Ante Review (EAR) Process Performance* award: based on each IOU's respective performance as evaluated with scoring of specified metrics. The EAR award is aimed at motivating IOUs to produce energy savings estimates more closely aligned with post-project evaluations. The EAR award is capped at 3 percent of budgeted expenditures.
3. *Codes and Standards Advocacy* award: paid as a management fee of 12 percent of the authorized budget for codes and standards advocacy program expenses, excluding administrative costs; and
4. *Non-Resource Programs* activity award: paid as a management fee of 3 percent of the authorized budget for non-resource programs (*i.e.*, for which energy savings are not directly attributed, but which supports the energy efficiency portfolio through activities such as marketing, training and education, etc.).

In adopting the ESPI in D.13-09-023, we concluded at the time that despite its limitations, ESPI was sufficient "to encourage IOU performance while protecting the interests of ratepayers."[7] Now seven years later, we reevaluate the

[7] D.13-09-023 at 12.

effectiveness of the ESPI in light of current conditions including changes in EE portfolio design and administration.

3. Overview of Parties' Positions

3.1. Cal Advocates Position

Public Advocates Office (Cal Advocates) proposes the elimination of the ESPI, challenging its effectiveness, particularly as IOUs transition from being primarily implementers to primarily administrators of EE programs.
Cal Advocates claims there is no empirical evidence that ESPI motivates the IOUs to prioritize EE beyond what is already required by statute and Commission decisions.

Cal Advocates argues that in view of significant changes in the structure of ratepayer-funded EE programs, ESPI awards are no longer linked to individual IOUs' energy savings and performance. When ESPI was initiated in 2013, each IOU was responsible for managing its own EE programs to achieve energy savings and high portfolio performance. In 2016, however, the Commission directed significant shifts in how the IOUs manage the EE programs. As a result, a significant portion of the EE portfolio is intended to be administered on a statewide basis, with third-party design and implementation of most of the budget, and is intended to increase the use of normalized metered energy consumption as a method for calculating energy savings. Under statewide programs, one IOU serves as statewide lead with responsibility for achieving the energy savings while the others only contribute funding. Cal Advocates characterizes the IOUs' role in managing third party programs as limited to running solicitations and providing advice on program design after third-party bids are solicited.

Cal Advocates argues that an ESPI award should not be paid for merely transferring funds to another IOU without accomplishing a substantive objective. Cal Advocates argues that paying ESPI awards for geographically allocated energy savings via the savings-based ESPI category does not motivate program accomplishments.

Cal Advocates also argues that the EAR award does not align award values with portfolio performance objectives, and that scoring EAR performance for individual IOUs is an ineffective way to prompt improvements in workpapers prepared by an administrator of statewide programs.
Cal Advocates makes similar objections to paying ESPI management fees for funding non-resource programs and codes and standards (C&S) advocacy.

Cal Advocates further claims that paying ESPI awards for meeting or exceeding EE goals may create perverse incentives for the IOUs to over-report claimed energy savings and expenditures because inflated numbers benefit shareholders. Cal Advocates further claims that ESPI is counterproductive to planning and delivery of robust EE programs, and can lead to evaluation, measurement, and verification (EM&V) efforts focused on administrative purposes, rather than improving program design or maximizing benefits to ratepayers. Cal Advocates argues that payment of ESPI awards is inconsistent with the Commission's cost-effectiveness objectives.

3.2. NRDC's Position

NRDC recommends that the Commission rethink whether the ESPI is really needed in view of current realities. NRDC notes (1) the robust regulatory process already in place for resource energy efficiency programs and (2) third-party implementation contracts which should reward attainment of cost-effective savings. NRDC proposes an evaluation of the robustness of the existing regulatory process to set goals for and to oversee attainment of those goals for non-resource programs. If the ESPI is not structured to improve the efficacy of current energy efficiency programs, NRDC argues, it becomes a cost without a resulting benefit, potentially becoming an obsolete mechanism that merely transfers public funds to utility shareholders.

NRDC warns against trying to prove ESPI effectiveness through analytical or empirical methods. To attribute performance impacts to the ESPI, NRDC argues, it must first be determined whether and by how much program performance has improved over the last ten years. NRDC believes this is a near-impossible task, requiring an understanding of program performance indicators.[8] Selecting such indicators and applying them to demonstrate improvement is analytically burdensome and subjective.

NRDC notes that even without ESPI, the shift towards third-party program implementation should naturally encourage attainment of cost-effective savings as long as contracts are thoughtfully crafted by utility program administrators. NRDC believes these contracts should reward attainment of cost-effective energy savings by motivating third-parties program administrators to exceed Commission set energy savings goals.

3.3. TURN's Position

TURN supports the elimination, or at least suspension of, ESPI. TURN characterizes the responsibility to meet EE goals cost-effectively as the core function of a portfolio administrator entrusted with ratepayer funds, not a special service warranting shareholder incentives. TURN argues that the IOUs

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[8] Possible indicators could include total portfolio claimed savings, realized savings, cost-effectiveness results through the total resource cost test and the program administrator cost test, average measure life, participant satisfaction, energy savings realization rates, Commission Staff's experience regulating programs over the years.

do not require incentive earnings to work effectively with third party program implementers or to carefully consider third-party program design solicitations.

TURN believes that while there is a plausible nexus between ESPI and at least some of the performance benefits reported by the IOUs, continuation of ESPI is unnecessary to preserve any benefits that may have occurred.

TURN likewise argues that the IOUs do not require ESPI awards to compensate for risk of third-party contractors' underperformance. TURN characterizes EE contract risks as similar to other business risks utilities take on when outsourcing work. TURN argues, however, that the utilities face no direct financial consequences for portfolio underperformance warranting ESPI compensation.

TURN notes that under the previous incentive mechanism adopted in D.07-09-043, the IOUs faced the risk of financial penalties for substandard performance in achieving savings goals. Under ESPI, however, no such penalty provision exists for failure to achieve goals. Although the Commission could adopt such penalties, as suggested in D.18-05-041, this has not happened yet. [9] Thus, TURN disputes the IOUs claimed need for shareholder incentives to compensate for a future possibility of increased risk.

TURN notes that in any case, Commission already has policies to help the utilities mitigate performance risks, such as by encouraging pay for performance contracting and improving ex ante estimates.

[9] In D.18-05-041, the Commission indicated that it would consider establishing penalties for the potential scenario in which a Program Administrator's Annual Budget Advice Letter for program years starting in 2023 is rejected. Possible penalties might include: withholding ESPI payments for portfolios that are not cost-effective; increased oversight and CPUC-directed cancelling of programs with low TRCs; shifting costs for non-cost-effective programs from ratepayers to PAs (i.e., ratepayers only pay for the part(s) of a portfolio that is/are cost-effective).

3.4. CEDMC's Position

The CEDMC believes that ESPI is conceptually sound, but should be modified to incentivize innovation, rather than merely compliance. The CEDMC characterizes ESPI as being more of a reward for good behavior on the part of IOUs in working with Energy Division to meet ESPI reporting requirements, rendering it out of step with the current realities facing EE portfolios.

The CEDMC favors disbursement of ESPI funds to third-party program implementers. The Council argues that in the current structure of program delivery, third party implementers take on a significant amount of risk in delivering EE savings. While the IOUs are financially insulated from the downsides, the CEDMC argues that third party implementers have minimal incentive beyond what is contractually stipulated for even a perfectly implemented program that often takes significant time to evaluate.

3.5. IOUs' Position

The IOUs all support continuation of ESPI with no interruption in the filing for ESPI awards on the current schedule.

PG&E argues that ESPI helps to ensure successful EE programs, and to meet California's clean energy objectives. PG&E argues that the policies and goals in D.13-09-023 as justification for ESPI remain valid. PG&E points to the passage of Senate Bill (SB) 350, which calls for doubling EE savings by 2030. PG&E believes SB 350 makes the policies and goals justifying ESPI even more important to meet those EE savings goals. The ESPI is based on lifecycle energy savings, which is generally the same metric applied under SB 350.

PG&E argues that while shareholder incentives may not be *necessary* to ensure the planning and delivery of robust EE programs, they signal the importance and support of programs not primarily intended as resource programs, like Workforce Education & Training and Marketing, Education and Outreach. PG&E believes that an incentive for investing in non-resource activities can motivate IOUs beyond minimum compliance obligations, despite internal pressure to reduce impacts to portfolio cost-effectiveness and customer bills.

SoCalGas and SDG&E acknowledge that numerous changes have occurred to the role of IOUs in managing the energy efficiency portfolios in recent years and that a review of ESPI is warranted. They oppose, however, eliminating ESPI, but emphasize reexamining the original objectives of the ESPI mechanism. They argue that the Commission's desire to set aggressive yet achievable energy savings goals continues to support offering financial incentives.

SoCalGas notes that while California and other states have adopted a robust set of energy policies, many others still have not. As states look to California as an example, SoCalGas argues that elimination of the incentive mechanism may not send the right signal.

SDG&E recommends that ESPI continue as is, at least through the transition to third party program implementation of EE programs, mandated to have a minimum 60 percent of the IOUs budgeted implementation by January 1, 2023. SDG&E recommends that during the transition, the Commission begin aligning with other state goals, such as greenhouse gas reduction.

SCE notes that the IOUs may still be conducting solicitations for 40 percent of their portfolios beyond 2022. As stated in D.18-01-004, the outsourcing of 60 percent of the utility portfolio is only a floor not a maximum percentage.

3.5.1. Past Performance as a Measure of ESPI Effectiveness

The IOUs point to their past performance as evidence that the ESPI is effective in motivating them to prioritize EE program goals. SCE notes, for example, that from 2015 through 2018, it achieved, and in most of those years substantially exceeded, the savings goals set by the Commission. [10]

PG&E argues that it would not have invested as heavily and consistently into project quality assurance absent the ESPI, given (a) the time and investment required, (b) slowing of project approval, (c) reduced gross savings claims and incentives paid to customers, and (d) reduced customer satisfaction with programs.

SDG&E argues that since the inception of ESPI, its portfolio has been trending towards longer measure lifecycles, resulting in longer-lasting energy savings. SDG&E attributes ESPI as motivating the average measure life increase from 2013 to 2019 and improvement in its scores relating to the ex ante review process. As previously discussed above, the ex ante review process is subject to a scoring process that yields ESPI awards. SoCalGas likewise credits ESPI as motivating improved ex ante review performance and increase average portfolio measure life.

SoCalGas includes a category for "ESPI achievement" as an annual performance metric for its Customer Programs & Assistance department. ESPI updates are tracked by financial planning and given to shareholders in the annual report.

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[10] *See* Table IV.2 of SCE's pleading

3.5.2. Effects of Third-Party and Statewide Programs on ESPI

The IOUs dispute Cal Advocates' arguments as to the effects of third-party and statewide administration of EE programs on the need for ESPI. In particular, the IOUs dispute Cal Advocates' characterizations of IOUs' role and responsibilities within the new structure for EE program implementation that includes third-party implementation and Statewide initiatives. The IOUs emphasize the importance of their responsibility for determining the types and levels of EE investment that the third-parties implement and for quality control and policy requirements for the programs. Even though most, if not all, of the portfolio is implemented through third parties, SDG&E argues that the corresponding responsibility and financial risk still rests with the IOU as contract administrator. The IOUs oversee implementers to ensure they are on track to meet program savings targets and remain cost-effective. For statewide programs, each IOU operates a subset of the statewide programs and solicitations to share workload. The IOUs continue to administer and implement their own local programs.

Given their role in this context, the IOUs argue that their performance continues to be of great significance to the success or failure of EE. Consequently, the IOUs argue that ESPI remains relevant and warranted to motivate them in the prioritization of EE goals.

The IOUs further argue that ESPI is necessary to compensate for risks of a third-party program implementation structure that replaces IOU implementation. SCE claims that performance risk increases with the transition to third-party program implementation as the IOUs have less control over program design and implementation. For statewide program administration, the

IOU remains responsible for portfolio goal attainment and evaluated savings. SCE claims the IOUs incur risk if third parties are unable to meet contractual obligations so that the IOUs can achieve the Commission's EE goals cost-effectively. Although the IOUs can mitigate risk through pay-for-performance contracting, SCE believes uncertainty remains about what risk mitigation measures final contracts will include. Unless the IOUs' obligation to cost-effectively meet savings goals, as well as any associated potential penalty or disallowance, is removed, SCE argues that ESPI earnings are required as compensation for risk.

SDG&E adds that additional risks are introduced with the Lead Statewide Administrator structure that requires one IOU to oversee delivery of cost-effective EE savings for the whole state.

3.5.3. Mitigation of Supply-Side Bias

SCE further argues that ESPI is required to compensate for additional risks associated with EE in comparison to supply-side resources. SCE notes that unlike a supply-side resource, EE relies on complex and variable evaluation processes to measure and verify the resource delivered through the IOU's portfolio management. The IOUs' supply-side resources procurement compliance is governed by the Commission approved Bundled Procurement Plan. Pursuant to AB 57 the Commission established up-front standards and criteria to guide IOUs' procurement activities. The IOU must comply with these approved procurement plan standards and criteria for its procurement-related expenses to be found eligible for cost recovery.

PG&E likewise argues that while the State's clean energy objectives now include more renewables alongside the doubling of EE, the fundamental regulatory and financial biases in favor of supply side resources that existed in

1993 and 2007 still exist today. PG&E cites D.07-09-043 in this regard which stated:

> The fundamental regulatory and financial biases against energy efficiency (in favor of supply-side resources) identified in D.93-09-078 also exist under the current regulatory framework, in which utilities have returned to their traditional role as resource portfolio managers.[11]

PG&E claims that terminating the ESPI would hinder the IOUs' incentive to overcome the supply side bias and to vigorously and earnestly support achieving all cost effective, reliable, and feasible EE.

SDG&E argues that ESPI should recognize IOU risk associated with contract administration and contract risk associated with management of local and Statewide third-party implementers to ensure state goals and at the same time recognize the IOUs' support for a successful transition to a robust third-party implementation structure.

4. Discussion

As a starting point, we address whether the ESPI mechanism should remain unchanged or be reformed, suspended, or eliminated permanently. As previously noted, we have had a long history of using incentive mechanisms. In view of our past experiences, we recognize the potential usefulness of incentive mechanisms under the right circumstances. We also, however, have modified, terminated or replaced incentive mechanisms when we determined that a change was warranted. We will not perpetuate ratepayer funding of a shareholder incentive mechanism when or if it is no longer effective. In past Commission decisions and rulings, we have discussed at some length the difficulties and challenges in implementing and sustaining an effective EE incentive mechanism.

[11] D.07-09-043, at 215, Conclusion of Law 1.

As discussed below, we find evidence lacking that ESPI currently remains effective in achieving all of its originally intended purposes. Accordingly, while we stop short of eliminating the ESPI mechanism, under our statutory obligations to protect ratepayers from unjust cost burdens, we impose a moratorium on ESPI awards beginning with advice letter filings scheduled for the 2021 program year.[12] The moratorium shall remain in effect until or unless we devise incentive reforms that can be effective in advancing the Commission's EE goals.

In Section 4.9 below, we discuss the timetable for future consideration of possible incentive reforms. In the meantime, it would be unfair to require ratepayers to fund ESPI awards under a design that has not adequately demonstrated its effectiveness in achieving energy efficiency goals. Because we defer the issue of future incentive mechanism reform, we do not resolve herein parties' proposals for ESPI redesign in this decision. [13]

4.1. Commitment to Prioritizing EE Goals Continues

Imposing a moratorium on ESPI awards in no way diminishes our continuing commitment to advancing EE goals as the first cost effective resource in the loading order. The Commission's leadership role in EE advancements does not depend on continuing to fund ESPI awards merely for the sake of having an incentive mechanism. To justify continued ratepayer funding, ESPI must be more than just a symbolic gesture of commitment to prioritizing EE

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[12] Pub. Util. Code § 451 requires us to ensure that utility rates are "just and reasonable."

[13] For example, SCE and SDG&E recommend a modification of the ESPI to tie to the State's GHG emissions reduction goals. At the time when we consider changes to the Commission's potential and goals policy, it may be appropriate to examine the ESPI mechanism in light of these policy decisions.

goals. It must be a proven driver of real net-positive benefits for California's energy customers and society at large.

Likewise, during the period that the ESPI moratorium applies, the IOUs still remain obligated by statutes, state policies and past Commission decisions to prioritize cost-effective EE and to achieve specified EE savings goals. Public Utilities Code Section 454.5, [14]California's Energy Action Plan, [15]and past Commission decisions (*e.g.,* D.04-09-060) all prioritize cost-effective EE first in the loading order. In addition, the IOUs remain bound by Public Utilities Code Section 350 which requires a doubling of energy efficiency savings by 2030. The IOUs will continue to receive timely funding for all of their EE program activities in retail rates. Through the decoupling of sales and generation levels from earnings, any disincentives to reduce load through EE programs will be neutralized. [16] Particularly in view of the strong measures and statutory requirements that continue in place irrespective of ESPI award payments, the advancement of EE goal attainment will continue unabated while the ESPI moratorium remains in effect.

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[14] Public Utilities Code Section 454.5(b)(9)(C) ("The electrical corporation shall first meet its unmet resource needs through all available energy efficiency and demand reduction resources that are cost effective, reliable, and feasible.");

[15] California's principal energy agencies, including this Commission, joined to create the Energy Action Plan (EAP) in 2003. The EAP identifies goals and actions to ensure that adequate, reliable and reasonably-priced electrical power and natural gas supplies are procured through cost-effective and environmentally sound strategies. The Energy Action Plan at pp. 1, 6 (2008 Status Update) states that EE is first in the loading order and that "utility energy efficiency investments must be cost-effective");

[16] Decoupling is a ratemaking tool to track differences between actual and forecasted revenues collected. If actual sales fall below forecasted levels (due to energy efficiency installations, for example), the rates may not recover the utility's fixed costs. With decoupling of revenues from sales, under-collections of revenue are recovered in subsequent rate adjustments. Over-collections are refunded to ratepayers.

Although the IOUs argue that ESPI is required to motivate performance beyond statutorily required compliance levels, nonetheless, ESPI earnings also compensate for below average performance, and for mere "business as usual" performance levels, as characterized in D.13-09-023 .[17] Unlike the RRIM, the ESPI has no restrictions to withhold incentive payments for lesser levels of performance. Parties' claims regarding actual performance improvements as a response to ESPI are evaluated below.

4.2. EE Portfolio Shift to Third Parties and Statewide Programs

Since the ESPI was adopted in 2013, EE program structure and management have continued to evolve. As a result, our approach and thinking about ESPI effectiveness needs to change accordingly. Even though IOUs still directly administer some EE programs, growth in third parties and statewide EE programs, in particular, has caused us to rethink the premises underlying the rationale for ESPI. In view of changes in the management structure for EE programs in recent years, we conclude a misalignment has developed between ESPI awards and the IOU's ability to control energy savings achieved.

While the core objective of EE resource programs to be first in the loading order remains unchanged, program design and execution has evolved. The use of third-party and statewide administration of EE programs has continued to grow. In May 2018, the Commission approved a set of statewide EE programs and directed each energy IOU to allocate at least 25 percent of its EE portfolio budget to statewide programs (except SoCalGas, which is only required to allocate 15 percent of its EE budget). In August 2016, the Commission also directed the IOUs to transition the majority of their portfolios to third-party

[17] *See* D. 13-0-023 at 27,

designed-and-implemented programs. As designated in D. 18-05-041, during the 2018-2022 period, the IOUs are to transition toward running third-party solicitations, including more statewide solicitations; evaluating the viability of third parties to perform the program design and delivery functions to achieve EE savings goals; and overseeing those programs.

We acknowledge the importance of the IOU role to solicit, advise and oversee third party contractors. As EE portfolios shift into statewide administration and third-party implementation, the IOUs remain accountable for portfolio savings and goal attainment. The IOUs' responsibility for program outcomes has continuously existed and not merely because third-party administrators are running programs. The IOUs are still responsible for program performance to meet energy savings goals and cost effectiveness thresholds that we set for them. Nonetheless, bearing such responsibility and accountability does not inherently justify a need for ESPI awards. We do not fund IOU incentive awards for other sorts of administrative oversight functions for third party contract administration. Likewise, we do not typically award incentive earnings for other core responsibilities that require IOU management care for ensuring reliable and safe utility service.

The IOUs' role in relation to third-party or statewide program administration, while important, differs from having direct control over EE program design.

The ESPI was designed to reward the IOUs for performance results they can directly control. Yet, in the case of statewide programs, one IOU administers the program on behalf of all other IOUs. The lead IOU is charged with contracting with a third party to design the program and oversee its effectiveness. While the non-lead IOUs are monetary contributors only, however, all IOUs earn ESPI awards for all statewide programs. As a result, paying ESPI awards in such situations cannot motivate IOUs to act beyond their sphere of control. At the same time, third-party contractors can be motivated to achieve greater cost-effective energy savings through the performance terms of their contracts. Instead of ESPI, rewarding performance within third-party contract clauses offers a more direct tool for promoting EE savings goals. In a similar manner, we do not fund IOU incentive awards for other sorts of administrative oversight functions for third party contract administration. Likewise, we do not typically award incentive earnings for other core responsibilities that require IOU management care for reliable and safe service.

Likewise, ESPI awards are not an appropriate vehicle to compensate for risk of underperformance of programs that third parties or statewide administrators control. Each IOU is compensated for risk and uncertainty in the authorized rate of return on equity.

The IOUs identify no specific monetary losses incurred due to EE underperformance. Under rules governing the RRIM, the predecessor incentive mechanism, financial penalties were a risk for substandard performance in achieving savings goals. No similar monetary penalty applies to the ESPI. There is no dead band for ESPI below which IOUs receive no incentive earnings. Although SCE warns that penalties or disallowances could possibly be imposed in the future if third-party implementers do not perform, as alluded to in D.18-05-041, no such policy is in place today. If such a policy were to be adopted in the future, that would be the time to consider whether the risks warrant extra compensation. For the present, however, ESPI is not a suitable vehicle to compensate for such risk.

4.3. Performance Changes for Lifecycle Resource Savings

The ACR solicited responses to the following directive: *"Provide empirical evidence that ESPI has motivated utility investors and managers to prioritize energy efficiency differently from what priorities would have been absent ESPI, or has improved the performance of energy efficiency portfolios overall."*

We acknowledge parties' responses, including the IOUs' claims of improvements in lifecycle EE savings and attributing them to ESPI. In granting the Cal Advocates motion, the Assigned Commissioner also observed that: "… *the ESPI mechanism has performed largely consistently with many of the intentions articulated in the ESPI decision. It has reduced contention associated with Commission-evaluated savings and resulting award payments, improved ex ante savings estimates, encouraged a shift in the portfolio towards measures with longer-lasting savings, and rewarded IOUs for codes and standards advocacy and administering non-resource programs.* " The ACR referred to life cycle savings data trending upward with the average portfolio measure effective useful life (EUL) increasing from 10.59 years in the 2010-12 portfolio cycle to 11.06 years for 2017. At the same time, however, the ACR acknowledged that "many factors affected these changes and we are unable to state with certainty whether and to what extent the ESPI mechanism influenced them…" [18]

Based on the subsequent comments filed by parties, we echo the observations of the ACR, and also find no conclusive proof that EUL changes occurred expressly because the IOUs were paid ESPI awards. As noted by NRDC, improvements in IOU performance should occur naturally as knowledge and experience are gained in designing, implementing and overseeing EE

[18] ACR at 11

programs. Such improvements translate into policy refinements and better decision making. Even assuming some linkage could be inferred between the EUL changes and ESPI awards, the increasing role of statewide and third party administration of EE programs raises questions of the extent to which EE performance improvements in EUL measures are directly attributable in any event to actions within direct IOU control.

4.4. Performance Improvements in the Ex Ante Review Process

The ex ante review (EAR) component of the ESPI was intended to motivate each IOU to produce ex ante estimates more closely aligned with ex post evaluations. [19] Previously, D.12-12-032 had incorporated performance metrics and a scoring scale to derive an incentive payment relating to EAR processes. The ESPI utilized a similar scoring scale to rate and award IOU performance, based on performance scores from the 2010 program year shareholder incentive mechanism decision. [20]The EAR award level was capped at 3 percent of resource program expenditures.

We note the IOUs' claims of EAR process improvements as evidence of ESPI effectiveness. For example, SCE has doubled its EAR performance score since 2015. SDG&E's reported EAR scores also show upward movement over

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[19] The *ex ante* review (EAR) incentive component is defined as follows. It is based on each IOU's performance as evaluated with scoring of specified metrics. The EAR award is aimed at motivating IOUs to produce energy savings estimates more closely aligned with post-project evaluations The IOU earns a score for each EAR performance metric, as follows: timing and timeliness of submittals; content, completeness, and quality of submittals; proactive initiation of collaboration; due diligence and quality assurance / quality control effectiveness; responsiveness to need for process/program improvements. (*See* D.13-09-023, D.15-10-028, and D.16-08-019)

[20] D.13-09-023 at 27

time. SDG&E argues that the ESPI incentive encouraged it to continue improving conformance of ex ante assumptions with ex post savings.

SoCalGas notes that in its 2019 EAR Memo,[21] the Commission recognized SoCalGas' leadership in statewide workpaper development and noted "SoCalGas continues to demonstrate efforts to improve its performance," and called out the successful transition to statewide workpapers and SoCalGas' role in making this submission cycle successful and timely, which contributed to a score of 41.33 out of 50.

PG&E claims that the ex ante review component of the ESPI has resulted in a much narrower range between ex ante savings and *ex post* evaluated results. Between the 2010-12 portfolio and 2017, PG&E's evaluated MWh savings relative to ex ante estimates increased from 77 percent to 91 percent, the ratio of evaluated MW savings to ex ante estimates increased from 72 percent to 94 percent, and the ratio of evaluated therm savings to ex ante estimates increased from 92 percent to 95 percent.

While we acknowledge these EAR improvements, we question how much the ESPI was the primary driver, outweighing the cost of the award. Particularly for ex ante workpapers relating to programs administered on a statewide basis, we question the link to EAR awards paid to individual IOUs who were not the statewide administrator.

Moreover, to the extent ex ante quality control improvements may have been influenced by ESPI, as TURN observes, such improvements will likely continue to support quality control effectiveness, regardless of ESPI. The EAR

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[21] Twice each year, the CPUC provides feedback to the IOUs on their EAR process performance by issuing midyear and final performance memos. The final performance memos contain EAR performance scores for deemed and custom projects.

incentive component was a response to ex post true-up challenges associated with the 2006-2008 RRIM. The EAR award was intended to motivate the IOUs to apply due diligence and engineering rigor in locking down ex ante savings. EAR improvements already noted, however, indicate that earlier problems that led to adoption of the EAR incentive have largely been addressed.

In view of these considerations, we find no necessity for burdening ratepayers with funding EAR awards to continue to sustain adequate quality control in the ex ante process going forward. Nonetheless, we find usefulness in continuing to evaluate and report on IOU performance relating to the ex ante processes. Evaluating performance continues to be important independent of whether the IOU receives extra earnings for performance. Accordingly, while we impose a moratorium on EAR awards, we retain the existing processes used to score and rate EAR performance. These EAR scores shall continue to be produced and used by Energy Division for monitoring and evaluation purposes along with other aspects of EM&V activities.

4.5. Academic Studies in Support of Incentive Mechanisms

We are not persuaded that academic studies such as those identified by PG&E can be relied upon to conclude that the ESPI is necessarily effective. PG&E cites academic studies regarding the merits of incentive mechanisms for advancing demand side management goals. As part of the National Action Plan for Energy Efficiency, the EPA produced the report "Aligning Utility Incentives with Investment in Energy Efficiency" in 2007. The report addresses shareholder incentives as an appropriate and effective use of ratepayer funds. PG&E also cites a 2011 American Council for an Energy-Efficient Economy (ACEEE) report concluding that "shareholder incentives influence utility behavior and are correlated with higher per person investment in efficiency programs by utilities," and "that even when compared to states that have attempted to align incentives to encourage efficiency through such mechanisms as decoupling or lost revenue recovery, per capita spending is notably higher in states that have adopted a shareholder incentive mechanism." [22] PG&E notes that in 2015, ACEEE produced a follow up report that showed "states with incentive policies had somewhat higher spending as a percentage of revenues (2.0 percent) than states without incentive policies (1.4 percent); and substantially higher savings (0.9 percent) than states without incentives (0.5 percent)." The report concluded that "shareholder incentives influence utility behavior and are correlated with higher per person investment in efficiency programs by utilities," and "that even when compared to states that have attempted to align incentives to encourage efficiency through such mechanisms as decoupling or lost revenue recovery, per capita spending is notably higher in states that have adopted a shareholder incentive mechanism."

We conclude that the academic studies cited by PG&E, while offering theoretical support for the use of incentive tools, are too generalized to be relied upon for assessing the specific effectiveness of ESPI. The cited studies look at incentive mechanisms from jurisdictions outside of California and do not necessarily reflect current conditions faced by California IOUs. As NRDC notes, to determine the impact of the ESPI on the behavior of IOUs, California's EE program performance would have to be compared with a control region with similar policy and market characteristics but that does not offer an ESPI.

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[22] *See* PG&E comments citing Hayes et al., Carrots for Utilities: Providing Financial Returns for Utility Investments in Energy Efficiency 16 https://www.aceee.org/research-report/u111.

Conducting such an empirical study would not be an efficient use of the Commission's resources. For the reasons noted by NRDC, without a California-specific study compared with a suitable control region, there is insufficient empirical basis to draw conclusions as to the specific merits of the ESPI.

4.6. Supply Side Bias and the ESPI Moratorium

As noted in D.13-09-023, IOUs generate earnings when they invest in supply-side resources, but not when promoting EE to reduce load demand. To address this disparity inherent in the different approaches to addressing energy load requirements, an incentive mechanism, in theory, may help offset this bias by offering earnings for EE investment. In D.13-09-023, however, we previously acknowledged the limitations of ESPI awards in actually counterbalancing this IOU financial bias in favor of supply side resources. Rather than setting incentive earnings potential by attempting to match earnings from supply-sided resources, ESPI earnings potential was merely capped at 10.85 percent of the EE budget. Given its known limitations in this regard, a moratorium on ESPI awards won't change the IOUs' supply-side bias in one direction or the other. In this regard, in adopting the ESPI in D.13-09-023, we expressly acknowledged that designing:

> "….ESPI earnings potential based on supply-side equivalent resources, at best, would offer limited usefulness. The PEB shared savings methodology, previously used to set EE incentive earnings, does not realistically track supply-side investment behavior. Supply-side investments are "lumpy." That is, they do not occur evenly as a function of load growth, but increase in discrete steps as plants come on line as rate base. By contrast, EE investments are dispersed, occur more evenly, and are individually small.
>
> Moreover, the accuracy of supply-side comparisons depends, in part, on how closely procurement planning accounts for EE

value in the avoided cost model. Supply-side procurement is driven by resource adequacy, renewables integration, and local reliability needs, which are a function of local peak demand forecasts. It is not clear to what extent such assumptions are reflected in modeling to derive the PEB.

… Rather than setting incentive earnings potential by attempting to match earnings from supply-sided resources, we set the earnings potential as a percentage of the EE portfolio budget."[23]

4.7. ESPI Management Fees

The ESPI award includes the payment of "management fees" to the IOUs for (a) codes and standards (C&S) advocacy; and (b) non-resource programs (*i.e.*, programs for which energy savings are not directly attributed, but which support the EE portfolio through activities such as marketing, training and education, or emerging technology).

C&S advocacy work is different from other resource-based activities, because expenditures incurred during each cycle do not result in resource savings until after the cycle ends. Calculating savings associated with the these activities involves additional, complicating factors, including code compliance estimates, attribution factors that estimate how much of the IOUs' efforts contributed to the code development, and estimates of measures captured by code that were naturally occurring market development. Because of the complications associated with measuring savings from C&S advocacy as part of the resource savings calculations, we adopted a simplified incentive approach in D.13-09-023, paying a management fee. Likewise, payment of a management fee was adopted as a means of encouraging the IOUs to focus on funding non-resource program goals rather than shifting funds and resources away from non-

[23] D.13-09-023 at 30-31.

resource programs. SoCalGas, in particular, argues that its spending on non-resource programs and C&S advocacy has led to significant savings for ratepayers.

We recognize the importance of C&S advocacy and non-resource program goals, such as workforce education and training and local government partnerships. [24] We question, however, whether ESPI management fees are required as the best way to accomplish these goals.

ESPI management fees are paid merely as a function of program expenditures, but not based on verification of any actual results relating to direct or indirect energy resource savings-related benefits. D.13-09-023 set the management fee at a 12 percent rate for the C&S advocacy spending versus at a 3 percent rate for non-resource programs. Empirical support for these percentage levels as being necessary to produce actual benefits, however, does not exist. Payment of a management fee as a fixed percentage of program expenditures is administratively simple. But simplification also makes the award less effective in ensuring meaningful performance results compared with use of specific program performance metrics.

We also stated in D.13-09-023 that we would reevaluate the basis for the management fee components in the future and consider changes to make it more savings based. As we engage in this reevaluation, we note that the management fee approach is still not sufficiently savings based.

Consistent with our findings regarding ESPI awards for resource savings and the EAR, we find the lack of compelling evidence of a link between ESPI management fees and accomplishments for C&S advocacy and non-resource

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[24] *See* for example, D.18-05-041, Ordering Paragraph 7, p. 183 and Conclusion of Law 69, at 180.

programs. In any event, the ESPI management fees account for a small fraction of the total ESPI award.[25] With the moratorium being imposed for the other ESPI award elements, any small remaining impact of the management fees standing alone is not significant enough to change IOU behavior in a material way. Accordingly, the moratorium on ESPI awards will include management fees paid for C&S advocacy and non-resource programs.

4.8. ESPI Impacts on Cost Effectiveness Goals

Imposing a moratorium on the payment of ESPI awards will improve the cost effectiveness of EE programs. In the ACR, comments were solicited regarding how ESPI has affected the cost of obtaining energy savings. ESPI awards negatively impact the cost-effectiveness of EE portfolios because incentive awards are included in the Total Resource Cost (TRC) and Program Administrator Cost (PAC) tests as a cost, with no corresponding benefits. Based on the IOUs responses to the ACR, Question 1, ESPI award payments have reduced TRC scores by an average of 3 percent and PAC scores by an average of 6 percent over the past few years.

The ESPI award element for C&S advocacy, non-resource programs, and EAR performance categories, in particular, reward the utilities as a function of expenditures, resulting in higher costs that negatively impact portfolio cost effectiveness

The IOUs have struggled to file Annual Budget Advice Letters (ABALs) that are cost-effective and meet energy savings goals, as required by D.18-05-041. For example, in the utilities' 2020 annual budget advice letters (ABALs), ESPI accounts for $35.5 million of costs in the forecasts. Without commensurate

[25] Based on assumed ESPI earnings potential at the time, ESPI management fees accounted for only between 5.1 percent and 7.7 percent of total ESPI awards. (*See* D. 13-09-023 at 28)

benefits, this measurably depresses the cost-effectiveness of the portfolios. Cost-effective EE potential has diminished in recent years due to the Commission's EE investments during the past several decades and the success of California's improvements to codes and standards. EE program administrators have been unable to consistently maintain cost effective portfolios for several years. The statewide EE portfolio cost effectiveness has been challenging since the 2010-2012 period.

The ESPI does not directly align with EE cost-effectiveness objectives. In D.13-09-023, ESPI incentive earnings formulas were based on lifecycle savings, and not simply first-year goals for the 2013-2014 cycle. The incorporation of these stretch values in calculating incentive earnings factors reflected a focus on measures that provide deeper savings and programs that demonstrate efficiency impacts above and beyond savings that otherwise would have occurred. Our expectation was that through careful program design to reduce free ridership [26] and focus on cost-effective, longer life measures, the IOU portfolios could achieve the higher portfolio savings associated with the target net-to-gross ratios. However, some of the evaluated measure level net-to-gross ratios have not improved since the ESPI mechanism was put in place.[27]

As noted in D.13-09-023, the shift away from first-year savings to life-cycle savings plus removing cost-effectiveness as a component of the incentive

[26] The term "free ridership" refers to program participants who would have undertaken an energy efficiency activity in the absence of the program. Program savings exclude the effect of free riders because their participation would have happened anyway. Savings from free riders thus are not recognized as a benefit of the program.

[27] The Commission anticipated that the IOUs would take steps to embed improvements in program influence into their program designs and potentially into employee compensation structures. However, we do not have evidence that the ESPI mechanism has resulted in changes in IOU program designs or employee compensation structures.

mechanism would likely reduce portfolio cost effectiveness over time.[28] In acknowledging this potential outcome, we determined to prioritize the focus on deeper and longer-lasting savings over maximizing net economic benefits. Yet, achieving the longer-term policy vision results in a shift in the portfolio towards a higher percentage of future savings, which receive less value in today's dollars when discounted to present-value per our adopted cost-effectiveness tests.

Imposing a moratorium on ESPI awards will reduce the need for spending to evaluate and contest the accuracy and precision of the utilities' claimed awards. Energy Division shall be able to redirect contract funds previously earmarked for ESPI. Some utility and/or Energy Division EM&V funds can be redirected toward studies that examine how programs can be made more effective to increase future savings or to invest in innovative programs.

4.9. Timeline for Implementing the ESPI Moratorium

Parties disagree concerning a timeline for implementation of measures adopted in this decision,

SoCalGas argues that any changes to the ESPI should only be prospectively applied, and prior years' activities should be incentivized under the structure in place at the time of program delivery. SoCalGas, SCE and SDG&E agree that before making modifications to the ESPI mechanism, a workshop should be held first. However, SoCalGas recommends that due to current economic conditions associated with COVID-19, and the need to prioritize regulatory action, this workshop be held no sooner than September 2020.

[28] Removing cost-effectiveness from the incentive calculus has a direct impact, by not providing a financial incentive for IOUs to maximize portfolio cost-effectiveness overall.

PG&E proposes deferring discussion of ESPI reforms until after addressing issues in the *Administrative Law Judge's Ruling Inviting Responses to Potential and Goals Policy Questions* (P&G Ruling) issued March 12, 2020.

TURN recommends that the Commission's decision on ESPI apply to Program Year 2020 activities and beyond. TURN notes that the IOUs have been on notice that the Commission might modify or eliminate ESPI since the ACR issued on March 18, 2020. TURN suggests alternatively that if the Commission accepts the IOUs' assertions that an incentive mechanism materially impacts how they carry out their duties as portfolio administrators, a more conservative timeline would be to make changes to ESPI effective for Program Year 2021 activities. TURN argues that this timing would ensure that that the IOUs have full notice of the change before it becomes effective.

We conclude that the starting point to implement the ESPI moratorium should begin effective with the 2021 program year advice letter claims. We decline to go as far as proposed by SoCalGas for continuing to fund ESPI awards for all performance activities under the structure in place at the time of program delivery for two additional years in order to cover all 2019 and 2020 activity. In view of the time lag between when program activity occurs and when ESPI awards are paid out for the activity, the SoCal Gas proposal would mean ESPI awards continue for 2021 and 2022 claims for all remaining past activity covering the 2019 and 2020 periods. Such a treatment perpetuating funding of ESPI awards into 2022 would not be fair to ratepayers in view of our findings regarding the questionable effectiveness of ESPI in the current EE policy landscape.

On the other hand, we conclude that ESPI advice letter earnings claims filed before the effective date of this decision should be processed under ESPI rules in effect at the time of filing. Accordingly, the IOUs shall remain eligible for ESPI awards claimed in their advice letter filings made in the 2020 program year consistent with the rules in effect prior to today's decision. Since the 2020 ESPI advice letter claims cover all remaining 2018 performance activity, the IOUs remain eligible for recovery of all ESPI earnings claimed for 2018 activity.[29]

For earnings claims relating to 2019 program year activities, whatever portion of 2019 earnings claims is otherwise subject to inclusion in the 2020 advice letter claims will be eligible for recovery under ESPI rules in effect prior to today's decision, as previously noted. Any 2019 earnings claims that would be subject to the 2021 ESPI advice letter will be subject to the moratorium adopted herein and NOT recoverable through retail rates. We consider this treatment of 2019 earnings claims to be fair to the IOUs even though it means not all 2019 earnings will be subject to recovery. During 2019, the IOUs were aware of the inherent time lag between when performance occurred and when they become eligible to claim awards for that performance The IOUs were on notice that the awards could be cut off based on the date of the claim, irrespective of when the actual performance occurred. Our adopted timetable provides due notice to the IOUs of the moratorium before it takes effect. As TURN observes, when the RRIM was replaced with the ESPI in D.13-09-023, those changes applied to Program Year 2013 activities – the same year in which the decision was issued. In similar fashion, the timetable for implementation of the ESPI moratorium that we adopt herein provides a fair balancing of both ratepayer and IOU interests.

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[29] Because the 2018 earnings claims disposition for SoCalGas were further deferred pending a ruling on the Order to Show Cause, however, the final disposition of 2018 earnings claims for SoCalGas remains subject to that pending ruling.

As a result of the moratorium adopted herein, additional ESPI processes as described in D.13-09-023, such as creating an "uncertain measure list" by October of each year, the Performance Statement Report, and updating the ESPI earnings coefficients are not needed. Energy Division may still determine how best to prioritize any future evaluations activities, as those studies are not solely conducted for ESPI purposes.

The moratorium shall continue in effect pending further actions to consider whether or how the ESPI can be reformed or replaced with an effective incentive alternative. Consideration of ESPI reform, however, shall be deferred pending disposition of certain proposed changes relating to energy efficiency programs management and administration reform identified in the Assigned Commissioner's Scoping Ruling dated July 3, 2020. Specifically, we refer to (a) the proposal to transition to a four-year portfolio filing process, in place of the current ten-year rolling portfolio filing process and (b) issues related to the identification of energy efficiency potential, as well as the setting of energy savings goals for program administrators as previously set forth in the Assigned Commissioner's Ruling issued March 12, 2020 (the P&G ruling). These issues must be addressed and resolved before we can comprehensively assess the potential for successful incentive reform. The Commission is considering foundational changes to EE via the P&G Ruling, including optimization of EE in the Commission's Integrated Resource Plan (IRP) proceeding. The structure of EE goals could change as the Commission considers optimizing EE in the IRP.

The Assigned Commissioner accordingly will issue a subsequent ruling with a schedule for addressing incentive reform issues at the appropriate time.

5. Comment Period

The alternate proposed decision of the Assigned Commissioner 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_____________.

6. Assignment of Proceeding

Liane M. Randolph is the assigned Commissioner and Julie A. Fitch is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The Efficiency Savings and Performance Incentive (ESPI) mechanism was adopted in D. 13-09-023 to offer incentive awards to the major investor owned energy utilities, based on performance in four categories: (1) energy efficiency (EE) resource savings; (2) ex ante review performance; (3) EE building codes and standards advocacy; and (4) non-resource programs (which support savings based programs but in which there are no direct savings).
2. The Commission's purpose in implementing the ESPI mechanism was to motivate utility investors and managers to view EE as a core part of the utility's regulated operations. At the same time, the ESPI was to protect ratepayers' financial investment and ensure that program savings are real and verified,
3. Although the lifetime energy resource savings measures have increased somewhat since ESPI was adopted, various factors could have affected these changes. The extent to which the ESPI mechanism specifically influenced the changes remains unproven.

4. Apart from incentive earnings as a motivation, improvements in IOU performance should occur naturally as knowledge and experience are gained in designing, implementing and overseeing EE programs.

5. To affirmatively conclude whether ESPI awards are effective in changing IOU behavior to advance EE goals, an empirical study would be needed comparing California IOUs' energy efficiency program performance over time with a control region having similar policy and market characteristics but without a mechanism equivalent to ESPI. Such a study would not be feasible given the practical limitations of Commission resources.

6. Over the past several years, changes have occurred regarding how the energy efficiency portfolio is designed and administered. These changes impact the manner and degree of IOUs' influence over program designs.

7. A significant portion of the EE portfolio has been mandated to be administered on a statewide basis, with third-party design and implementation of a majority of the EE budget.

8. Pursuant to D.16-08-019 and D.18-05-041, each utility is required to allocate 25 percent of its EE portfolio budget to statewide programs, except SoCalGas, which is required to allocate 15 percent of its EE budget to statewide programs.

9. Under the statewide management structure, although the statewide lead utility has responsibility for program success, every utility program administrator gets allocated a portion of the savings and receives a corresponding ESPI award.

10. The management structure for statewide EE programs creates a misalignment between ESPI awards and an individual utility's ability to influence the energy savings achieved through such programs.

11. In D.16-08-019, each of the IOUs was directed to outsource a minimum of 60 percent of its portfolio by the end of 2020, up from the previous 20 percent requirement. In D.18-01-004, the deadline was extended to December 2022 for outsourcing 60 percent of each IOU portfolio.

12. The shift from utilities managing EE programs to procuring third-party program reduces the direct control of individual IOUs over performance outcomes used to determine ESPI awards.

13. ESPI awards were designed to motivate the IOUs for performance within their control, but not to compensate for the risk of uncertainty of third-party actions beyond their control. The IOU shareholders are separately compensated for risk of uncertainty beyond IOU control through the authorized rate of return.

14. While the IOUs remain responsible for program performance to meet adopted energy savings goals and cost effectiveness thresholds, bearing such responsibility does not inherently justify a need for ESPI awards. The Commission does not typically award incentive earnings for other essential core responsibilities for ensuring reliable and safe utility service.

15. Although there is a possibility that in the future, the Commission may impose penalties or disallow recovery if the third-party implementers do not perform, no such provisions currently exist in the ESPI mechanism. There is no justification for ESPI awards to compensate for a risk that does not now exist.

16. The ex ante review component of the ESPI was intended to motivate each IOU to produce ex ante estimates more closely aligned with ex post evaluations.

17. Although EAR process improvements have occurred since ESPI was adopted, the extent of the cause and effect relationship between improvements and ESPI payments remains unproven, as does how much the ESPI was the driver of those improvements, or outweighed the cost of the award.

18. To the extent ex ante quality control improvements may have been influenced by ESPI, such improvements will likely continue to support quality control effectiveness, regardless of ESPI.

19. The EAR incentive component was a response to the ex post true-up challenges associated with the 2006-2008 RRIM, and to motivate the IOUs to apply due diligence and engineering rigor in locking down ex ante savings. Given improvements in the EAR process, however, the earlier problems that led to a perceived need for an EAR incentive in 2013 appear to have largely been addressed.

20. On balance, evidence is lacking that EAR awards continue to be required to sustain adequate quality control in the ex ante process going forward.

21. Even without the payment of EAR incentive earnings, there is still value in continuing to evaluate and report on IOU performance relating to the ex ante processes.

22. A management fee for non-resource programs was adopted as part of the ESPI in D. 13-09-023 as a tool to encourage greater focus on achieving non-resource program goals while removing a disincentive to shift funds and resources away from non-resource programs.

23. Because of the complications associated with measuring savings from codes and standards advocacy as part of the resource savings calculations, in D.13-09-023, the Commission adopted a management fee approach which was deemed to be a practical solution at the time

24. Paying the ESPI management fees merely as a fixed percentage of the approved program expenditures is administratively simple compared with use of specific program performance metrics, but it also makes the fees less effective as an incentive for targeting and motivating meaningful performance results.

25. Since ESPI management fees account for a small fraction of the total ESPI award, their financial impact on motivating IOU actions is correspondingly limited.

26. Consistent with findings justifying a moratorium on ESPI awards for resource savings and the EAR, compelling evidence is lacking to justify, on the basis of advancing Commission goals, the need to continue ESPI management fees paid based on spending for C&S advocacy and non-resource programs.

27. ESPI award payments divert resources from EE programs and reduce the cost effectiveness of EE portfolios.

28. The Commission's expectation in adopting the ESPI was that through a focus on cost-effective, longer life measures, the IOU portfolios could achieve the higher portfolio savings associated with targeted net-to-gross ratios. Instead, evaluated net-to-gross ratios for a number of EE measures have not improved since the ESPI mechanism was put in place.

29. Because the ESPI mechanism is not currently serving ratepayers' best interests, and pursuant to the statutory requirements of Public Utilities Code Section 451 for just and reasonable rates, and given the heightened importance of affordability during the COVID-19 pandemic (as noted in D.20-07-032), it is reasonable to impose a moratorium on ESPI earnings awards effective with the 2021 program year advice letter claims.

30. As noted in D.20-07-032 at 3, while ensuring the affordability of utility services is a longstanding priority for the Commission, its importance has been magnified by COVID-19, which has placed great financial stress on millions of Californians.

31. It is reasonable to process ESPI advice letter earnings claims filed during the 2020 program year under the ESPI rules in effect at the time of the filings.

32. In view of the time lag between when program activity occurs and when ESPI awards are paid out for the activity, the adopted moratorium will apply to some program activity for 2019 and 2020 that occurred prior to the effective date of this decision.

33. Perpetuating funding of ESPI awards into the year 2022 would not be fair to ratepayers given our findings regarding the current ineffectiveness of ESPI.

34. Pursuant to the Assigned Commissioner's Ruling dated July 3, 2020, the Commission is considering foundational changes to EE relating to (a) a proposal to transition to a four-year portfolio filing process, in place of the current ten-year rolling portfolio filing process and (b) issues relating to EE potentials and goals, including optimization of EE in the Commission's Integrated Resource Plan (IRP).

Conclusions of Law

1. Consideration of changes to the ESPI Mechanism is within the scope of this rulemaking, pursuant to the Assigned Commissioner's April 26, 2018, Amended Scoping Memorandum, which included "updates to the ESPI mechanism" in the scope of this proceeding as an ongoing policy issue.

2. The Assigned Commissioner's Ruling dated March 18, 2020, appropriately framed the focus of inquiry for purposes of this decision with the question: "*Are shareholder incentives, in any form, necessary to ensure the achievement of energy savings?*"

3. Parties' comments filed in response to the Assigned Commissioner's Ruling granting the Cal Advocates motion provide a sufficient basis for the Commission's decision as rendered in the instant order.

4. Based on the Assigned Commissioner's Ruling dated March 18, 2020, the burden of proof requires an affirmative showing ESPI award payments continue

to be required in order to achieve the Commission's goals relating to energy efficiency programs.

5. To justify continued ratepayer funding, ESPI must be more than just a symbolic gesture of our commitment to prioritizing EE goals. It must be a proven driver of real net-positive benefits for California's energy customers and society at large.

6. An incentive mechanism can be an appropriate use of ratepayer resources, but only to the extent that the mechanism drives incremental program performance resulting in net-positive benefit for California's energy customers and society at large.

7. The assessment of whether continued funding of ESPI awards is a justifiable ratepayer cost is informed by statutory requirements of Public Utilities Code Section 451 that retail utility rates be just and reasonable, and in view of current economic hardships faced by California ratepayers relating to the COVID-19 pandemic.

8. It would be unfair and inconsistent with Pub. Util. Code Section 451 and counter to the affordability constraints facing ratepayers as articulated in D. 20-07-032 to impose ESPI award funding on ratepayers without a showing that those awards are required to motivate the IOUs to make EE the first cost effective resource in the loading order and to meet the other specified goals as articulated in adopting ESPI in D.13-09-023.

9. Imposing a moratorium on ESPI awards in no way diminishes the Commission's continuing commitment to advancing EE goals as the first cost effective resource in the loading order.

10. Given the lack of evidence to the contrary, good cause has been shown to impose a moratorium on further funding of ESPI awards to project ratepayers from unjustified cost burdens.

11. Further consideration of possible reforms to the ESPI, or design of a new incentive mechanism, is appropriate only after the issues identified in Finding of Fact 34 have been addressed.

12. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. A moratorium is hereby imposed on awards otherwise payable under the Efficiency Savings and Performance Incentive (ESPI) mechanism, effective beginning with the 2021 program year. ESPI award advice letter claims made during the 2020 program year shall be subject to processing and approval under rules in effect at the time of filing. The moratorium shall apply to all investor owned utilities eligible to file ESPI claims, namely: Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company.

2. The moratorium on Efficiency Savings and Performance Incentive (ESPI) award payments shall continue in effect pending further Commission action to determine whether or how ESPI can be reformed or how a new incentive design can be effectively devised and implemented. Further Commission action shall be deferred, however, until certain issues identified in the July 3, 2020 Assigned Commissioner's Scoping Ruling are resolved relating to: (a) the proposal to transition to a four-year portfolio filing process, in place of the current ten-year rolling portfolio filing process and (b) issues related to the identification of energy efficiency potential, as well as the setting of energy savings goals for

program administrators as previously set forth in the ALJ Ruling issued March 12, 2020.

3. Any new or revised incentive mechanism will apply only to activities performed on or after the date of implementation. No retroactive recovery of earnings will be allowed based on activities performed during periods prior to implementation of any new or revised incentive mechanism.

4. Although the moratorium adopted in Ordering Paragraph 1 of this decision includes award payments relating to the Ex Ante Review (EAR) component, the actual EAR scoring and evaluation processes already in place shall continue in effect.

5. Since the moratorium on Efficiency Savings and Performance Incentive (ESPI) awards will reduce the need for spending to evaluate and contest the accuracy and precision of the utilities' claimed awards, the Energy Division shall be authorized to redirect contract funds previously earmarked for ESPI.

6. The Assigned Commissioner will issue a subsequent ruling to address a schedule for addressing incentive reform issues consistent with today's decision at an appropriate time.

7. Hearings are not required.

8. This proceeding remains open.

9. This order is effective today.

Dated ___________, at San Francisco, California