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

September 16, 2003

Agenda ID #2731
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 00-05-002 ET AL.

RE: NOTICE OF AVAILABILITY OF DRAFT DECISION ON WHETHER TO REOPEN THE SHARED-SAVINGS INCENTIVE MECHANISM ADOPTED IN DECISION 94-10-059 FOR ENERGY EFFICIENCY

Consistent with Rule 2.3(b) of the Commission's Rules of Practice and Procedure, I am issuing this Notice of Availability of the above-referenced draft decision. The draft decision was issued by the Assigned Commissioner Lynch and Administrative Law Judge (ALJ) Gottstein on September 16, 2003. An Internet link to this document was sent via e-mail to all the parties on the service list who provided an e-mail address to the Commission. An electronic copy of this document can be viewed and downloaded at the Commission's Website (www.cpuc.ca.gov). A hard copy of this document can be obtained by contacting the Commission's Central Files Office [(415) 703-2045].

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

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages.

Consistent with the service procedures in this proceeding, parties should send comments in electronic form to those appearances and the state service list that provided an electronic mail address to the Commission, including ALJ Meg Gottstein at meg@cpuc.ca.gov. Service by U.S. mail is optional, except that hard copies should be served separately on ALJ Gottstein and the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail or other expeditious methods of service. In addition, if there is no electronic

address available, the electronic mail is returned to the sender, or the recipient informs the sender of an inability to open the document, the sender shall immediately arrange for alternate service (regular U.S. mail shall be the default, unless another means – such as overnight delivery is mutually agreed upon). The current service list for this proceeding is available on the Commission's Web page, www.cpuc.ca.gov.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:hkr

Attachment

Decision **DRAFT DECISION OF COMMISSIONER LYNCH AND ALJ GOTTSTEIN** **(Mailed 9/16/2003)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company (U904G) for Authority to increase its Gas Revenue Requirements to Reflect its Accomplishments for Demand-Side Management Program Years 1995 and 1997, Energy Efficiency Program Year 1999, and Low-Income Program Years 1998 and 1999 in the 2000 Annual Earnings Assessment Proceeding ("AEAP").	Application 00-05-002 (Filed May 1, 2000)
And Related Matters.	Application 00-05-003 Application 00-05-004 Application 00-05-005 Application 01-05-003 Application 01-05-009 Application 01-05-017 Application 01-05-018 Application 02-05-002 Application 02-05-003 Application 02-05-005 Application 02-05-007

INTERIM OPINION ON WHETHER TO REOPEN THE SHARED-SAVINGS INCENTIVE MECHANISM ADOPTED IN DECISION 94-10-059 FOR ENERGY EFFICIENCY PROGRAMS

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INTERIM OPINION ON WHETHER TO REOPEN THE SHARED-SAVINGS INCENTIVE MECHANISM ADOPTED IN DECISION 94-10-059 FOR ENERGY EFFICIENCY PROGRAMS

1. Summary[1]

Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), and Southern California Gas Company (SoCal), collectively referred to as "the utilities," administer energy efficiency programs that are paid for by their electric and gas ratepayers. Since the early 1990s, the utilities have been awarded profits (also referred to as shareholder earnings) for administering these programs, based on various shareholder incentive mechanisms adopted through the years. Among other issues, this consolidated Annual Earnings Assessment Proceeding (AEAP) addresses the utility profits related to energy efficiency programs that were implemented or, in the case of long lead-time new construction projects, initiated, during program years (PYs) 1994-1997.[2]

By ruling dated March 13, 2002, the assigned Administrative Law Judge (ALJ), in consultation with the Assigned Commissioner, solicited comments on whether we should reopen Rulemaking (R.) 91-08-003/Investigation (I.) 91-08-002 to modify the shareholder incentive mechanism adopted in Decision (D). 94-10-059 for shareholder incentives before us in this proceeding

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[1] Attachment 1 explains each technical acronym or other abbreviation that appears in this decision.

[2] We use the term "energy efficiency" throughout this decision to refer to the utilities' non low-income energy efficiency program activities, and associated shareholder earnings. The earnings claims associated with low-income energy efficiency (or "LIEE") programs are being addressed in a separate phase of this proceeding.

and in future AEAPs. We address this issue today in full recognition that our authority under Public Utilities Code (Pub. Util.) Code § 1708 to reopen proceedings must be exercised with great care, with adherence to procedural due process requirements, and justified only by extraordinary circumstances. Consistent with our prior decisions, we examine whether the determinations reached in D.94-10-059 relied on misconception of fact or law, and whether the subsequent developments in electric restructuring would have materially changed our determinations on a shared-savings mechanism for the pre-1998 program years.

We conclude that the shared-savings incentive mechanism adopted in D.94-10-059 should not be reconsidered, and R.91-08-003/I.91-08-002 should not be reopened for that purpose. However, nothing in today's decision is intended to preclude us from disapproving or modifying the utility profits associated with this incentive mechanism that the utilities submit in pending and future AEAPs. All profits claimed by the utilities are subject to verification, consistent with our adopted measurement and evaluation protocols.

2. Procedural History

By ruling dated March 13, 2002, the assigned ALJ, in consultation with the Assigned Commissioner, solicited comments on whether the Commission should reopen R.91-08-003/I.91-08-002 to modify the shared-savings incentive mechanism adopted in that proceeding. The ruling described the issue as follows:

> "In D.94-10-059, the Commission stated that it wanted to adopt a level of earnings opportunity that was sufficient (and not too much) to off-set the regulatory and financial biases against demand-side management (or in favor of supply-side resources) that the utilities might have in procuring least-cost resources. (57 CPUC 2d at 51.)

> The mechanism authorized payments over a 7 to 10 year period based on a complex process of measuring long-term energy savings. Over the objections of ORA and The Utility Reform Network (TURN), the Commission set a target shareholder earnings level of 30% of long-term energy savings, without a cap, stating this was a reasonable level in light of the utilities assuming a downside risk of penalties.
>
> "Almost seven years later, our experience under this mechanism shows that (1) no penalties have ever been assessed; (2) the adopted measurement protocols award incentives for events unrelated to any utility actions, such as technical degradation levels of customers' equipment; and (3) SDG&E projects its shareholders will earn a profit of 92.5% on its 1996 programs and 80.8% on its 1995 programs, and PG&E will earn 70.7% on its 1995 programs if the incentive mechanism remains unchanged.
>
> "Based on this information, I find good cause exists to request parties to comment on whether the Commission should, based on these comments, reopen D.94-10-059 for shareholder incentives before us in this and future AEAPs."[3]

Comments in response to the ruling were filed on March 29, 2002, by the California Energy Commission (CEC), Office of Ratepayer Advocates (ORA), Natural Resources Defense Council (NRDC), PG&E, SCE, TURN, Women's Energy Matters (WEM) and jointly by SoCal and SDG&E. Reply comments were filed on April 12, 2002, by NRDC, PG&E, SCE, jointly by SDG&E and SoCal, and TURN.

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[3] ALJ Ruling dated March 13, 2002, pp. 1-3.

On February 27, 2003, a further prehearing conference (PHC) was held before Judge Gottstein in this consolidated proceeding.[4] In response to requests made by Judge Gottstein during and after the PHC, the utilities filed supplemental information related to the issue of reopening D.94-10-059 on March 17, March 18, May 19, July 23, and August 1, 2003.[5] This information included updated data on shared-savings incentives as a percentage of authorized program budgets and net resource benefits, supplemental information on avoided cost calculations, shared-savings incentives paid to date as well as pending and future shared-savings claims for pre-1998 programs, and the status of measurement and evaluation studies.

3. The Shared-Savings Mechanism Adopted in D.94-10-059

By way of background, it is useful to describe the incentive mechanism that is at issue in this proceeding. Beginning in 1995, the utilities' energy efficiency programs became subject to the "shared-savings" mechanism adopted in D.94-10-059. This mechanism was in effect for all energy efficiency programs implemented, or for longer lead-time activities initiated, during program years 1995 through 1997. It has the following features:

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[4] The 2000 and 2001 AEAPs were reassigned from Judge Walwyn to Judge Gottstein in January 2003, and were consolidated with the 2002 AEAP in this proceeding. See ALJ Ruling dated January 24, 2003.

[5] Filing of PG&E, SCE, SDG&E, and SoCal Providing Additional Information Requested by ALJ Meg Gottstein, March 17, 2003; Supplement to Filing, March 18, 2003; See also the utilities' May 19, 2003 responses to Energy Division's May 5, 2003 Data Request. Corrected and updated data related to pre-1998 programs was submitted jointly by the utilities on July 23, 2003, and August 1, 2003, at the direction of Judge Gottstein.

- Ratepayers invest in energy efficiency programs by funding the programs through rates. The "return" on the investment is the net benefits (energy savings less costs) achieved by the programs. This return does not reflect the profits paid under the shared-savings mechanism to utility shareholders.
- Ratepayers and utilities share any positive return (net benefits) as follows: 70% to ratepayers, 30% as profits to utility shareholders. The percentage paid out as profits to utility shareholders (30%) is referred to as the "shared-savings rate."
- The net benefits from energy efficiency programs are calculated on a portfolio basis, e.g., individual programs are grouped together for the purpose of calculating whether there are net benefits, and for the purpose of calculating the profits to utility shareholders. There are two separate portfolios under the mechanism: one made up of all residential programs and one made up of all nonresidential programs.
- Utilities compensate ratepayers for 100% of any losses (negative net benefits) up to the total amount of program costs recovered in rates, on a portfolio basis.
- Before any profits (shareholder earnings) can accrue, the utility must achieve 75% of forecasted performance for each portfolio, as verified in the first earnings claim. That performance threshold is referred to as the "minimum performance standard" or "MPS." Once the utilities meet the MPS, their profits for each portfolio are calculated at the 30% shared-savings rate.[6]
- All energy savings are verified after-the-fact through *ex post* measurement studies that are filed and litigated before the Commission in AEAPs. The *ex post* Measurement and Evaluation (M&E) Protocols were adopted by Commission order.

[6] The utilities earn profits at the shared-savings rate even if they do not reach 100% of their forecasted performance, as long as they exceed the MPS for the portfolio.

- Net benefits for earnings claims purposes are adjusted to reflect the aggregate measurement and evaluation costs associated with that program year.
- The payout of utility shareholder incentives occurs over four earnings claims, which extend over a 7-10 year period after measure installation. Each installment represents 25% of the total earnings associated with the program.
- The first earnings claim is subject to verification of the program costs and actual number of participants in the program (measures installed), relative to the number projected in initial savings estimates.
- The second earnings claim is subject to *ex post* verification of the *ex ante* (forecasted) savings per measure assumed in the initial savings projections.
- The third and fourth earnings claims are subject to *ex post* verification of the persistence/retention of energy savings over time, e.g., by assessing equipment degradation or removal.

Attachment 2 presents a detailed history of the development of the shared-savings incentive mechanism, and includes a description of how the mechanism functions based on the results of M&E studies. To illustrate how it works for a specific program, the following example from SoCal's 1997 AEAP filing is provided below.[7] This describes in detail how this process works for SoCal's PY1996 Commercial Energy Efficiency Incentives (CEEI) program, and shows how a study can modify an initial claim and how the earnings are then adjusted. Our discussion below as to what happens with the claim in the 2001 and 2004

[7] The example is taken from the Joint Comments of SoCal and SDG&E, January 18, 2002, pp. 12-14.

AEAPs is hypothetical, since the 2001 AEAP is pending and the 2004 AEAP applications have not yet been filed.

SoCal submitted its first earnings claim for the PY1996 CEEI program in the 1997 AEAP. SoCal became eligible for earnings on the program by demonstrating that it exceeded the 75% minimum performance threshold for the nonresidential portfolio.[8] In the first earnings claim, SoCal estimated that it would earn a total of $1.138 million for the PY1996 CEEI program over the ten-year measurement period, or 30% of the $3.793 million in net benefits to ratepayers. That is, based on the actual number of measures installed and *ex ante* estimates of measure savings, SoCal projected that the "return" on ratepayers' investment in the PY1996 CEEI program would be $3.793 million. The actual amount SoCal requested for PY1996 CEEI earnings was 25% of $1.138 million, or $284,000. This represented the *first* of four claims for the program.

A first-year load impact study was conducted on the CEEI program in 1997, the year subsequent to the program year. Load impact studies are designed to verify per measure savings estimates, using billing data and other *ex post* measurement approaches. The 1997 study found that the *ex post* measure savings were significantly lower than what was forecasted in the energy savings calculations used in the first earnings claim. The estimate of $3.793 million in net benefits presented during the first claim (see above) was revised downwards to $1.383 million based on the load impact study. Therefore, as part of the *second* claim for PY1996 CEEI program (filed in the 1998 AEAP), the lifecycle earnings claim was revised from $1.138 million to $415,000 (i.e., 30% of $1.383 million).

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[8] SoCal achieved 136% of its performance forecast for its portfolio of 1996 non-residential programs. *Ibid*. Attachment.

The second claim was then 50% of the new lifecycle earnings of the program, minus what was collected in the first claim. In this case, the claim was *negative* $77,000.[9] SoCal's total portfolio claim made in the 1998 AEAP reflected this reduction from its CEEI program.

In the pending 2001 AEAP, SoCal has filed its third earnings claim for the PY1996 CEEI program, based on the results of its fourth-year retention study. According to SoCal, the results of that study suggest no change to the *ex ante* expected useful lives for the measures. Assuming that the study methodology and results are found to be valid in the pending 2001 AEAP, the lifecycle earnings value of $415,000 (derived for the second claim and revised from the original claim) would not change from the second earnings claim. The third claim is 75 percent of the lifecycle earnings for the program, *minus* what has already been collected as part of the first and second claims. Therefore, SoCal submitted a third earnings claim for $104,250.[10]

The M&E Protocols requires a ninth-year retention study to be completed for the program and submitted in 2004. Therefore, SoCal is expected to file its fourth earnings claim in the 2004 AEAP. If it is assumed that the results of the ninth study confirm the expected useful measure life, the fourth earnings claim is equal to 100 percent of the lifecycle earnings ($415,000) minus the earnings recovered from the three previous earnings claims: $284,000 in the first claim,

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[9] Revised Lifecycle earnings = $415,000; 50 percent of Revised life cycle earnings = $207,500, minus Earnings Recovered From First Claim ($284,000) = *-$77,000*.

[10] Lifecycle earnings = $415,000; 75 percent of lifecycle earnings = $311,250; *minus* earnings recovered from the First and Second Claims = $207,000 [$284,000-$77,000]; Total = $104,250 to be collected as part of the third claim filed in the 2001 AEAP.

minus $77,000 in the second claim, plus $104,000 in the third claim, totaling $311,000. Therefore, the fourth claim would equal $415,000 minus $311,000 or $104,000.

In this example, the four payments add up to the total lifecycle earnings claim of $415,000 for the PY1996 CEEI Program. This amount represents 30% of the net benefits to ratepayers ($1.383 million), as verified by *ex post* measurement studies over the ten-year period.

The shared-savings mechanism described above was in place for PY1995-PY1997 for all utilities. It applies to all energy efficiency programs implemented during 1995-1997 or, in the case of long lead-time new construction projects, initiated during that period. Before 1994, the experimental mechanisms were in place that shared savings between ratepayers and shareholders, but that varied by utility. The potential for utility profits under these earlier mechanisms was much lower than under the shared-savings mechanism adopted in D.94-10-059. However, the utilities were not required to measure savings on an *ex post* basis as a condition for payment, and were not subject to financial penalties if the programs did not prove to be cost-effective.

By D.93-05-063, the Commission modified the existing incentive mechanisms for PY1994 to require a 7- to 10-year payout of utility profits based on *ex post* measurement. The same measurement protocols and payout conditions were also applied to the shared-savings mechanism adopted in D.94-10-059. Therefore, even though the formula for calculating earnings for PY1994 programs is significantly different than the one adopted in D.94-10-059 for PY1995-PY1997, the payout schedule and *ex post* measurement requirements are identical. Accordingly, there are still outstanding claims for PY1994 in this

and future AEAP proceedings, based on the shared-savings mechanisms in place during that transition year.

4. Scope of the Decision

Today's decision addresses whether the shared-savings incentive mechanism adopted in D.94-10-059 should be modified. At issue are the outstanding profits (earnings claims) for 1994-1997 energy efficiency programs requested by the utilities in this consolidated proceeding, as well as those that would be filed in future years. These include the profits associated with the shared-savings mechanisms in place during the 1994 transition year, since the payout and *ex post* measurement features are identical to those adopted in D.94-10-059 and, in fact, the utilities' requests for profits associated with PY1994 are still pending in this and future AEAPs.[11] Therefore, throughout this decision we use the term "pre-1998" to refer to PY1994-PY1997.

The utilities estimate that the claims in this consolidated proceeding and in future AEAPs for pre-1998 shared-savings programs will total $191 million, in addition to the approximately $155 million in earnings that they have already been authorized. Attachment 4 presents this and other current data associated with pre-1998 shared savings programs, including program budgets, forecasted and actual program performance, and other information referred to in the March 13, 2002 ruling or subsequently requested by the assigned ALJ.

In 1998, the Commission changed the measurement of success for energy efficiency programs and the basis for utility profits by generally de-linking those

[11] We also note that inclusion of the PY1994 shared-savings claims in our inquiry is consistent with the March 13, 2002 ALJ Ruling, which included the utilities' requests for profits associated with that year in the attached table.

profits from the measurement of savings. In the place of the shared-savings mechanism adopted in D.94-10-059, the Commission introduced performance milestones showing the programs' market transformation effects (e.g., increased stocking of energy efficiency appliances by retailers, better training of architects and builders, etc.). In 2001, the Commission reduced the utility's earnings potential under milestone-based incentives significantly, and as of PY2002, the Commission eliminated shareholder incentives for energy efficiency programs altogether.[12]

The earnings claims filed by the utilities in this proceeding for post-1997 energy efficiency activities will be the subject of separate Commission decisions. In addition, per the Assigned Commissioner's Ruling dated May 6, 2003, we will be consider whether to continue shareholder incentives for LIEE programs in a subsequent decision. Our ongoing energy efficiency rulemaking, R.01-08-028, continues to be the forum for considering prospective changes to energy efficiency policies, administration and programs.

5. Positions of the Parties

In the following sections, we briefly summarize the positions of the parties on the issue of modifying the shared-savings incentive mechanism adopted by D.94-10-059. Because the positions presented by PG&E, SCE, and jointly by SDG&E and SoCal are very similar, we present them collectively as the utilities' position, in our summary below.

[12] See Attachment 2.

5.1 CEC

In the CEC's view, the arguments presented in the March 13, 2002 ruling are insufficient to reopen D.94-10-059. The CEC contends that the ruling does not consider the Commission's rationale in past decisions for adopting a shared-savings mechanism, or include the facts necessary to assess the reasonableness of past and current shareholder earnings. The CEC also argues that it is unreasonable to change the incentive mechanism rules under which the energy efficiency programs have operated for eight years. Rather than seek recovery from past earnings, the CEC suggests that the Commission change the incentive mechanisms prospectively.

5.2 ORA

ORA concurs with the CEC that the tentative findings made in the ruling regarding the Commission's experience with the shared-savings mechanism do not constitute grounds to change the mechanism. In addition, ORA contends that the ruling misinterprets measures designed to protect ratepayers as arbitrarily representing windfalls to the utilities. ORA also argues that the ruling inappropriately concludes that the incentive mechanism is flawed based simply on the magnitude of profits. ORA expresses concern that reopening the docket would affirm the utilities' objections to the lengthy payment period for profits (that ORA supported and the Commission adopted), and make future ratemaking with deferral of utility cost recovery even more difficult. Finally, ORA fears that if the Commission were to modify the shareholder profits for these past years at this time, it might be creating a precedent that the utilities could use against ratepayers in the future.

In sum, ORA believes that reopening the old proceeding would result in costs, both in terms of perception of regulatory risk, and resources of both

utilities and the Commission, and would create difficult problems about the role of hindsight in reviews of past utility actions. ORA recommends that the Commission be fully aware of these implications and difficulties, in deciding whether to reopen the proceeding.

5.3 NRDC

NRDC argues that the Commission should not modify D.94-10-059 with respect to the incentive mechanism associated with pre-1998 energy efficiency programs. NRDC contends that the evidentiary record developed in AEAPs since 1995 demonstrates that these programs have produced net benefits to ratepayers of well over a billion dollars. In fact, NRDC argues that the value of the programs to ratepayers is significantly higher than those savings levels when adjusted for actual market prices during the energy crisis. No penalties were assessed because, as NRDC views it, the utilities demonstrated an impressive record of success in administering the programs. NRDC also argues that comparing utilities' earnings with program costs is an outdated, counter-productive perspective that suggests, in effect, that the programs cost too little. Instead of reopening D.94-10-059 or returning to a cost-plus incentive mechanism, NRDC argues that the Commission should focus its attention on establishment of a firm foundation for future energy efficiency programs.

5.4 The Utilities

In the utilities' view, reopening D.94-10-059 is unjustified by the facts and uncalled for under the Commission's own guidelines. They contend that reopening the incentive mechanism for retrospective application to past program years will change the rules for the purpose of punishing program administrators for a job well done.

More particularly, the utilities contend that the circumstances identified in the ALJ's ruling were fully within Commission expectations at the time it adopted the shared-savings incentive mechanism. In their view, D.94-10-059 encouraged utilities to maximize energy savings and incentives and anticipated the level of earnings that occurred. Moreover, PG&E contends that penalties have been assessed under the program, contrary to the ALJ's assertions.

In sum, the utilities argue that there is no valid ground that would justify modifying the incentive mechanism.

5.5 TURN

TURN argues that there is no legal bar to modifying the incentive mechanism adopted in D.94-10-059, especially as it applies to expected future earnings. TURN believes that D.95-05-043, cited in the ALJ ruling, is an appropriate analogous example where the Commission altered the Diablo Canyon pricing mechanism intended to continue into the future before the expiration date, effectively reducing expected future earnings by an amount considerably larger than at issue in this proceeding. TURN also cites D.97-05-088 as an example where the Commission further altered the Diablo Canyon payment mechanism.

In TURN's view, a change in the shared-savings mechanism is warranted because the fundamental assumptions of 1994 regarding the relative risks and rewards between supply-side and demand-side investments were incorrect. In particular, TURN argues that the assumption that shareholders would bear a substantial risk of nonperformance is belied by the fact that the utilities have suffered no penalties for performance below the threshold level, and have received an average return of over 25%. In addition, TURN argues that the assumption that an uncapped incentive mechanism would encourage the

utilities to maximize ratepayer net benefits is belied by the drop in program spending in 1995. Overall, TURN argues that by December 1995 at the latest, and probably as early as April 1994, it was clear that the shareholder risk for Demand-Side Management (DSM) versus supply-side investments was substantially different than portrayed during testimonies and pleadings submitted in 1992 and 1993.

In sum, TURN argues that the assumptions underlying the Commission's decision in 1994 have proven to be erroneous and were largely invalidated by events that started in 1995. TURN believes that the potential injustice of forcing ratepayers to pay an additional $175 million to utility shareholders for the pre-1998 programs warrants a review and possible modification of the shareholder incentive mechanism adopted in D.94-10-059.

5.6 WEM

WEM argues that D.94-10-059 should be reopened because the Commission erred in several respects in adopting the shared-savings mechanism. Quoting extensively from TURN's testimony and briefs in R.91-08-003/I.91-08-002, WEM contends that: (1) the 30% shared-savings rate was not justified by evidence that it would improve delivery of demand-side management, (2) the Commission failed to make incentives dependent upon objective verification, (3) the Commission relied on testimony that ignored TURN's perspective on shareholder incentives and program design by failing to adopt TURN's recommendation to suspend shareholder incentives altogether. Finally, WEM argues that deregulation changed all the rules, rendering shareholder incentives obsolete even before the new mechanism began.

6. Discussion

Section 1708 of the Pub. Util. Code permits the Commission to "rescind, alter, or amend any order or decision made by it," after notice to all the parties and with an opportunity to be heard. The statutory language of Section 1708 provides no limitations on the Commission's authority to reopen and reverse its decisions. As stated by the California Supreme Court: "That section…permits the commission at any time to reopen proceedings even after a decision has become final."[13]

However, we have long recognized that this broad authority should be exercised with great care and justified only by extraordinary circumstances:

> "By its very nature, Section 1708 provides the possibility of an extraordinary remedy. *Res judicata* principles are among the most fundamental in our legal system, protecting parties from endless relitigation of the same issues. Section 1708 represents a departure from the standard that settled expectations should be allowed to stand undisturbed. Our past decisions recognize that the authority to reopen proceedings under Section 1708 must be exercised with great care and justified by extraordinary circumstances…"[14]
>
> "…[O]nly a persuasive indication of new facts or a major change in material circumstances, which would create a strong expectation that we would make a different decision based on these facts or circumstances, would cause us to reopen the proceedings."[15]

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[13] City of Los Angeles v. Public Utilities Com., 15 Cal.3d 680, at 706 (1975). In William A. Sale v. Railroad Com., the Court similarly held that the Commission has continuing jurisdiction to rescind, later, or amend its prior orders at any time. (15 Cal.2d 612, at 615 (1940).)

[14] D.92058 (1980), 4 CPUC 2d 139, at 149.

[15] *Ibid.* at 150.

We have also articulated specific parameters for this authority, stating in several decisions that we "may only modify or rescind a decision if (1) new facts are brought to the attention of the Commission, (2) conditions have undergone a material change, or (3) the Commission proceeded on a basic misconception of law or fact."[16] It is within this legal context that we consider whether we should reopen R.91-08-003/I.91-08-002 for the purpose of rescinding or modifying the shared-savings incentive mechanism adopted in D.94-10-059.

We first turn to WEM's position. Although WEM does not refer to the legal standards discussed above, WEM argues that the Commission reached its determinations in D.94-10-059 under misconceptions of fact because it rejected TURN's position in that proceeding on several issues. We disagree. The Commission considered TURN's testimony during both the threshold and implementation phases of the proceeding, and concluded that it was not persuasive.[17] The fact that the Commission did not adopt a position that WEM apparently prefers is not a legitimate basis for reopening the proceeding.

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[16] *Re United Parcel Services, Inc.* (1997) 71 CPUC 2d 714, 719; Cal. PUC LEXIS 427, *13 citing *Application of So.Pac. Co.* (1969) 70 CPUC 150, 152, *Cal Manufacturers Assn.* v. *Cal. Trucking Assn.* (1991) 72 CPUC 442, 445, and *Winton Manor Mutual Water Co.* (1978) 84 CPUC 645, 651.

[17] See: 51 CPUC 2d 371 at 382-86 and 57 CPUC 2d at 39, 42, 43, 49-50, 56, 60, 70, 77, 78, 80 and 84. For example: "TURN argues that, because shareholders do not put up the capital for DSM, utility shareholders are entitled to a minimal management fee…We disagree with TURN's conclusions and recommendations…. With regard to TURN's assessment of investment risks, we surmise that money managers would demand considerably more than single-digit fees if they earned only in proportion to portfolio gains, as measured over a 7 to 10 year period and if they were also required to pay for all losses on their clients' investments." (57 CPUC 2d at 56.)

The March 13, 2002 ruling and TURN's comments point to the lack of penalties under the adopted shared-savings mechanism as an indication that the Commission proceeded under a factual misconception in adopting that mechanism. They also suggest that the sheer magnitude of earnings under this mechanism warrants Commission reconsideration of the underlying incentive mechanism. However, our review of D.94-10-059 indicates that the utilities' claims for profits are not out of line with the monetary value that we expected in adopting the shared-savings mechanism, assuming that the utilities deployed cost-effective programs based on verified savings. In other words, they are not unexpected.

Table 1 in Attachment 2 presents the range of potential profits at various levels of energy savings that we estimated in D.94-10-059. In the following discussion, we use the term "net benefits" to reflect the performance earnings basis for the shared-savings mechanism. The performance earnings basis, or "PEB" represents a calculation of energy savings minus costs (in dollar terms) associated with the utility's energy efficiency programs. The PEB is multiplied by the 30% shared-savings rate to produce the level of utility profits awarded under the mechanism.[18]

Our best estimate at the time we issued D.94-10-059 was that the utilities could earn profits of $89 million (collectively) for a typical program year if they met their savings targets. These profits would be paid over the ten-year measurement period in four equal installments. We estimated that those savings targets would yield $295 million in net benefits on a statewide basis. At 200% of

[18] See Attachment 2, footnote 21 for more detail on the calculation of PEB net benefits under the shared-savings rate adopted in D.94-10-059.

target savings, we estimated that profits could be as high as $177 million under the incentive mechanism. If energy efficiency activities were not cost-effective, the penalties could be as large as $215 million, or the total ratepayer cost of the programs.

Attachment 4 presents the utilities' claims for profits for pre-1998 shared-savings programs, by program year, along with forecasted and actual performance. Although the shared-savings mechanism was discontinued for all new program initiatives effective January 1, 1998, it still applied to pre-1998 program commitments that could not be fully implemented until later program years, such as new construction activities and the competitive bidding pilots. Accordingly, there are some program activities implemented during PY1998-PY2000 that are subject to the shared-savings mechanism. (See Attachment 4.)

As indicated in that Attachment, the net benefits achieved for pre-1998 programs have exceeded the forecasted performance at that time. Overall, the forecast of net benefits for the period totaled $972 million. However, the utilities have actually achieved $1.7 billion in net benefits based on *ex post* measurement verification to date, or $425 million per year on average over the 1994-1997 period. This has exceeded the Commission's expectations of approximately $295 million in net benefits on an annual basis, per the table presented in D.94-10-059.

Attachment 4 also shows that the utilities' claims for profits have been in line with profit levels discussed in D.94-10-059. Collectively, the utilities request approximately $315 million in profits for programs associated with the shared savings incentive mechanism adopted in D.94-10-059. This translates to an average of $105 million in claims for profits per program year when the incentive

mechanism was in effect. This level of profits is within the range of profit levels presented in D.94-10-059 for performance at or above target.[19]

The fact that the utilities' claims have never reached the bottom of that range, in the form of "negative incentives" or penalties, does not in and of itself justify reopening the proceeding, as TURN suggests. All this indicates is that the utilities implemented energy efficiency programs during 1995-1997 that are cost-effective to ratepayers. As ORA observes:

> "ORA is surprised to see the absence of penalties being imposed in the past being put forward as evidence of failure of the incentive mechanism. Yes, the utilities were able to meet or exceed the minimum performance levels that form the threshold for penalties. That was the Commission's desire. We don't think the Commission was looking to penalize the utilities. Not only are the utilities glad that they did not incur penalties, ratepayers should be too since this is evidence that the utilities were able to generate energy savings."[20]

While none of the utilities incurred penalties under the mechanism's cost-effectiveness guarantee, we note that other penalty mechanisms and risks under the shared-savings mechanism have come into play. For example, there have

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[19] We do not compare the utilities' claims for profits associated with PY1994 in evaluating whether the claims are within the range anticipated in D.94-10-059. As described in Attachment 2, the transitional shared-savings mechanisms that applied during PY1994 produced a substantially lower level of utility earnings, in exchange for ratepayers assuming considerable risks, e.g., that the programs would not be cost-effective. Therefore, the level of earnings claimed for that single program year is significantly below the $89 million estimate in D.94-10-059, even though actual performance exceeded expectations.

[20] Comments of the Office of Ratepayer Advocates on ALJ Walwyn's Ruling Regarding Reopening R.91-08-003/I.91-08-002 to Modify the Incentive Mechanism Adopted in Decision 94-10-059, March 29, 2002, p. 4.

been instances where a utility has not met the MPS for a program and had to forego any earnings associated with that program.[21]

The March 13, 2002 ruling also suggests that the proceeding should be reopened based on a "rate-of-return" calculation where the lifecycle earnings are divided by program costs. Attachment 4 (Table 2) includes rate of return calculations similar to the ones presented in the March 13, 2002 ruling, but uses updated data that is specific to the shared-savings program.

The comments raise several valid concerns about the March 13 ruling. First, the incentive mechanism adopted in D.94-10-059 was designed to encourage energy savings, thereby allowing the State to reduce investments in generation, transmission, and distribution facilities. Accordingly, the profits should be compared to how much ratepayers would have had to pay if those savings had not been realized.

Second, even if one does compare the level of incentives relative to ratepayer-funded program budgets, one should take into account the fact that the lifetime of the program (both the benefits of the energy savings and the incentive payment period) is considerably longer than one year. Energy efficiency program delivers energy savings for several years, and the earnings are spread out over a ten-year period. The returns calculated in the ALJ ruling (and updated in Attachment 4) do not represent *annual* returns on the utilities' programs, as indicated in the March 13, 2002 ruling. Rather, they represent a *ten-year* return.

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[21] See March 29, 2002 Comments of PG&E on Whether the Commission Should Reopen R.91-08-003/I.91-08-002 in Response to Administrative Law Judge's Ruling Dated March 13, 2002, pp. 10-11.

Third, as NRDC points out, a retrospective evaluation of profits from a rate-of-return perspective is counterproductive because it suggests that the programs cost too little: "For example, if the utilities had spent twice as much to achieve the same result, the earnings 'rate' would probably have been so low as to escape notice. In effect, the Commission would be sending the message that it would prefer utilities to spend more ratepayer money than less."[22] In D.94-10-059, we determined that the effective earnings rate associated with supply-side resources deferred or avoided by energy efficiency investments range from 26% to 52%.[23] As indicated in Attachment 4, even under a rate-of-return approach, the 44% rate achieved by the utilities for pre-1998 program activities is within the range of effective earnings rates allowed for supply-side investments during that same period.

In today's decision, we ask whether the incentive mechanism resulted in the deployment of cost-effective energy efficiency programs and rewarded the utilities for that deployment as envisioned in D.94-10-059. If, for example, the utilities earned profits on programs that were not cost-effective due to some unintended flaw in the incentive mechanism that had not been anticipated when it was authorized, then we might have a basis for reopening the proceeding. However, none of the data submitted on the performance of the programs indicate that such a flaw exists. These energy efficiency programs have been

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[22] Comments of the Natural Resources Defense Council on the Administrative Law Judge's Ruling, March 29, 2002, p. 4.

[23] D.94-10-059, Finding of Fact 84. See Attachment 2, Appendix 1.

cost-effective based on our *ex post* verification to date.[24] Accordingly, the incentive mechanism has produced profits in the form of shared-savings to the utilities. We also note that the effective shared-savings rate has not exceeded the 30% authorized level. (See Attachment 4.)

The March 13, 2002 ruling also characterizes the shared-savings incentive mechanism as awarding profits for "events unrelated to any utility actions, such as technical degradation levels of customers' equipment," and suggests that this is one reason to reconsider D.94-10-059. This characterization implies that the incentive mechanism should be neutral with respect to factors that the utilities cannot directly control, such as actual equipment failure or early equipment replacements. However, this view is at odds with the mechanism we adopted—not through misconception of fact or law—but through deliberate consideration of how shareholder incentives should be structured for both the upside and downside earnings potential:

> "As described in previous sections, the next generation of DSM incentive mechanisms will have a risk/reward profile different from any of the individual supply-side options discussed above, as well as from the DSM incentive mechanisms we have authorized in the past. Although ratepayers continue to put up the investment capital for DSM programs, shareholders will now be at risk for 100% of any losses to that capital. Unlike a rate-based plant, shareholder earnings will vary in direct proportion to performance, i.e., realized net benefits, *even when factors entirely beyond the utility's management*

[24] We note, however, that verification of pending and future AEAP claims could reduce the cost-effectiveness results, render some programs non cost-effective, and even require that the utility refunds prior payouts of earnings if the savings verified in the first and second claim dramatically degrade over time. The incentive mechanism, as described in Section 3, provides for such adjustments in earnings as we proceed with each AEAP claim.

> *control affect that performance*. And unlike any of the DSM shared-savings incentives in the past, DSM performance will be measured over a 7 to 10-year period for the purpose of calculating both earnings and penalties, and earnings for each program year will be distributed in four equal installments over that timeframe."[25]

In sum, based on our review of D.94-10-059, the record in R.91-08-003/I.91-08-002 and the actual performance of the incentive mechanism adopted therein, we find no basis for reopening the proceeding due to a basic misconception of fact or law.

We now turn to the issue of whether D.94-10-059 should be reopened based on new facts or a major change in material circumstances. Clearly, the electric industry has undergone major changes since 1994. However, as discussed above, the relevant question is whether we would have made a different decision in R.91-08-003/I.91-08-002 given those changes.

TURN answers this question in the affirmative. According to TURN, the circumstances surrounding electric restructuring "moved faster than anticipated" and "[b]y 1996 at the latest the utilities knew they would be exiting the field of new plant construction. Nevertheless, the sharing mechanism adopted in 1994 was left unchanged."[26] As a result, TURN argues: "by December 1995, at the latest, and probably as early as April 1994, it was clear shareholder

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[25] D.94-10-059, 57 CPUC 2d 1, at 56 (emphasis added.)

[26] Comments of TURN in Response to ALJ Ruling on Whether to Reopen R.91-08-003/I.91-08-002, March 29, 2002, p. 8.

risk for DSM versus supply-side investments was substantially different than portrayed during testimonies and pleadings submitted in 1992 and 1993."[27]

TURN's statements imply that we adopted the shared-savings mechanism without anticipating potential changes in the electric industry, and then failed to make timely modifications to that mechanism when such changes became apparent. To the contrary, we proceeded to adopt the shared-savings mechanism in full recognition that such changes could be imminent. In fact, we knew the nature of those changes, since both Commission proposals being debated at the time shared an identical vision for energy efficiency in a restructured electric industry.[28]

Accordingly, in D.94-10-059 we specifically acknowledged that the adopted mechanism would need to be reevaluated sometime in the near future, and directed that such a review occur no later than the 1997 AEAP. We also provided interested parties the opportunity to petition for an earlier review if a final decision on electric restructuring fundamentally altered the role of utilities in energy efficiency or the regulatory disincentives to energy efficiency. We issued our electric restructuring policy decision on December 20, 1995, and the Governor signed Assembly Bill (AB) 1890 into law on September 23, 1996. No parties filed petitions to reconsider D.94-10-059 in response to these actions. Nonetheless, shortly after the issuance of AB 1890, we solicited comment on

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[27] *Id*. The term "DSM" refers to "demand-side management" programs such as energy efficiency, which focus on the customer side of the utility meter.

[28] See: *Proposed Policy Decision Adopting a Preferred Industry Structure*, pp. 19-20 and *Customer Choice Through Direct Access*, pp. 112-113, issued by the Commission for comment on May 24, 1994. For a description of the energy efficiency vision articulated in these documents, see Attachment 2.

reevaluating the shared-savings mechanism in light of changes to energy efficiency brought about with restructuring.

Attachment 2 describes in detail the steps we took to develop the shared-savings mechanism and, after the issuance of D.94-10-059, to consider changes to that mechanism in response to changes in the electric industry. As discussed in Attachment 2, we concluded that it would not be productive to reassess the issue of shareholder incentives under a restructured electric industry until the fundamental issues of energy efficiency administrative oversight and governing policies were resolved. Our goal was to have these issues resolved by January 1, 1998. By that date, we expected to have fully transitioned away from utility-administered programs that focused on resource savings to those that focused on market transformation under an independent administrator. In the meantime, we directed that: "During this transition, utilities should retain their stewardship of demand-side management programs funded in prior years and continue to implement the adopted measurement and evaluation protocols. During this transition, the existing shareholder incentive mechanisms should continue to apply to utility DSM programs."[29]

We also addressed the changes in risks and rewards under a restructured electric industry. Notably, we concluded that the new AB 1890 regulatory structure created greater disincentives than in the past for utility development of

[29] D.97-02-014 in R.94-04-031/I.94-04-032, Conclusion of Law 6. Conclusion of Law 7 also states: "Existing Shareholder incentive mechanisms should continue to apply to prior program years and to demand-side programs under the utility administration during the transition to new administrators." (70 CPUC 2d, 774 at 813.)

energy efficiency.[30] Our decision to retain the existing shared-savings incentive mechanism for utility programs during the transition was consistent with this conclusion. The decision language on this issue is presented in Attachment 2, Appendix 2.

In sum, we adopted a shared-savings mechanism in D.94-10-059 fully expecting that it would need to be reevaluated in light of industry restructuring, and established a procedural vehicle for interested parties to petition for such a change. Once electric restructuring was underway with the passage of AB 1890, we developed a transition plan for the associated shift in energy efficiency program focus and administration. In developing that plan, we considered the changed risks and rewards for utilities under electric restructuring and determined that the shared-savings mechanism adopted in D.94-10-059 should be continued until January 1, 1998. On that date, we discontinued the shared-savings mechanism and replaced it with a mechanism based on market transformation milestones. Given this chronology, we find no merit to the argument that we would have made a different decision in R.91-08-003/I.91-08-002 due to changed circumstances, either by adopting a materially different shared-savings mechanism for the 1994-1997 period, rescinding or modifying it earlier, or authorizing no incentive mechanism at all.

TURN also suggests that a valid criterion for modifying the shareholder incentive mechanism would be if substantially changed circumstances "would result in gross injustice or unfairness to ratepayers." That is not the standard we

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[30] *Ibid.*, at 790-792.

have adopted and this is not the proceeding in which to change that standard.[31] Pointing to the drop in program spending in 1995 relative to previous years, TURN argues that the shared-savings mechanism did not provide incentives to the utilities to aggressively pursue cost-effective energy efficiency, despite the continuation of substantial shareholder incentives.[32] However, as even TURN acknowledges, the reasons for the reduction in program spending are certainly debatable.[33] TURN fails to point out one very plausible factor to explain this reduction, namely, that we authorized reductions in DSM expenditures in order to continue an electric rate freeze that eventually became the basis for the electric rate freeze codified in AB 1890.[34]

Moreover, no parties assert in this proceeding that net benefits to ratepayers from the utilities' 1995-1997 program activities, even with the payment of utility profits, have not materialized. In general, the estimates of net benefits have already been verified in prior AEAPs with respect to program participation, program costs and first-year load impacts.[35] We will be verifying

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[31] See, for example, D.92058 (4 CPUC 2d, 139) in response to a Petition to reopen proceedings related to the Diablo Canyon nuclear plant. In that decision, we stated that we would need to assess the financial and other costs to not only the ratepayers, but to the "parties," because "one or more parties have relied on decisions granting authority to construct a major generating facility, with substantial investments of time money and other resources in accordance with the terms therein." *Ibid.*, pp. 149-150.

[32] Comments of TURN in Response to ALJ Ruling, March 29, 2002, pp, 8-9.

[33] *Ibid.*, footnote 3.

[34] See D.94-12-054, 58 CPUC 2d 398.

[35] There are some exceptions to this level of verification for programs subject to the shared-savings mechanism adopted in D.94-10-059. See Attachment 4, Table 1 under "Reviewed and Approved Studies Verifying Current Shareholder Incentives."

the persistence of program savings over time in pending (and future) AEAPs, as Energy Division completes its independent verification of the utilities' retention and persistence studies.[36] Shareholders will earn profits under the shared-savings mechanism only if (1) these savings are found to be "real" through *ex post* verification, (2) program benefits are greater than costs, and (3) the level of program savings surpasses the required performance thresholds across portfolios. If those requirements are met, ratepayers will have benefited by the deployment of pre-1998 energy efficiency measures that continue to save energy over the life of the equipment.

Our best estimate to date is that the energy efficiency programs implemented (or initiated) during 1995-1997 have paid for themselves and, in fact, will yield net benefits after the payout of utility profits of approximately $795 million to ratepayers over the life of the measures. This represents benefits to ratepayers over and above program costs of $531 million and utility profits of $315 million. When PY1994 shared-savings programs are added to this calculation, net benefits to ratepayers (after program costs of $780 million and utility profits of $346 million) increase to approximately $1.4 billion.[37]

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[36] Pursuant to D.03-04-055, Energy Division is contracting for an independent verification of the retention and technical performance studies related to pre-1998 shared-savings earnings claims. See *Request for Proposal for a Review of Retention and Persistence Studies, Program Milestones, and Program Accomplishments*, dated May 2, 2003. This document can be accessed from the Commission's Website at www.cpuc.ca.gov/static/industry/electric/energy+efficiency/rulemaking.htm.

[37] Net Benefits before the payout of shareholder incentives are presented under the "Actual PEB" column in Table 2, Attachment 4. Net Benefits after the payout of utility profits are calculated by subtracting figures under "Current Total Shareholder Incentive Level" from "Actual PEB." Program costs are presented under the "Ratepayer Funded Authorized Program Budget" column of that same table.

At the same time, we recognize that electric restructuring did alter the nature of the avoided costs associated with energy efficiency investments. For the years 1994-1997 the utilities still owned a majority of the generation facilities used to produce the power they distributed. For the period 1998 to 2000, the utilities were procuring all of their marginal energy in the California Power Exchange and Independent System Operator (ISO) spot markets. For the period 2000 to 2002, they were using power purchased through the ISO day ahead market to cover any system imbalances. (See Attachment 3.)

However, these changes are not reflected in the forecasts of avoided costs used to value program savings under the 1995-1997 shared-savings incentive mechanism. The avoided cost forecasts adopted before 1998 were based on the incremental production costs, expected fuel purchases and energy contracts associated with the utility's long-term resource plan, i.e., a "pre-AB 1890" market structure.[38] Once adopted for a program year, the forecasts remained in place for the duration of the incentive recovery period (i.e., over all four earnings claims). Therefore, the net benefit (and shareholder incentive) calculations associated with the 1995-1997 program years do not reflect any of the changes in market conditions described above.

This raises the issue of whether ratepayers have been disadvantaged by such changes, in terms of the calculations of net benefits (and shareholder earnings) under the 1995-1997 shared-savings mechanism. At the direction of Judge Gottstein, the utilities presented a comparison between the energy avoided cost forecasts used to estimate the benefits of their pre-1998 energy efficiency

[38] See Filing of PG&E, SCE, SDG&E, and SoCal Providing Additional Information Requested by Assigned Administrative Law Judge Meg Gottstein, March 17, 2003.

programs, and the actual cost of energy in the years following program implementation. The information submitted is summarized in Attachment 3, and accompanying charts present the percentage differences between forecasted avoided costs and actual costs of energy over the 1994-2002 period. It is important to note that the actual costs of energy (associated with the last amount of power actually purchased or generated), will underestimate the actual avoided cost of the energy saved. This is because avoided costs are not directly measurable after the fact: One only observes data related to the costs that were *not* avoided.

With this caveat in mind, we observe the results of this comparison. (See Attachment 3.) As predicted by NRDC and others, the actual costs of procuring energy in a restructured industry for the years 2000 and 2001 were significantly higher than the utilities' forecasted avoided costs for those periods. For the years prior to 2000 and for the year 2002, the difference between the actual cost of energy and the forecasted avoided costs varies by utility, but in no case was the difference as significant as during 2000 and 2001. On the whole, it appears that the costs avoided by the pre-1998 energy efficiency programs under a restructured industry are higher than expected when these programs were initiated, to the benefit of ratepayers.

For the reasons discussed above, we conclude that R.91-08-003/I.91-08-002 should not be reopened to reconsider the shared-savings incentive mechanism adopted in D.94-10-059. However, nothing in today's decision is intended to preclude us from disapproving or modifying the requests for profits associated with pre-1998 programs that the utilities submit in the pending and future AEAPs. All claims for profits are subject to verification, consistent with our adopted measurement and evaluation protocols.

Moreover, in reaching today's determinations we recognize that the shared-savings incentive mechanism at issue in this proceeding was in place for a relatively short time, relative to the time period over which utilities have administered energy efficiency programs both before and after 1994-1997. As the energy industry has changed in California, we have revised our approach and thinking about energy efficiency program goals, implementation approaches and the utilities' role in administering energy efficiency activities. Since 2002, we have directed the implementation of successful energy efficiency efforts in California without the payment of profits to utilities. We continue to address policy and program implementation issues in our ongoing energy efficiency rulemaking, R.01-08-028. Accordingly, we emphasize that nothing in today's decision portends where we may be headed with energy efficiency in the future. Rather, we have addressed only the specific issue of whether actions taken by the Commission to encourage energy efficiency in the mid-1990s should be revisited at this time.

7. Comments on Draft Decision

The draft decision of Commissioner Lynch and ALJ Gottstein in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

8. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Meg Gottstein is the assigned ALJ in this proceeding.

Findings of Fact

1. The shared-savings mechanism adopted in D.94-10-059 applies to energy efficiency programs implemented or, in the case of long lead-time new construction projects, initiated during PY1995-PY1997.

2. The shared-savings mechanism adopted in D.94-10-059 has functioned as expected: Utilities earn only when the programs are cost-effective and produce net benefits to ratepayers on a portfolio basis, as verified through *ex post* verification over a 7- to 10-year measurement period. Consistent with D.94-10-059, shareholder earnings vary in direct proportion to portfolio performance, i.e., realized net benefits, even when factors entirely beyond the utility's management or control affect that performance (such as equipment degradation).

3. Contrary to WEM's assertions, the Commission did not proceed under a misconception of fact or law by not adopting TURN's position in D.94-10-059. Rather, the Commission considered TURN's testimony during both the threshold and implementation phases of R.91-08-002/I.91-08-003 and concluded that it was not persuasive.

4. The utilities' earnings claims under the shared-savings mechanism are in line with the monetary value that the Commission projected in adopting the mechanism, assuming that the utilities deployed cost effective programs based on verified savings. They are not unexpected.

5. For PY1994, the Commission transitioned from experimental shared-savings mechanisms that relied on *ex ante* savings estimates to mechanisms based on *ex post* verification of savings. Therefore, there are some outstanding claims for utility profits associated with energy efficiency activities implemented in that year, as well as during the 1995-1997 period, in this AEAP proceeding.

6. Based on the verified results to date, the Commission has not had to impose any monetary penalties under the shared-savings mechanism, i.e., required the utilities to reimburse ratepayers in full or in part for their investment in energy efficiency. This indicates that utilities have implemented pre-1998 energy efficiency programs that are cost-effective to ratepayers on a portfolio basis.

7. A retrospective evaluation of earnings from a rate-of-return perspective is counterproductive because it suggests that the programs cost too little. As discussed in this decision, the rate-of-return figures presented in the March 13, 2002 ruling do not reflect the fact that the life of the program (both the benefits of the energy savings and the incentive payment period) is considerably longer than one year. The rate-of-return calculations presented in the ruling represent a *ten*-year (as opposed to an annual) return. Even under a rate-of-return approach, the 44% earnings rate achieved by the utilities for 1994-1997 program activities is within the range of effective earnings rates allowed for supply-side investments during that period.

8. None of the data submitted on the performance of pre-1998 programs suggest that the incentive mechanism rewarded utilities for programs that are not cost-effective, or produced a shared-savings rate that is higher than the rate authorized.

9. Utility profits under the shared-savings mechanism should be compared to how much ratepayers would have had to pay if the program savings had not been realized. Based on *ex post* verification efforts to date, we estimate that the 1995-1997 energy efficiency programs will yield net benefits after the payout of utility profits of approximately $795 million to ratepayers over the life of the measures. This represents benefits to ratepayers over and above program costs

of $531 million and utility profits of $315 million. When PY1994 shared-savings programs are added to this calculation, net benefits to ratepayers (after program costs of $780 million and utility profits of $346 million) increase to approximately $1.4 billion.

10. Ratepayer expenditures for energy efficiency during 1995-1997 dropped relative to 1994 levels due to various factors, as discussed in this decision. Despite this reduction in expenditures, no parties assert that the energy efficiency programs implemented after 1994 have not produced net benefits to ratepayers, even after the payment of utility profits.

11. As discussed in this decision, the Commission anticipated changes in industry structure that might warrant revisiting the shared-savings mechanism adopted in D.94-10-059 before the end of 1997. The Commission considered the changes in risks and rewards for utilities under electric restructuring, and concluded that restructuring created greater disincentives than in the past for utility development of energy efficiency. Consistent with those conclusions, the Commission elected to retain the shared-savings mechanism adopted in D.94-10-059 without modification through 1997, as it shifted program emphasis to market transformation efforts.

12. As discussed in this decision, it appears that the actual costs avoided by the pre-1998 energy efficiency programs under a restructured industry are higher than expected when these programs were initiated, to the benefit of ratepayers.

Conclusions of Law

1. As discussed in this decision, the Commission has exercised its authority under Pub. Util. Code § 1708 to rescind, alter or amend its orders or decisions with great care and only when justified by extraordinary circumstances.

2. The Commission has articulated specific parameters for considering the modification or rescission of a prior decision, namely, if (1) new facts are brought to the Commission's attention, (2) conditions have undergone a material change, or (3) the Commission proceeded on a basic misconception of law or fact.

3. The Commission did not proceed to adopt the shared-savings mechanism in D.94-10-059 based on mistaken law or fact.

4. Commission would not have made a different decision in D.94-10-059 due to subsequent changes in the electric industry, either by adopting a materially different shared-savings mechanism for the 1994-1997 period, rescinding or modifying that mechanism earlier, or authorizing no incentive mechanism at all.

5. Nothing in today's decision precludes the Commission from disapproving or modifying the claims for utility profits submitted by the utilities in the pending and future AEAPs related to pre-1998 shared savings programs, based on *ex post* verification. All such claims are subject to verification, consistent with the Commission's adopted measurement and evaluation protocols.

INTERIM ORDER

IT IS ORDERED that Rulemaking 91-08-003/Investigation 91-08-002 shall not be reopened for the purpose of reconsidering the shared-savings incentive mechanism adopted in Decision 94-10-059.

This order is effective today.

Dated _____, at San Francisco, California.

ATTACHMENT 1 ACRONYMS OR ABBREVIATIONS

Acronym or Abbreviation	Name
AB	Assembly Bill
AEAP	Annual Earnings Assessment Proceeding
ALJ	Administrative Law Judge
CEC	California Energy Commission
CEEI	Commercial Energy Efficiency Incentives
D.	Decision
DSM	Demand-Side Management
I.	Investigation
ISO	Independent System Operator
LIEE	Low-Income Energy Efficiency
M&E	Measurement and Evaluation
MPS	Minimum Performance Standard
NRDC	Natural Resources Defense Council
ORA	Office of Ratepayer Advocates,
PEB	performance earnings basis
PG&E	Pacific Gas and Electric Company
PHC	Prehearing Conference
Pub. Util.	Public Utilities
PY	Program Year
R.	Rulemaking
SCE	Southern California Edison Company
SDG&E	San Diego Gas & Electric Company
SoCal	Southern California Gas Company
TURN	The Utility Reform Network
WEM	Women's Energy Matters

(END OF ATTACHMENT 1)

ATTACHMENT 2

ATTACHMENT 2

APPENDIX 1

ATTACHMENT 2

APPENDICES 2 & 3

ATTACHMENT 3

ATTACHMENT 3

APPENDIX 1

ATTACHMENT 3

APPENDIX 2

ATTACHMENT 3

APPENDIX 3

ATTACHMENT 3

APPENDIX 4

ATTACHMENT 3

APPENDIX 5

ATTACHMENT 4

TABLE 1

ATTACHMENT 4

TABLE 2