Decision 05-01-055 January 27, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Examine the Commission's Future Energy Efficiency Policies, Administration and Programs.	Rulemaking 01-08-028 (Filed August 23, 2001)

INTERIM OPINION ON THE ADMINISTRATIVE STRUCTURE FOR ENERGY EFFICIENCY: THRESHOLD ISSUES

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1. Introduction and Summary[1]

By this decision, we address the threshold issues for designing an administrative structure for energy efficiency programs beyond 2005. The administrative structure we adopt today applies to our electric energy efficiency programs, which are funded through the public goods charge (PGC) and a non-bypassable procurement surcharge, and our natural gas energy efficiency programs, which are funded through the natural gas surcharge, but does not apply to low-income energy efficiency programs.[2] As described below, energy efficiency administration encompasses all the functions related to the planning, oversight and management of energy efficiency programs, including decisions on what programs to fund with ratepayer dollars. Attachment 1 lists and describes the various administrative functions, and Figure 1 presents this listing in a flow chart form.

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[1] Attachment 3 explains each acronym or other abbreviation that appears in this decision.

[2] By statute, low-income energy efficiency programs (also referred to as "LIEE") and other low-income assistance programs are administered by the IOUs and funded separately from other public purpose programs, based on an assessment of need. (See Pub. Util. Code § 327, § 382.) All issues related to LIEE funding levels, program planning and implementation are addressed in Rulemaking (R.) 04-01-006. Therefore, the term "energy efficiency" used throughout today's decision does not include LIEE.

Our use of the term "administration" or "administrative structure" in this decision does not, however, include the various tasks associated with program delivery, e.g., recruiting of customers and installation of measures. We refer to the entities that perform these functions as "program implementers," who operate under contracts / agreements with the entity or entities managing the entire portfolio of ratepayer-funded programs. Program implementers may deliver programs directly to customers, or hire contractors to perform these services, or a combination of both.[3]

There are many potential program implementers in the energy efficiency market, including investor-owned utilities (IOUs), private energy service companies (ESCOs), local government agencies, nonprofit organizations and other entities that can influence customer decisions over energy services and deliver energy savings measures to them. The proposals presented in this proceeding all recognize that IOUs as well as non-IOUs will continue to play a role in delivering energy efficiency services to customers as program implementers. They differ significantly, however, with respect to the future role of IOUs in performing two key administrative functions: Program Choice and Portfolio Management.

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[3] Program implementers are also responsible for certain administrative functions, including overseeing their contractors, collecting data on program milestones, preparing invoices and reporting progress towards goals. In fact, we refer to program implementers as "administrators" in other Commission decisions related to energy efficiency because they do perform all the general administrative tasks necessary to manage the delivery of programs for which they are funded. However, for the purpose of establishing a common terminology for the key functions and areas of administrative responsibility that we address today, we use the vocabulary presented in Attachment 1.

Program Choice involves the selection of activities and implementers for the portfolio of energy efficiency programs, and the allocation of ratepayer dollars to those activities for each funding cycle. Portfolio Management involves the day-to-day tasks associated with general administration and coordination of those ratepayer-funded programs between funding cycles. For example, at the beginning of each funding cycle, the entity responsible for program choice will select among commercial lighting programs, programs to weatherize and upgrade appliances in single- and multi-family residences, programs to educate builders and designers of new construction projects, and many others, and decide how best to allocate authorized funding levels across those activities. Program choice also involves decisions over what combination of IOU and non-IOU implementers will receive program funds to offer and deliver the energy efficiency services to customers.

Once the portfolio of programs is selected, the Portfolio Manager will review and approve program implementation plans, oversee the contracts with implementers and track the costs and performance of the programs (and implementers) selected. As the programs "roll out" during the funding cycle, the Portfolio Manager is also responsible for identifying areas where program design and implementation can be improved, and for making (or recommending) changes to improve portfolio performance, including funding allocation changes. In addition, the Portfolio Manager is responsible for reviewing and approving invoices from implementers, generating required reports to regulators on portfolio performance, and for other general administrative and coordination tasks.

As part of its policy oversight responsibility, the Commission may establish parameters for program choice and portfolio management that limit the discretion of the entity or entities responsible for those functions. For example, the Commission may establish a policy that allocates a minimum percentage of total program funding to the residential sector, or limits the degree of fund shifting that the Portfolio Manager can initiate across the major market sectors (residential / non-residential) without prior Commission approval. The Commission may also establish a policy that a certain percentage of program funding must be allocated based on competitive responses to a Request For Proposal (RFP), or that a certain amount of funding must be set aside for statewide initiatives. Nonetheless, within Commission-established parameters, the entity or entities responsible for the Program Choice and Portfolio Management functions will be responsible for making numerous decisions that affect the way in which energy efficiency choices are presented to customers, and how energy efficiency technologies are made available to them.

It is therefore not surprising that the most controversial issue related to administrative structure is what entity or entities should be responsible for these two key functions. Some parties to this proceeding propose that the Commission delegate these responsibilities to an independent administrator (or administrators), selected based on a competitive solicitation. Others argue that the IOUs should perform these functions, as they did prior to electric industry restructuring, with input from advisory groups and other safeguards to ensure that the IOUs will not favor their own programs over those of non-IOU implementers, or favor supply-side investments over cost-effective energy efficiency. [4] Based on the proposals and comments in this proceeding, we believe

[4] As discussed in today's decision, none of the administrative structure proposals filed on April 8, 2004 recommend continuing with the current structure, which places the

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that this major "fork in the road" must be addressed before we can proceed further to design an administrative structure for energy efficiency programs.

As discussed in today's decision, we choose the fork in the road that returns the IOUs to the lead role in Program Choice and Portfolio Management. In considering our options, we recognize that the energy crisis of 2000 and 2001 has changed the regulatory landscape in a profound way for California. As a result of California's painful experience with electric industry restructuring, the Legislature and this Commission have directed the IOUs to resume responsibility for procuring resources to meet customer demand. The energy crisis has also brought about a renewed and expanded appreciation for energy efficiency as a cost-effective resource to meet that demand. Accordingly, the Energy Action Plan has placed energy efficiency at the forefront of energy policy and resource procurement in California.

Decisions in California concerning the optimal levels of energy efficiency and supply-side resources will now be made in the resource planning process undertaken by the IOUs, subject to our oversight and approval. In this context, making another entity (or entities) responsible for Program Choice and Portfolio Management of energy efficiency means that all of the program selection and day-to-day management decisions would be "handed down" to the IOUs to incorporate into their resource plans and resource adequacy projections. As we stated in Decision (D.) 04-01-050, California IOUs should not be required to

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Commission and its staff in the role of Program Choice and Portfolio Management. This structure was put in place as a "rapid response" approach to implement the summer 2000 initiatives during the height of the energy crisis in California. We agree with the City of Oakland and others that continuing this structure on a long-term basis is untenable, for the reasons discussed in Section 5 below.

adopt the forecasts and resource plans of others because "[w]e strongly believe that the utilities themselves must be responsible and accountable for providing their customers reliable service and just and reasonable rates; this is the utilities' statutory obligation to serve."[5]

We have also been presented with a proposal for energy efficiency administration structure that would leave Program Choice and Portfolio Management to the private competitive market, through a program of standard offer contracts administered by multiple non-IOU entities. As we discuss in this decision, our experiences in California have left us unwilling to rely solely on competitive market solutions to meet customers' energy needs. Moreover, we conclude that under this approach statewide programs could cease to exist entirely, customers would be faced with multiple and sometimes overlapping programs, and overall, the program synergies and leveraging necessary to optimize savings from energy efficiency would not be achieved.

We also discuss in today's decision how returning the IOUs to the Program Choice and Portfolio Management roles for energy efficiency is the logical corollary for the market structure we have recently adopted for supply-side resource procurement. In D.04-01-050, we established a market structure that placed the California IOUs in the role of program selection and portfolio manager of supply-side resources (including dispatch decisions for IOU-owned generation plant), but also allowed them to directly participate as supply-side implementers by owning and / or building new generation facilities. We did so

[5] D.04-01-050, p. 127. We note, however, that in developing the IOU long-term plans for resource procurement we do closely coordinate with the California Energy

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after hearing arguments similar to the ones raised in this proceeding concerning the pros and cons of allowing IOUs to both serve as administrators and potential implementers. In response to those arguments, we adopted certain safeguards to protect against bias in the selection process, including the use of procurement advisory groups, Commission review of procurement plans with notice and opportunity for comment, and a ban on affiliate transactions.

Even if the IOUs were not once again responsible for resource procurement, we would have significant concerns about placing responsibility for Program Choice and Portfolio Management responsibilities with third-party administrators. One of those concerns relates to the degree of control we could exert over third parties under the contractual arrangements relied on under those proposals. In order to meet our goals for energy efficiency, we must have the authority to hold program administrators fully accountable for delivering energy savings. As discussed in this decision, we believe that this authority is clearly established with our regulatory oversight of the IOUs, but considerably less certain under the proposals for independent administration.

In addition, our unsuccessful attempts to shift to independent administration for energy efficiency during electric restructuring persuades us that pursuing this approach again would require new statutory authority. The Attorney General and the Department of Finance have clearly articulated the position of these agencies: Ratepayer money such as the PGC is public money that can be held by the IOUs and spent under Commission direction, but in the absence of specific legislation, cannot be moved to an outside trust account or

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Commission's (CEC) biennial integrated resource planning process in order to avoid duplication of effort. *Ibid.*, p. 175.

bank account. Therefore, even if we desired to pursue a model that transfers funds from the IOUs to an outside entity, we would first need to seek legislation similar to the provisions that authorize the transfer of telecommunication public purpose funds to treasury accounts, or PGC funds to the CEC treasury accounts. This would delay our ability to move forward with a permanent administrative structure for energy efficiency, create uncertainty with respect to the outcome of that legislative process, and render program funding vulnerable to borrowing by the Legislature.

In addition to the uncertainty and implementation delays associated with seeking new legislation, the independent administrative structures proposed in this proceeding create other substantial implementation challenges. These include significant start-up costs and transition time, as well as the challenge of finding third-party administrator(s) capable of assuming the huge fiduciary responsibilities associated with over $400 million in annual program funding. While a “single purpose” independent entity sounds simple and appealing in theory, it is also far from certain that that a single organization or partnership of firms capable of administering energy efficiency in California will emerge as truly single purpose, i.e., free from conflicting financial interest with respect to energy efficiency.

In contrast, returning the IOUs to a lead role in program choice and portfolio management will not create the legal obstacles described above or require statutory changes. Transitioning responsibilities from Commission staff to IOU staff could be accomplished by the beginning of the 2006 program cycle in a manner that would not disrupt program delivery. Based on our experience with utility administration during the pre-restructuring / collaborative era, we are also confident that the IOUs have the requisite expertise and capability to administer energy efficiency consistent with the Energy Action Plan and the savings goals we establish in this proceeding. That experience has demonstrated to us that IOUs can meet aggressive savings goals under an administrative structure that holds them directly accountable for program results. As we reported in D.03-10-057, we estimate that IOU administrators during the restructuring / collaborative era produced $1.4 billion in net benefits to ratepayers (savings minus costs, including shareholder incentives) for programs implemented or initiated over the 1994-1997 period.

For the above reasons, we return the IOUs to the lead role in Program Choice and Portfolio Management for energy efficiency program administration beginning with program year 2006. At the same time, we realize that returning IOUs to these roles will also require us to institute appropriate safeguards, as part of our overall approach to quality control for both supply-side and demand-side resource procurement. To this end, we adopt an advisory group structure and competitive bidding minimum requirement, as described in this decision. To further safeguard against bias in program selection, we adopt a ban on affiliate transactions between IOU administrators and program implementers. We also clarify the functions for which the Commission and our staff will retain responsibility.

In today's decision, we also provide direction on how evaluation, measurement and verification (EM&V) should be structured in the future. As described in Attachment 1, the tasks under EM&V include: (1) establishing the EM&V plan for the portfolio of programs; (2) selecting evaluation firms and managing the evaluation of individual programs within the portfolio and for the portfolio as a whole; (3) overseeing the verification of program milestones, load impacts, completion of cost-effectiveness studies and other appropriate measurements of program performance; and (4) making recommendations for improvements based on EM&V program results. Based on the comments, we are persuaded that we must improve upon our current and past approaches to EM&V by requiring a clearer separation between "those who do" (the program administrators and implementers) and "those who evaluate" the program performance.

In particular, for program year 2006 and beyond, Energy Division will assume the management and contracting responsibilities for all EM&V studies that will be used to (1) measure and verify energy and peak load savings for individual programs, groups of programs and at the portfolio level, (2) generate the data for savings estimates and cost-effectiveness inputs, (3) measure and evaluate the achievements of energy efficiency programs, groups of programs and / or the portfolio in terms of the "performance basis" established under Commission-adopted EM&V protocols and (4) evaluate whether programs or portfolio goals are met. As a further safeguard to ensure against conflict-of-interest in EM&V, we prohibit entities from performing these types of EM&V studies at the same time they are under contract for program delivery work—either as a non-IOU program implementer or subcontractor to an IOU implementer.

Energy Division will also take the lead in performing research and developing recommendations to assist in developing energy efficiency policy goals and priorities, in evaluating the remaining potential to achieve additional energy or peak savings, and other research activities needed to support our policy oversight. In recognition that IOU portfolio managers and program implementers need access to market information to perform their responsibilities, we adopt a process that allows them to manage a limited subset of evaluation studies as long as there is no potential for conflict due to the nature of the study, and as long as Energy Division makes the final selection of contractors.

As described in this decision, our adopted administrative structure provides significant opportunities for public input during the planning and design of the energy efficiency portfolio, the competitive bid solicitation process and selection of program implementers, as well as the during development and review of EM&V plans and funding levels. Finally, we reiterate our commitment to continued collaboration with the CEC at both the staff and Commissioner level on a broad range of energy efficiency issues, as exemplified during this proceeding under the leadership of Commissioner Kennedy and CEC Commissioner Art Rosenfeld. We will also explore creating a more formal arrangement with the CEC for collaboration in the administrative areas of EM&V and Research and Analysis in support of energy efficiency policy development, as described in this decision. A summary of our adopted administrative structure for energy efficiency is presented in Figure 10, attached to this decision.

By addressing these threshold issues today, we resolve a major area of uncertainty regarding post-2005 energy efficiency program implementation. We can now turn to issues that have been put on hold pending their resolution, and proceed on several fronts to prepare for the 2006 funding cycle. Between now and the end of 2005 we will need to complete a variety of tasks, some of which are currently underway. These include: (1) updating avoided costs for the evaluation of program savings; (2) developing the performance basis for energy efficiency programs that defer or avoid more costly supply-side resources; (3) updating EM&V protocols and procedures for measuring program performance; and (4) updating our Energy Efficiency Policy Rules. In addition, the portfolio design and program selection process described in this decision must be completed before the end of 2005. We also intend to address the issue of risk / reward mechanisms for energy efficiency, as well as for the overall procurement framework, before the end of 2005.

By D.04-09-060, we adopted electric and natural gas savings goals by IOU service territory through the year 2013, subject to updates for 2009 and beyond.

Completing all the remaining tasks in time for the 2006 funding cycle will require an ambitious schedule during 2005. We call on all the stakeholders to put past differences aside and work collaboratively in the months ahead. Working together, all stakeholders will benefit from the result of these efforts: The full recognition of energy efficiency as a viable resource that can be relied upon to reduce the demand for energy in California.

2. Procedural History

By rulings dated July 3 and September 24, 2003, the Assigned Commissioner (Commissioner Kennedy) articulated several priorities for the coming months, including: (1) selecting 2004-2005 energy efficiency programs; (2) adopting specific savings goals based on the overall potential for cost-effective energy efficiency; (3) updating measurement and evaluation protocols; and (4) addressing the issue of long-term program administration. To provide a foundation upon which the Commission could decide these issues, Commissioner Kennedy initiated a series of informal workshops during late 2003 and early 2004 on related topics. All workshops were co-chaired by Commissioner Kennedy and Commissioner Rosenfeld from the CEC, attended by a California Power Authority (CPA) representative and facilitated by both Commission and CEC staff.

Consistent with the inter-agency collaborative model this Commission has utilized in other resource-related proceedings, Commissioner Kennedy and the assigned Administrative Law Judge (ALJ) have worked closely with the CEC and CPA in developing the policy direction for this proceeding, including the development of this draft decision on threshold administrative structure issues for the Commission's consideration.

In December 2003, in its Procurement Rulemaking (R.01-10-024), the Commission increased funding for 2004-2005 energy efficiency programs by $245 million "due to the integration of energy efficiency and procurement programs."[6] This represented an increase of 43% above levels authorized by statute via the PGC, bringing total authorized funding for energy efficiency to over $800 million for the two-year 2004-2005 funding cycle. Parties to that rulemaking urged the Commission to resolve the issue of energy efficiency administration as a high priority during 2004. The Commission responded in D.04-01-050 as follows:

> "Many parties comment on the issue of administration of energy efficiency programs. In its testimony, TURN took no explicit position on whether utilities should or should not administer energy efficiency programs but strongly urged the Commission to address this issue in the energy efficiency proceeding. ORA concurs with TURN, urging the Commission to 'promptly' address this issue. NRDC urges the Commission as well to resolve the 'unsettled issues' regarding the administration of energy efficiency programs. Utility long-term plans also support prompt resolution of this issue in R.01-08-028.
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> "Both the initial Order Instituting Rulemaking and the July 3 [Assigned Commissioner's Ruling] for R.01-08-028 identify administration of energy efficiency programs as one of the key issues to be addressed in that Rulemaking, with a goal of resolving this issue in 2004. As the Commission will authorize a uniform portfolio of energy efficiency, we believe it is necessary that the Commission have in place a unified administrative structure to oversee all energy efficiency programs, regardless of the source of funding in the years ahead. For this reason, we are referring the issue of

[6] D.03-12-060 in the Commission's Procurement Rulemaking (R.01-10-024), *mimeo.*, p. 1.

> administration of energy efficiency programs authorized in this proceeding to R.01-08-028."[7]

By D.03-12-060 and D.04-02-059, the Commission completed the program selection for the 2004-2005 energy efficiency funding cycle, after reviewing over 400 proposals exceeding $1.2 billion in requested funding. Concurrently, Commissioner Kennedy held workshops on the following topics: (1) The Potential For Energy Efficiency; (2) Customer Needs; and (3) Collaboration and Partnership among Program Implementers. A further prehearing conference (PHC) in this proceeding was held on January 23, 2004. Per the direction articulated in D.04-01-050, a schedule for addressing the issue of administrative structure by the end of 2004 was established at the PHC and subsequent scoping ruling.[8]

Workshops on administrative structure were held on March 17 and 18, 2004 in San Francisco. Over 100 individuals and organizations were in attendance. The workshop included presentations by the Commission's Strategic Planning Division and the Regulatory Assistance Project on administrative structures for energy efficiency in other states.[9] CEC and Commission staff also

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[7] D.04-01-050, *mimeo.*, p. 106.

[8] See Assigned Commissioner's Ruling Establishing Schedule For Addressing High Priority Issues During 2004 and Notice of Workshop on Administrative Structure, February 6, 2004.

[9] The Regulatory Assistance Project is a non-profit organization of experienced state utility regulators. It works exclusively with state public utility regulators and other governmental agencies primarily on electric issues, and does not have any financial interest in the outcome of this proceeding. At the Commission's request and with funding from the Hewlett Foundation, the Regulatory Assistance Project prepared the survey and discussion paper: "Who Should Deliver Ratepayer Funded Energy Efficiency," which was made available to all parties prior to the workshop.

facilitated discussions to develop a common terminology, format and list of policy and implementation considerations for parties to address in their administrative structure proposals. Stakeholders were encouraged to work together to find common ground on the issues and develop joint proposals where possible. To address competitive concerns and encourage the broadest possible participation, the ALJ also developed procedures for participants who would prefer to file proposals or comments with their identities under seal.[10]

On April 8, 2004, four coalitions and Cal-Ucons, Inc. (Cal-Ucons) filed proposals for the post-2005 administrative structure. Cal-Ucons is a private ESCO that contracts with California IOUs and utilities (both public and private) in other states to implement energy efficiency programs, including programs tailored to reach hard-to-reach market sectors such as mobile homes. The four coalitions are comprised of the organizations listed below. For ease of reference, we have given each coalition a shortened title that indicates some, but certainly not all, of the coalition members.

- <u>IOUs Coalition</u> (also referred to as the *Integrated Portfolio Management* Coalition): Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), Southern California Gas Company (SoCalGas), Building Owners and Managers Association, Coalition of California Utility Employers, Efficiency Partnership, Northern California Power Agency, Richard Heath and Associates, Inc., Sacramento Municipal Utility District and The Energy Coalition.
- <u>NRDC / LIF Coalition</u> (also referred to as the *Reaching New Heights* Coalition): Natural Resources Defense Council

[10] See ALJ Ruling: Instructions for Filing Proposals on Energy Efficiency Administrative Structure, March 23, 2004.

(NRDC), Latino Issues Forum (LIF) American Council For An Energy-Efficient Economy, CHEERS, Electric Gas Industries Association, Equipoise Consulting, Heschong Mahone Group, Inc., ICF Consulting, KEMA-Xenergy, Nexant, Inc. and Silicon Valley Manufacturing Group.

- TURN / ORA Coalition (also referred to as the *Efficiency California* Coalition): The Utility Reform Network (TURN), Office of Ratepayer Advocates (ORA), San Diego Regional Energy Office (SDREO), City and County of San Francisco (CCSF) and K. J. Kammerer & Associates.

- WEM / SESCO Coalition (also referred to as the *California Coalition for Energy Efficiency*): Women Energy Matters (WEM), SESCO, Inc. (SESCO), RESCUE, Community First Coalition and Local Power and Public Citizen.[11]

Opening comments were submitted by the following parties:

- American Lighting
- Association of Bay Area Governments
- Cal-Ucons
- City of Berkeley
- CCSF
- City of Santa Monica[12]
- Ecology Action
- ICF Associates, Inc.
- Latino Issues Forum

[11] These are the joint sponsors that submitted (and signed) the filed proposal. At the end of the signature page of WEM's proposal, 18 additional names / organizations are listed as members of the California Coalition for Energy Efficiency, in support of this proposal.

[12] These comments were filed by letter dated April 23, 2004 and amended by letter dated September 1, 2004, with service to all parties.

- National Association of Energy Service Companies (NAESCO)
- NRDC

- Jointly by members of the IOUs Coalition and NRDC / LIF Coalition (see above), California Retailers Association, California State Chamber of Commerce, City of Bakersfield, City of Fresno, City of Stockton, County of Kern, Energy solutions and Quantum Consulting, Inc.
- Jointly by PG&E, SDG&E, SCE and SoCalGas
- Quality Conservation Services, Inc.
- Redwood Coast Energy Authority
- Rita Norton and Associates LLC
- SDREO
- SESCO
- South Bay Cities Council of Governments
- TEDCO Energy Services, Inc.
- TURN
- Utility Consumers' Action Network (UCAN)
- WEM
- "John Doe" representing a firm that provides consulting services to IOUs and other parties in energy efficiency programs, filing its identity under seal per the procedures established by the ALJ.

Reply comments were filed by American Lighting, CCSF, Insulation Contractors Association, the IOUs (jointly), LIF, NRDC, SESCO, the TURN / ORA Coalition members (jointly), Cal-Ucons and WEM.

In its reply comments, SESCO submitted cost-effectiveness data regarding 2003 programs implemented by the IOUs to support its position that the IOUs should not perform program administration functions. The IOUs requested an opportunity to respond and, with approval from the assigned ALJ, filed supplemental reply comments on May 18, 2004. In their responses, the IOUs refuted the accuracy of SESCO's evaluation of their 2003 program performance.

We note that this is not the forum for evaluating the performance of either IOU or non-IOU implemented programs during 2003. Such an evaluation should comprehensively consider all of the performance attributes we established for that program year, in contrast to SESCO's selective review. Accordingly, we do not consider SESCO's reply comments with respect to the issues being addressed in this phase of the proceeding. However, as discussed below, the EM&V administrative structure we adopt today is designed to produce objective evaluations of the program performance for all implementers, irrespective of what entity or entities are responsible for the Program Choice and Portfolio Management functions.

Subsequent to the filing of reply comments, Steve Schiller on behalf of a group of parties (referring to themselves as "Collaborating Parties") contacted the assigned ALJ to report that meetings had been held among various coalition members to seek a common ground with respect to the future EM&V administrative structure. The Collaborating Parties are: NRDC, TURN, ORA, SDREO, the IOUs, Nexant Inc., Heschong Mahone Group, Inc., Bevilacqua-Knight, Inc., California Building Performance Contractors Association, Ridge & Associates, UCONS, LLC, and Quantum Consulting, Inc.

Although they did not agree on the threshold issues regarding who should perform the Program Choice and Portfolio Management roles, Mr. Schiller informed the ALJ that the Collaborating Parties were close to consensus on advisory group structure with particular focus on EM&V administration that could be adopted by the Commission irrespective of its final determination on the threshold issues. The assigned ALJ authorized the Collaborating Parties to file their proposal, and provided interested parties an opportunity for comment.

Comments on the Collaborating Parties' proposal were filed on June 4, 2004 by CCSF, NAESCO, Residential Energy Service Companies' United Effort (RESCUE) and WEM. In addition, ORA, TURN, NRDC and the IOUs (filing jointly) submitted comments addressing the remaining non-consensus issue.

On September 30, 2004, Commissioner Susan Kennedy and CEC Commissioner Art Rosenfeld held an oral argument on an initial version of their proposal for energy efficiency administrative structure, which was posted on the Commission website for discussion purposes only. Following the oral argument, Commissioner Kennedy solicited legal briefs and written comments on policy issues related to affiliate transactions and EM&V structure.[13] Opening comments and legal briefs were filed on October 18, 2004 by the IOUs (jointly), NRDC and other members of the *Reaching New Heights* Coalition, TURN, CCSF and ORA (jointly),[14] and WEM on behalf of the *California Coalition for Energy Efficiency*. Reply comments and briefs were filed on October 25, 2004, by these parties / coalitions, as well as by SESCO, NAESCO and Cal-Ucons.

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[13] See Assigned Commissioner's Ruling and Notice of Oral Argument on The Future Administrative Structure for Energy Efficiency, dated August 18, 2004, and Assigned Commissioner's Ruling Requesting Further Comment on Selected Administrative Structure Issues, dated October 7, 2004.

[14] TURN and CCSF joined in the filing of reply legal briefs, and TURN, CCSF and ORA joined in the filing of comments on policy issues.

3. Past Experience and Current Administrative Structure

The proposals submitted by the four separate Coalitions are in large part reminiscent of the administrative structures (or components thereof) that we have either implemented or attempted to implement in the past for ratepayer-funded energy efficiency since the early 1990s. It is therefore instructive to review our past experience with the issues related to administrative structure for energy efficiency and examine how we arrived at the current structure. We divide this discussion into three distinct "eras" of program administration. The discussion that follows is not intended to provide a detailed description of how each administrative function was carried out during these three eras, but rather to highlight the key features with respect to Program Choice and Portfolio Management and the context in which these functions were (and are now) performed. We also describe the use of various advisory groups during these eras, since all of the proposals recommend that one or more variation of these advisory groups be incorporated into the future administrative structure. Throughout the discussion, we use the terms and definitions presented in Attachment 1.

3.1. Pre-Restructuring ("Collaborative") Era: 1990-1997

Prior to electric industry restructuring, the IOUs were responsible for resource procurement on behalf of their customers, subject to Commission oversight. That is, the IOUs were responsible for investing in and building new generation plants, dispatching their existing generating plants, purchasing power from other utilities or third-party generators (referred to as "qualifying facilities" or "QFs"), and purchasing natural gas supplies to meet customer demands for energy. During the aftermath of the 1970s energy crisis, California was viewed as a leader in the nation in requiring IOUs to investigate and implement demand-side management (DSM).[15] However, by the mid-1980s, efforts to develop demand-side alternatives languished significantly in California, in large part because of excess generating capacity in the State. In July 1989, the Commission and CEC convened a joint en banc hearing to consider ways to revitalize energy efficiency in California.

In the notice announcing the hearing, the Commission cited the shrinking of the capacity surplus, the air quality consequences of inefficient energy use, and recent dramatic improvements in energy-efficient technologies as grounds for reinvigorating DSM activities. The purpose of the en banc was to address the central questions of how energy efficiency and other DSM programs should fit into utility resource procurement, and how regulation could encourage desirable investments in demand-side resources. The administrative structure in place from 1990 through 1997 grew out of recommendations offered in response to the en banc by a group of interested stakeholders called the "California Collaborative" (Collaborative).[16] The Collaborative recommendations led to the

[15] "Demand-side management" or "DSM" refers to programs that focus on the customer side of the utility meter, which include programs for load management and energy efficiency, among others.

[16] Members of the Collaborative included the four energy IOUs, representatives of various California state agencies, environmentalists, residential, commercial, industrial and low-income ratepayers, agriculture, energy service companies and independent energy producers. The Collaborative observers included legislative representatives, the South Coast Air Quality Management District and several energy consulting firms. The Commission's Strategic Planning Division also assisted the Collaborative. Their recommendations were submitted in *An Energy Efficiency Blueprint For California: Report of the Statewide Collaborative Process*, January 1990.

issuance of a DSM Rulemaking to further define policies and oversight responsibilities for energy efficiency programs.[17]

As indicated in Figure 2, the administrative structure that resulted from this process placed lead responsibility for Program Choice and Portfolio Management with the IOUs. In addition, the Commission put in place a system of financial rewards and penalties (shareholder incentive mechanisms) for energy efficiency programs to address the financial conflicts facing IOUs under cost-of-service regulation. In particular, IOUs earn a financial return for their shareholders when they invest in generation, distribution or transmission plant ("steel in the ground"). They did not at that time earn any return on energy efficiency programs. To address this financial conflict, the Commission provided the IOUs with an opportunity to earn on cost-effective energy efficiency. Experimental incentive mechanisms were adopted in 1990, and then subsequently refined into a "shared savings" mechanism for the 1995-1997 program years.[18]

Under the shared-savings mechanism, IOUs earned a fixed percentage of the net savings to ratepayers (energy savings minus costs) after a threshold level of savings was achieved.[19] These savings levels were based predominantly on

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[17] R.91-08-003 and Companion Investigation (I.) 91-08-002.

[18] For a detailed history of shared-savings incentive mechanisms for energy efficiency programs, see Attachment 2 of D.03-10-057.

[19] *Ibid.* The shared savings mechanism applied to "resource programs," that is, programs that could displace or defer more costly supply-side resources, such as the direct installation of energy efficiency measures. Other incentive mechanisms (e.g., in the form of fixed management fees) applied to programs that either produced savings that were hard to measure (e.g., information programs or energy management audits), or were implemented primarily for equity reasons and not expected to be cost-effective.

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post-installation (*ex post*) measurements and the IOUs were at risk for ratepayer expenditures if the program portfolio was not cost-effective on an *ex post* basis. The Commission established a California DSM Measurement Advisory Council (CADMAC) to provide a forum for presentations, discussions, and review of DSM program measurement studies. These studies were filed in each Annual Earnings Assessment Proceeding (AEAP), which was the forum for the Commission's review of the IOUs'earnings claims under the shareholder incentive mechanism. CADMAC also presented recommendations to the Commission on changes to adopted measurement protocols for consideration in each AEAP. Regular membership consisted of the IOUs, ORA, Energy Division and CEC staff, and supplemental members were added via advice letter filings. They included: NRDC, TURN, Sacramento Municipal Utility District, Los Angeles Department of Water and Power, NAESCO, Lawrence Berkeley Lab, among others. The CADMAC structure included voting rules and guidelines for participation and attendance.

Independent reviewers were also part of the CADMAC structure. They were selected and managed by Energy Division and paid for out of program funds. Their primary task was to provide input to Energy Division and the Commission on the savings estimates presented by the IOUs in each AEAP. In addition, program funds were allocated to ORA to conduct its own independent verification of the IOUs' savings studies.

The latter encompassed what we now refer to as low-income energy efficiency programs or "LIEE." Prior to restructuring, we referred to LIEE as "direct assistance" programs, and these programs were funded out of the energy efficiency budgets. Today, LIEE is funded separately from all other energy efficiency activities.

Other administrative features were put in place to address the Collaborative stakeholders' concerns with placing IOUs in the lead role for program choice and portfolio management. During the Collaborative process (and subsequent settlement agreements), the stakeholders recommended that the IOUs establish informal advisory committees as an outgrowth of the Collaborative working groups to review the utility programs. The Commission directed the IOUs to continue the use of these advisory committees in the DSM Rulemaking as a method of obtaining input on program choice and implementation issues, and they became an integral component of the administrative structure during the pre-restructuring era.[20]

The IOUs selected initial members from a broad range of interested stakeholders (e.g., regulatory staff, customer groups, environmental groups, among others) and participation evolved over time between 1990 and 1997 based on the interests of specific stakeholders and emerging program design issues.[21] The advisory committees met approximately once each quarter (or more

[20] In its DSM Rules, the Commission required that the IOUs establish a single clearinghouse for all advisory committee noticing and scheduling, provide appropriate notice of all meetings with advance agendas, provide the Committees with comprehensive information on program implementation activities and proposed program changes, and take other steps to ensure that parties had an opportunity to review the programs and work with them to improve program implementation. Order Instituting Rulemaking and Order Instituting Investigation (R.91-08-003 / I.91-08-002), *mimeo.*, p. 37; D.92-02-075, pp. 62-63, Attachment 3, Rule 24.

[21] The advisory committees differed with respect to representatives from customer groups. SDG&E's general practice at that time was to get input from customers via focus groups, including public meetings in some instances, and bring that information to the Advisory Committee comprised of stakeholders that represented broader interests, such as ORA, CEC, UCAN, Sierra Club and NRDC. SCE and PG&E, on the

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frequently as needed) to discuss the composition of the IOUs portfolio and consider modifications to program design or funding levels for individual programs as their performance was observed during the course of each program year. Participation was voluntary and there were no voting rules. In those instances where Commission approval was required (based on policy rules regarding fund shifting, and other guidelines for portfolio management), the IOUs filed their requests with the Commission indicating whether the advisory committee supported the proposed modifications. Individual advisory committee members could protest the filings if they did not concur with the proposed program selection or changes to those selections.

The advisory committees described above addressed some of the concerns expressed by the Collaborative over the IOUs' lead role in program choice and portfolio management by making the process more receptive to stakeholder input on an ongoing basis. However, they did not address competitive issues that were emerging in both supply-side and demand-side resource acquisition. In particular, the experience of the mid-to late 1980s with independent power producers and supply-side bidding in California led to analogues that appeared transferable to the demand-side. Both the Legislature and the Commission viewed the introduction of competitive bidding in demand-side resource acquisition as a vehicle to use competitive forces to reduce the cost (or increase the value) of ratepayer-funded programs.[22]

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other hand, included customer representatives on their Advisory Committees, along with broader interest groups.

[22] See Order Instituting Rulemaking / Investigation (R.91-08-003 / I.91-08-002), dated August 7, 1991, and Stats. 1990. Ch. 1369, Sec. 3, which added Section 747 to the Public Utilities Code.

Consistent with that vision, the Commission directed the IOUs to develop proposals for DSM bidding pilots and to form a DSM bidding advisory committee to assist the IOUs and the Commission in this task, with the Division of Strategic Planning (DSP) acting as facilitator.[23] The group included representatives from IOUs, consumer and environmental groups, ESCOs and other interested parties. During the next two years, a series of pilots were implemented to test the potential of DSM bidding to provide least-cost energy efficiency services and to assess the capabilities of third party providers to complement or replace existing or planned IOU programs. However, before the results of these pilots could be fully evaluated in the context of the industry structure in which they were conceived, electric industry restructuring fundamentally changed the IOUs'role in both supply-side and demand-side resource procurement.

3.2. Restructuring Era ("Attempted Independent Administration"): 1997-2000

In D.95-12-063, as modified by D.96-01-009 ("restructuring decision"), the Commission described its vision of a competitive framework for the electric services industry. Briefly, the decision describes a future in which customers would have choice among competing generation providers, and where traditional cost-of-service regulation would be replaced by performance-based regulation. In terms of market structure, the restructuring decision placed

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[23] See R.91-08-003 / I.91-08-002, *mimeo.*, p. 44 and ALJ Ruling and Notice of First Meeting of the Statewide Advisory Group on DSM Bidding Pilots, October 1, 1991 in that proceeding. See also: D.92-02-075, pp. 12-13; Attachment 1, Rules 26-29. Subsequent decisions provided specific direction on the design and implementation of bidding pilots: D. 92-09-080, D.92-09-080 and D.93-06-040.

control over all transmission assets in the hands of an independent system operator (ISO) and required the IOUs to bid all their generating assets (with the exception of must-take power) into a spot market pool over a five-year transition period, beginning January 1, 1998. During this transition period, some utility generating assets would undergo a market valuation process and possibly a transfer of ownership, while others would remain under the ownership of the utility and Commission regulation. The Commission would continue to have oversight over utility generation during the transition. The utilities would be given the opportunity to recover generation "transition costs" (i.e., the net above-market costs for each utility) over the five-year period, but the price for electricity, on a kWh basis, could not rise above the rate levels in effect as of January 1, 1996.

In its restructuring decision, the Commission acknowledged the continued need for energy efficiency programs, but signaled a major shift in emphasis away from financial incentives to individual customers towards energy efficiency programs with broader market transformation effects, such as educational programs and incentives targeted to equipment and appliance manufacturers. The Commission anticipated that public funding for energy efficiency would be needed "only for specified and limited periods of time, to cause the market to be transformed."[24] The Commission also articulated its expectation that the

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[24] The Commission's vision for the privatization of energy efficiency services did not extend to LIEE programs. In fact, continued funding for these low-income assistance programs was authorized under the electric restructuring statute (AB 1890) without dollar limits or sunset provisions. We continue to address all issues related to LIEE (e.g., annual budgets, program priorities, program design) in our separate rulemaking on low-income energy assistance, R.04-01-006.

administration of energy efficiency programs would transition from the utilities to an independent, nonprofit organization:

> "After a short transition period, we believe that the funds collected through a surcharge for energy efficiency should be competitively allocated by an independent, nonprofit organization, but we would like to capture the expertise and knowledge that the utilities have gained in administering DSM programs as we begin the transition. We expect to reach closure on this issue through the implementation activities we will undertake in the next few months and through ongoing coordination with the Legislature."[25]

On September 23, 1996, Assembly Bill (AB) 1890 was signed into law. (Stats 1996, Chapter 854.) Overall, AB 1890 endorsed the Commission's vision for a restructured electric industry. With respect to energy efficiency, the statute authorized the continuation of public purpose programs through the imposition of a nonbypassable charge on local distribution service (i.e., the PGC). However, in terms of funding levels for energy efficiency, AB 1890 mandated only a limited time period, commencing January 1, 1998 through December 31, 2001, during which ratepayer funds were earmarked for those activities. The statute's language did not articulate any specific expectations regarding program design or administration. Those details were left to the Commission.[26]

At the Commission's direction, working groups met during 1996 to discuss public purpose programs, including energy efficiency, and to present

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[25] *Id.*

[26] In passing AB 995 (Stats 2000, ch. 1051), the Legislature subsequently extended energy efficiency funding for the electric utilities until January 1, 2011, and at the same time established an annual funding limit of $228 million for PG&E, SCE and SDG&E, combined. See Pub. Util. Code § 399.8(d)(1) and § 381(c)(1).

recommendations responding to the issues identified in the restructuring decision. On August 16, 1996, the Energy Services Working Group presented a report entitled "Funding and Administering Public Interest Energy Efficiency Programs."[27] The report presented consensus and non-consensus views on market transformation goals, the types of energy efficiency activities to be funded by utilities in the future and program funding levels. It presented administrative options for setting policies, administering the public goods charge and delivering energy efficiency activities and programs.

In D.97-02-014, issued on February 14, 1997, the Commission reiterated its intent to establish an administrative structure that would "facilitate the privatization" of energy efficiency services in the marketplace.[28] For this purpose, the Commission established an independent board (California Board For Energy Efficiency or "CBEE") consisting of regulatory representatives and members of the public to oversee limited term contracts for the administration of market transformation programs.[29] Among other things, CBEE was directed to develop and issue a RFP articulating policy and programmatic guidelines for one or more administrators, subject to Commission approval. The Commission

[27] Over 30 organizations were represented in the Working Group, including the utilities, energy service providers, State agencies (e.g., CEC and Department of General Services), ratepayer advocates (e.g., DRA and TURN), and environmental organizations.

[28] D.97-02-014 in R.94-04-031 / I.94-04-032 (Electric Restructuring Proceeding), 70 CPUC 2d, 774 at 784.

[29] The Commission also established a Low-Income Governing Board at that time to make recommendations about low-income assistance programs in the restructured electric industry. Since we are focusing on non low-income energy efficiency in this decision, we do not describe developments related to the low-income board any further. However, similar legal obstacles did arise with respect to this board.

stated its goal of having the new administrative structure for energy efficiency programs in place by January 1, 1998. Figure 3 illustrates the administrative structure for energy efficiency that the Commission envisioned for a restructured electric industry.

To create this administrative structure, the Commission first addressed several issues related to CBEE start-up, including board appointments, legal structure, authorization to contract and hire staff, conflict of interest, per diem and expense reimbursements, Bagley-Keene Open Meeting Act, among others. In recognition that the transfer of functions, funding, assets and program commitments from utilities to the new administrator would take longer than expected, in D.97-09-117, the Commission extended interim utility administration until October 1, 1998. During the remainder of 1998, the Commission considered CBEE recommendations for directing utility energy efficiency activities during the transition, and proceeded to adopt a 1998 operating budget for CBEE, establish policy rules for independent administration and approve an RFP for that administration.[30] However, beginning in early 1998, the transition to independent administration for energy efficiency programs encountered several obstacles—and was ultimately put on hold indefinitely by the Commission.

In August 1997 the California State Employees Association (CSEA) challenged two agreements between CBEE and private contractors, and requested that the State Personnel Board (SPB) find that the agreements violated the requirement that state agencies use civil servants for completing tasks

[30] See D.98-02-040 (78 CPUC 2d, 439) and D.98-04-063 (79 CPUC 2d, 704).

traditionally performed by the state.[31] The contractors provided administrative and technical assistance to CBEE. In response to CSEA's challenge, the Commission pointed out that the agreements[32] were between CBEE and the contractors, but PG&E paid the contractors from PGC funds. The Commission argued that since the agreements were between CBEE and the consultants, and the money was not part of the Commission's budget, SPB did not have jurisdiction over the agreements. Moreover, the Commission argued even if SPB had jurisdiction, the services were exempt from the requirement that state agencies must use civil servants to perform the work.

Not persuaded by these arguments, SPB ruled in February 1998 that the CBEE was "created by the [Commission] to advise and assist it in developing and administering energy efficiency …programs and [is] performing functions which have been imposed by statute upon the [Commission] " and was therefore subject to the requirement its work must be performed by civil servants.[33] SPB rejected the Commission's contention that the work done by contractors for CBEE was exempt under any of the exceptions in Section 19130(b) of the Government Code.

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[31] Article VII Section 1 of the California Constitution is construed as an implied mandate limiting the state's authority to contract with private entities to perform services the state has historically performed. Professional Engineers in California Government v. Department of Transportation, 15 Cal. 4th 543, 547 (1997). Section 19130 of the Government Code contains exceptions to the general requirement that civil servants perform state work.

[32] Contracts between CBEE and the consultants were not executed. Letters of understanding were used because CBEE's legal status was uncertain. It was anticipated that PG&E and the contractors would ultimately sign contracts.

[33] February 4, 1998 letter from SPB Acting Executive Director Walter Vaughn to CPUC Executive Director Wes Franklin.

While the CSEA challenge was pending, Commission staff met with the California Attorney General's office and representatives from the Department of Finance, who raised additional issues with the Commission's use of CBEE and other advisory boards. The representatives opined that absent explicit statutory authorization, the Commission could not create additional entities to perform tasks under the oversight of the Commission. In their view, Sections 381 (c)(1) and 701 of the Public Utilities Code were not sufficient to allow the Commission to create CBEE.

Both the Attorney General's and the Department of Finance's representatives stated that the ratepayer money such as the PGC were public funds that could be held by the IOUs and spent under Commission direction, but in the absence of specific legislation, they could not be moved to an outside trust account or bank account. Thus, if funds were not held by the IOUs, then they needed to be held in a treasury account,[34] or other account authorized by the legislature.

To resolve these issues, the Commission proposed legislation, AB 2461, which would have authorized creation of CBEE and seven other advisory boards. The bill would also have created a "California Board for Energy Efficiency Fund" to receive money collected by the IOUs, which would be remitted to the Commission, and then forwarded to the Controller's for deposit in the "CBEE Fund." In addition, AB 2461 would have authorized the

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[34] The Department of Finance rejected the Commission's position that former Section 2881(d) of the Public Utilities Code, which stated that the "commission shall establish a fund and require a separate accounting for each of the programs [for deaf and disabled telephone subscribers] implemented in this section" authorized establishment of a trust fund outside the state treasury. (Emphasis added.)

Commission to contract for the services of one or more "independent administrators" to implement "programs to accomplish the research and environmental objectives" as provided in Section 381 of the Public Utilities Code. AB 2461 would have authorized the Commission to make advance payments to such an administrator,[35] and provided that the contracts of that administrator would not be subject to the requirements of the Public Contracts Code. Governor Wilson vetoed AB 2461 in September 1998.

Recognizing that these actions created insurmountable obstacles to handing off energy efficiency programs to new administrators as planned, the Commission extended interim utility administration through December 31, 2001, and cancelled the RFP authorized by D.98-07-036.[36] On June 10, 1999, the Assigned Commissioner suspended further exploration of administrative options until further notice.[37] On October 6, 1999, the Governor signed AB 1393 into law. Among other things, that law required that low-income assistance programs, including energy efficiency services to eligible low-income customers, continue to be administered by the IOUs.

In 2001, Governor Davis signed legislation that allowed the creation of six telecommunications advisory committees and created six Treasury Funds for the ratepayer money associated with the functions on which the boards provide

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[35] With limited exceptions, state agencies are prohibited from making advance payments under contracts. Public Contracts Code Section 10312.

[36] D.99-03-056.

[37] Assigned Commissioner's Ruling Regarding Administration of Energy Efficiency and Low-Income Assistance Programs in R.98-07-037, June 10, 1999.

advice. These boards now function in a purely advisory capacity, with no authority to enter contracts or spend money.

3.3. Current Structure (Summer 2000 Initiative to Present)

Huge price spikes and supply shortages that were the beginning of California's energy crisis marked the summer of 2000. The ISO was forced to call for curtailments of customers on interruptible tariffs throughout its control area (PG&E, SCE and SDG&E service territories) and in June 2000, the Bay Area experienced several days of rolling blackouts. These events prompted the Commission to adopt a "rapid response procedure" to provide "maximum impact of demand and energy usage reductions" during the Summer 2000 energy capacity shortage and for the potential energy shortage projected over the next few years.[38]

To implement this rapid response procedure, referred to as the Summer 2000 Energy Efficiency Initiative (Summer Initiative), the Commission solicited program proposals from the IOUs and other interested parties that would "bring about the largest reductions in electric demand and / or electric usage reductions in the shortest period of time.[39] The Commission directed that proposals for funding under the Summer Initiative be filed and served by July 21, 2000, that comments on the proposals be filed and served by July 31, 2000 and that the programs be approved and implemented by September 1, 2000. The Commission authorized the Assigned Commissioners and ALJ to approve the Summer Initiative programs by ruling, which was accomplished on

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[38] D.00-07-017, *mimeo.*, p. 199.

[39] *Ibid.*, p. 203.

August 21, 2000. The ruling authorized a total of $72 million in unspent PGC program funds for the initiative, and selected implementers were directed to spend these funds by December 31, 2001.

The Summer Initiative marked the beginning of a new administrative structure for energy efficiency programs, which is still in place today. (See Figure 4) Under this structure, the Commission establishes evaluation criteria for reviewing program proposals, solicits proposals for program funding from IOUs and non-IOU implementers, and makes final program selections for each funding cycle.[40] Commission staff oversees the implementation of multiple statewide and local energy efficiency programs. This oversight involves "review of proposals, program plans, budgets, expenditures and program activity reports, as well as program monitoring, program plan modifications, and other day-to-day management assignments."[41]

More specifically, Energy Division staff reviews program applications and makes selection recommendations to the Commission for each funding cycle. Energy Division staff also oversees portfolio management with respect to the development and review of program implementation plans, for both IOU and non-IOU programs. Energy Division reviews non-IOU program implementation plans and contracts (and any changes) which are subject to either Energy Division or ALJ approval. Energy Division also reviews and approves any IOU proposed changes to the program implementation plans that involve: (1) significant fund shifting across budget categories; (2) changes to incentive

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[40] See, for example, D.02-03-056 (Selection of 2002 Programs), D.03-04-055 (Selection of 2003 Programs), D.03-12-060 and D.04-02-059 (Selection of 2004-2005 Programs).

[41] D.03-04-055, p. 23.

amounts offered to program participants and (3) changes in program design or program offerings. ALJ approval is also needed for time extensions to non-IOU programs.

With respect to EM&V, Commission staff responsibilities include: (1) Energy Division review and ALJ approval of the IOUs' EM&V plans for statewide programs; (2) ALJ approval of a list of qualified EM&V contractors for implementers; and (3) Energy Division review (assisted by an independent contractor) and approval of non-IOUs' EM&V plans. In addition, the IOUs are required to submit their proposed contractors for EM&V studies to the Energy Division and ALJ for approval. Energy Division also contracts with independent consultants to evaluate program performance, including the methods and inputs used by EM&V contractors to evaluate program savings.

The Commission has not formally created any advisory groups under the current administrative structure. However, in 1999, the IOUs, ORA and CEC jointly recommended that a California Measurement Advisory Council (CALMAC) be established to provide a forum for discussing and reviewing post-1998 market assessment and evaluation studies, and for coordinating the development of statewide measurement studies. The Commission did not object to the concept of using CALMAC to assist the IOUs, ORA and others for this purpose, but specifically did not recognize it as an official Commission-sponsored advisory body.[42] CALMAC's organizational membership, voting rules and funding arrangements are similar to CADMAC, but no independent reviewers are part of the structure. CADMAC still exists for the limited purpose

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[42] See D.00-05-019, pp. 19-21; Finding of Fact 14; Attachment B.

of providing input during the Commission's review of the remaining AEAP earnings claims associated with pre-1998 programs.

4. Administrative Structure Proposals and Positions of the Parties

Attachment 2 describes and compares the proposals for administrative structure presented in this proceeding, including the various advisory groups recommended for our consideration. In this section and the discussion that follows, we highlight the major characteristics of each proposal and concentrate on the chief points of contention. Members of each coalition are listed in Section 2 above.

4.1. IOUs in the Role of Program Choice and Portfolio Management

The IOUs' Coalition and the NRDC / LIF Coalition propose an administrative structure that places the IOUs in the role of Program Choice and Portfolio Management. In addition to coalition members, American Lighting, American Synergy Corporation, Cal-Ucons, ICF Associates, Inc. and the National Association of Energy Service Companies filed comments in support of this approach.

4.1.1. IOUs Coalition Proposal: "Integrated Portfolio Management"

Figure 5 presents an overview of the "Integrated Portfolio Management" structure recommended by members of the IOUs' Coalition. This structure is almost identical to the administrative structure in place during the pre-restructuring / collaborative era. It places the IOUs in the role of Program Choice (subject to Commission approval) and ongoing Portfolio Management, with input from advisory groups. The differences relate to the advisory group structure. In addition to an advisory group for each IOU service territory, the proposal creates a statewide policy advisory committee to provide the IOUs with advice regarding program selection criteria and portfolio composition. Overall, the advisory groups are more formally structured than during the pre-restructuring/collaborative era, with membership appointed by the Commission. Parties seeking energy efficiency funds are excluded from membership on the advisory groups. Broader input from parties without a direct financial interest is solicited through public workshops held during the program selection and portfolio management process.

The EM&V framework presented under this proposal is also very similar to the pre-restructuring/collaborative era, including the use of a measurement advisory group. Under the proposed approach, the IOU administrators and implementers contract with EM&V consultants to perform measurement studies, which are required to follow Commission-approved measurement protocols. The study results are subject to independent verification. Similar to the pre-restructuring EM&V framework, ORA is allocated program funds to perform an independent evaluation of program accomplishments. However the structure does not include independent reviewers as part of the measurement advisory structure, as it did under CADMAC.

4.1.2. NRDC/LIF Coalition Proposal: "Reaching New Heights"

Under the "Reaching New Heights" proposal submitted by the NRDC/LIF Coalition, IOUs would also return to the Program Choice and Portfolio Management roles. Figure 6 presents an overview of this proposal. In addition to an EM&V and policy and Program Advisory Group (PAG) structure similar (but not identical) to the "Integrated Portfolio Management" proposal, this proposal includes 1) an Independent Observer and 2) a minimum set-aside for non-IOU implementers.

The Independent Observer is under contract to Energy Division to ensure that the IOUs portfolios are designed, and implementers are chosen, in a fair and transparent process. In particular, the Independent Observer provides feedback to the IOUs on portfolio plans, program selection criteria and final program selections, prior to the submittal of filings at the Commission. In addition, the Independent Observer serves as a conduit of information from market participants to Energy Division and the Commission. The NRDC/LIF Coalition also sets aside a minimum of 20% of the total portfolio funds to be competitively bid out for design and/or delivery by non-IOU implementers.

Subsequent to the filing of proposals, the IOUs Coalition and NRDC/LIF Coalition agreed on an amended version of the "Reaching New Heights" proposal, with the addition of several new supporters, including the City of Bakersfield, City of Stockton, City of Kern and California Retailers Association.[43]

The amended "Reaching New Heights" structure is illustrated in Figure 7. It retains the 20% set-aside for non-IOU implementers, but puts Energy Division in the role of Independent Observer, rather than a third-party contractor. It also blends certain characteristics of the advisory group structures proposed under the "Integrated Portfolio Management" and initial "Reaching New Heights"

[43] By letter dated May 10, 2004, an additional 15 organizations and businesses indicated their support of this proposal, including PacifiCorp, Alliance to Save Energy, Association of California Energy Efficiency Contractors, Institute of Heating and Air Conditioning Industries, The New Buildings Institute and League of California Homeowners, along with several private energy service providers.

proposals. Further description of the amended proposal is presented in Attachment 2.

4.1.3. Proponents' Arguments

Proponents of returning the IOUs to the Portfolio Choice and Portfolio Management roles argue that this is the best approach for capturing all cost-effective energy efficiency resources, given the structure of California's energy industry and the state's political climate. In their view, having the IOUs manage energy efficiency as an integral component of their energy procurement responsibilities will "treat energy efficiency as the valuable resource for meeting customers' needs that it is, and…stop treating it as a limited social program operating on the sidelines of the energy industry."[44] They contend that the IOUs have the staffing and contracting capability to administer a portfolio of programs of the magnitude necessary to meet the state's goals. In addition, they argue that this approach allows the Commission to retain clear and effective oversight over the entire energy efficiency administrative structure, as well as the combined portfolio of PGC and procurement-funded energy efficiency programs. In their view, the proposed structure can be implemented more easily and without the major start-up costs, uncertainty or potential delays associated with other options.

Proponents argue that these advantages overshadow the potential competitive or financial conflicts associated with putting IOUs in the lead role for program choice and portfolio management. Moreover, they contend that potential conflicts are effectively addressed by the checks and balances

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[44] NRDC / LIF Coalition Proposal, p. 16.

incorporated into the proposal, coupled with the overall procurement structure that holds the IOUs accountable for their resource selections.

4.2. Independent Administrator(s) For Program Choice and Portfolio Management

Both the TURN / ORA Coalition and the WEM / SESCO Coalition propose an administrative structure in which the IOUs do not select energy efficiency programs or manage the program portfolio. They recommend that the Commission oversee a competitive RFP to select a single independent administrator (TURN / ORA Coalition) or multiple administrators (WEM / SESCO Coalition) to perform these responsibilities. In almost all other respects, however, the proposals are different from one another, as described below. Figures 8 and 9 present overviews of these two approaches to independent administration.

4.2.1. TURN/ORA Coalition Proposal: "Efficiency California"

The TURN / ORA Coalition proposes an "Efficiency California" administrative structure that is reminiscent of the administrative structure the Commission attempted to put in place during restructuring. The major difference is the absence of a separate CBEE-type advisory board overseeing the RFP and contracting process. Under " Efficiency California," the Commission (rather than CBEE) contracts with a single administrator to perform the Program Choice and Portfolio Management functions. In addition to coalition members, the Association of Bay Area Governments and UCAN support this proposal.

Under “Efficiency California,“ the program administrator could consist of a single organization or a partnership of firms, but could not be an IOU or any other program implementer.[45] The program administrator selects all implementers through a competitive bidding process, and contracts directly with the winning bidders. A program advisory committee provides input to the program administrator on program design and mid-cycle program changes. (See Figure 8.)

An expanded CALMAC structure is responsible for managing and contracting for all portfolio-level and program-level EM&V studies, subject to Commission approval. Independent contractors conduct all EM&V studies, with input from Energy Division and other Commission-appointed CALMAC members. The program administrator and implementers do not oversee or contract for EM&V studies under this administrative structure.

4.2.2. WEM/SESCO Coalition Proposal: “The California Standard Offer Program For Energy Efficiency”

The WEM / SESCO Coalition proposes a “California Standard Offer Program For Energy Efficiency,” whereby multiple non-IOU entities would administer energy efficiency programs by overseeing a continuous standard offer program. The proposal is presented as a system modeled after the structure currently operating in Texas. In addition to coalition members, two third-party

[45] The proposal allows for an exception to this rule, stating that Community Choice Aggregators (CCAs) “may perform some of the same administrative functions as the program administrator and also implement programs pursuant to AB 117.” TURN / ORA Coalition Proposal, p. 6, footnote 5.

implementers in Texas (Quality Conservation Services, Inc. and TEDCO Energy Services) filed comments in support of the WEM/SESCO Coalition proposal.[46]

This approach envisions that program administrators would be comprised of CCAs, local governments, non-profit and/or for profit entities, and they would be permitted to overlap with respect to geographic regions and climate zones.[47] The Commission (or a System Director selected by the Commission) would accept applications from any parties who wish to serve as program administrators and evaluate those applications under the criteria set forth in AB 117 (Pub. Util. Code § 381.1).[48]

Each program administrator is responsible for administering contracts with implementers using standard offers developed by the Commission (or System Director, subject to Commission approval), and for assisting customers to participate in the program. These standard offers set forth a standard incentive amount based on a percentage of avoided costs (less than 100%) for installed measures. The payment terms and other conditions are fully spelled out in a standard contract that the implementer can sign without any further negotiations with the program administrator. Under the WEM/SESCO Coalition proposal, program implementers would only get paid after the measures are installed and verified through field inspections conducted by EM&V contractors. Savings per measure are based on "deemed" (*ex ante)* estimates, i.e., on engineering data or load impact studies, without on-site testing or metering.

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46 In its reply comments, WEM lists a total of 40 "Coalition member groups" and "environmental and energy activists" in support of this proposal, including the authors.

47 See page 21 of the WEM/SESCO proposal.

48 See endnote on page 5 of Attachment 2 for the language of Pub. Util. Code § 381.1.

Here's how the standard offer program would work: The program implementer approaches residential customers in a specific geographic area to install measures. The type of measures to be installed is the decision between the energy service provider and the customer. The incentive typically does not cover the full cost of the measures that are installed, and the customer usually must make a contribution. The level of the contribution is also between the customer and the program implementer. Typically, projects for residential customers involve insulating homes or upgrading heating or cooling systems. The standard offer program includes a list of these measures with associated "deemed" savings, and the program implementer is credited those savings once that particular installation (or a sample of the installations of that implementer) has been inspected. After that occurs, assuming that the inspector finds the measures to be installed properly, the program implementer receives a payment for the credited savings based on a percentage of avoided costs.

Under the WEM / SESCO Coalition proposal, no entity would be allowed to serve at the same time as program administrator, implementer or EM&V contractor. The Commission (and System Director) and CEC would convene an EM&V committee to oversee periodic updates of the measure savings database, initiate studies to research information in the database, and generally serve as the interface between energy efficiency and supply-side resource planning. This committee would replace the existing CALMAC.

The WEM / SESCO Coalition proposal also provides for a "Special Administrator" to manage program funds for statewide information and education programs, such as Flex-Your-Power, codes and standards advocacy and training programs. In the alternative, the Commission or the System Director (if different) could also administer these programs. Under the proposal, 5% of program funds would be set aside for this purpose. The rest would be administered under the standard offer program described above.

4.2.3. Proponents' Arguments

In general, proponents for independent administration argue that the conflicts-of-interest inherent in an administrative structure where IOUs serve as both program administrators and implementers severely undermine the Commission's resource procurement goals for energy efficiency. Moreover, they contend that regulatory efforts to resolve or mitigate these conflicts will "at best result in dueling incentives that will in the long-run be more expensive for ratepayers than simply changing administrators."[49] At worst, they argue that these efforts simply will not be effective. In addition, they contend that IOU program administration would not produce highly cost-effective results.

Supporters of "Efficiency California" argue that this approach is particularly well suited to meeting the energy savings goals of the Energy Action Plan and the Commission because it creates a single-purpose administrative entity with sufficient staff and resources to undertake the requisite tasks. In their view, a further advantage of this structure is that it could easily evolve into a statewide administrator for self-generation and demand response programs, thereby fostering more innovative and integrated approaches to serving customers' multiple energy needs. They also argue that this approach will reduce conflict and increase collaboration in the apportioning of the monies. In their view, this approach will build improved centralized information systems for managing the funds and portfolio of programs, as well as for tracking

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[49] TURN Opening Comments, p. 4.

performance and long-term results. They also contend that the single-purpose administrator can be established quickly under existing statutory authority. Finally, proponents of “Efficiency California” argue that strengthening and consolidating CALMAC’s role will clarify responsibilities for EM&V and ensure that all assessments of program and portfolio performance are conducted by independent, non-biased entities.

Supporters of the “California Standard Offer Program For Energy Efficiency” argue that this approach has the advantage of eliminating conflicts-of-interest by establishing a clear separation of roles between program administrators, implementers and EM&V contractors. They also argue that standard offers provide the added advantage of creating a “bottoms up” portfolio development process, whereby the choice of what measures to install (and where) is left to the competitive market based on the implementers’ assessment of costs and risks, and competition among them. Another key benefit they point to is the shift of performance risk from ratepayers to implementers, since the latter are paid only when measures are installed and inspected. Since payments to implementers are based on a percentage of avoided costs (less than 100%) they also argue that this approach will ensure that ratepayers pay no more than the costs of more expensive supply-side resources for the programs. Proponents of this approach also contend that the Texas standard offer-based administrative structure has demonstrated the ability to deliver large amounts of very cost-effective energy savings at relatively low administrative costs.

4.3. Cal-Ucons’ “Discrete Market Segment Focus Plan”

Cal-Ucons proposes a “Discrete Market Segment Focus Plan” that is designed to be complementary to whatever administrative structure is chosen.

Under this plan, the Commission would assemble an advisory group whenever necessary to provide input on how to improve success in an energy efficiency market segment, i.e., one that is under-producing in terms of energy savings. Focus advisory group members would serve by Commission-appointment and be comprised of stakeholders in the market segment. At any given time, there could be any number of Focus advisory groups in place to work on a variety of market segments statewide or in specified regions, such as an IOUs service territory. Any interested person may petition the Commission to create a Focus advisory group.

Cal-Ucons argues that this approach would provide the Commission with a powerful tool "to locate rich pockets of untapped [energy efficiency] savings on which to focus institutional attention," such as the hard-to-reach landlord-tenant market.[50] American Synergy Corp and Insulation Contractors Association supports the Focus Plan specifically in their comments. LIF expresses general support for the concept of focusing program efforts on hard-to-reach constituencies, such as the Latino and Asian communities, based on equity concerns.

4.4. Collaborating Parties' Proposal for Advisory Board and EM&V Administrative Structure

The Collaborating Parties have submitted a joint proposal for a statewide advisory group, called the "California Efficiency Advisory Council" (CEAC), to assist the Commission, program administrator(s) and a separate EM&V advisory group described further below. The purpose of CEAC would be to "provide pro-

[50] Cal-Ucons Proposal, p. 6.

active input on (a) overall procurement and PGC energy efficiency portfolio designs and implementation, as well as (b) feedback on administrator and portfolio performance in the context of meeting statewide energy efficiency goals, efficiency of administration / implementation, compliance with Commission policies, etc."[51] The CEAC would not have decision-making or contracting authority, but would be a formally constituted advisory group, complying with the Bagley-Keene Act. CEAC would submit an annual report on its findings and recommendations with respect to ratepayer funded and statewide energy efficiency programs. The CEAC would replace the statewide advisory groups proposed in the original filings by the IOUs Coalition, NRDC / LIF Coalition and TURN / ORA Coalition, but would not preclude adoption of regional advisory groups as well.[52] Additional detail on CEAC is provided in Attachment 2.

With respect to EM&V administrative structure, the Collaborating Parties have developed a joint proposal that is independent of their separate recommendations for Program Choice and Portfolio Management. They all agree that a Measurement and Evaluation Council (MEC) should be established to advise the Commission on technical issues related to EM&V. The purpose of this group would be threefold. First, MEC would be the primary entity responsible for portfolio-level EM&V. Second, MEC would advise the Commission on setting protocols for EM&V of individual programs. Third, MEC would coordinate the program-level EM&V studies. In addition, MEC would

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[51] Comments of Collaborating Parties on Energy Efficiency Administrative Structure Proposals, May 25, 2004, p. 2.

[52] *Ibid.*, p. 4.

make recommendations to the Commission on the level of EM&V funding during each program planning cycle, and on future updates to EM&V protocols.

MEC would consist of technical experts appointed by the Commission, as described further in Attachment 2. Under the proposed structure, MEC would operate by consensus and, if consensus cannot be reached, the assigned ALJ would make the final decision on any unresolved issues.

MEC would not have contracting authority. The Collaborating Parties propose that the IOUs administer and contract for the portfolio-level EM&V studies. These types of studies would include evaluations of energy savings potential, saturation studies, summary studies of statewide programs and achievements, market share tracking studies, updates to energy efficiency savings data, best practices studies, among others. The portfolio of studies would be developed though a public process and in close coordination with CEC and Commission staff through their participation on MEC. A Study Advisory Committee comprised of the IOU project manager and interested MEC members would select the EM&V consultant from among the bidders. The IOU project manager would contract with the EM&V consultant, review the consultant's invoices and approve the disbursement of EM&V funds accordingly.

As each portfolio-level study is underway, the Study Advisory Committee would meet on a regular basis to assess status and report findings and recommendations to the MEC. MEC, in turn, would provide opportunities for public input on the studies. Once finalized, MEC would report findings to the program administrator(s) and the Commission.

For program-level EM&V, the Collaborating Parties could not reach consensus on which organization should be the contracting entity for program-level EM&V. Some collaborating party members support Energy Division for this role (ORA and TURN) to avoid conflict-of-interest issues and others (IOUs and NRDC) support utility contracting for these EM&V studies due to utility expertise and potential limitations of state contracting rules and staff resources. The Collaborating Parties also put forth a third option; that MEC decides who should hold the contracts on a case-by-case basis, with the ALJ making the final decision if MEC cannot agree.

Irrespective of who contracts with the evaluators, the Collaborating Parties agree that MEC should create Project Advisory Committees (PACs) to oversee the efforts of each program-level evaluation study. MEC would appoint an IOU project manager to each PAC, and other PAC participants would include a representative from each program implementer being evaluated, an Energy Division staff person, and additional interested independent participants.

In accordance with the EM&V protocols established by the Commission, the PACs would develop measurement and evaluation plans for each program or group of programs. These plans would be reviewed by Energy Division and other MEC members and approved at a regularly notices MEC meeting. Each PAC would also develop the scope of work to be included in the evaluation consultant RFP, and recommend the selection of the independent evaluation consultant. Each PAC would meet on a regular basis, providing input while the evaluation is being conducted, and report findings and recommendations to MEC and the program administrators. Energy Division would also oversee a Summary Study that includes the issuance of Study Review Memos to verify the compliance of each evaluation study with the adopted protocols and summarize the total energy savings attributed to energy efficiency programs during the funding cycle. At its discretion, ORA may also verify any element of a program evaluation report as a further check on the evaluator’s performance and the validity of savings. The Commission would review program performance annually based on study reports and would hold hearings to resolve any disputed results.

The Collaborating Parties believe that this proposal represents a reasonable common ground among competing approaches to advisory group structure and EM&V administrative structure. In addition, they note that the process of developing this proposal has served to build trust and collaboration among parties with widely divergent views on other issues related to administrative structure.

5. Discussion

We are pleased to see the broad range of active participants in this phase of the proceeding, as evidenced by workshop participation, the diverse composition of the Coalitions and Collaborating Parties, and the large number of opening and reply comments. Although these participants clearly do not agree on how to structure the specific Program Choice and Portfolio Management functions, we note that the administrative proposals are more similar than different.

In particular, all of the proposals recognize that the Commission is responsible for the policy oversight and quality assurance functions, and provide thoughtful recommendations on how the Commission might best obtain the policy and technical expertise to assist it in carrying out those responsibilities. All of the proposals recommend approaches to EM&V designed to mitigate potential conflicts between the overall administrator, program implementers, and EM&V contractors. They all propose the use of an EM&V technical advisory group to assist the Commission in this effort. And all of the proposals envision an energy efficiency delivery system in California that continues to include a role for both IOU and non-IOU program implementers, although they differ with respect to how those IOU and non-IOU implementers should be selected. Finally, with the exception of the WEM / SESCO Coalition proposal, all proposals establish one or more advisory groups to provide guidance in program selection and portfolio management, irrespective of what entity or entities perform those functions.

While there are significant areas of agreement, there are also key differences among the parties with respect to the threshold issue of what entity (or entities) should be responsible for Program Choice and Portfolio Management in the future. Based on the proposals and comments in this proceeding, we believe that this major "fork in the road" must be addressed before we can proceed further to design an administrative structure for energy efficiency programs.

Before turning to this issue, we wish to comment on a proposal that was not put forth in the April 8 filings, namely, to continue with an administrative structure that places Commission staff in the role of Program Choice and Portfolio Management. As described above, this structure was put in place as a rapid response approach during the energy crisis, when the Commission perceived a need to play a more significant role in the Program Choice and Portfolio Management functions. We commend staff for performing an admirable job under very difficult circumstances and constraints over the past few years. However, we believe that this current structure should not be continued beyond 2005 for several reasons.

First and foremost, placing our staff in the role of Program Choice and Portfolio Management stretches limited staff resources between those functions and the quality assurance and EM&V responsibilities that we believe should be the primary focus of our staff efforts. While requesting increases in staff resources is always an option, the outcome of those efforts is highly uncertain, particularly given the budget realities in California today. Moreover, even if staff resources were not limited, we are concerned that many innovative programs may not be discovered through an application and review process at a regulatory agency. Past experience indicates that program administrators and program implementers, working together with public input, are well suited to the task of developing innovative and cost-effective energy efficiency programs from concept to full program design for our consideration--examples of which include Flex Your Power, Standard Performance Contracting and Energy by Design.

The City of Oakland and others note that placing the responsibility on this Commission to make the initial selections of energy efficiency programs and then to oversee the portfolio management of those selections puts us in the position of both "judge and jury."[53] We believe that the Commission could fairly perform the program selection function, while at the same time overseeing quality assurance and an EM&V process that provides us with an independent assessment of program performance, but on balance we agree that separating these two functions promotes more confidence in the process and is a better use of staff expertise.

Finally, we concur with Commissioner Kennedy's observations that:

> "The Public Utilities Commission is a regulatory agency, not an administrative agency. As such, the Commission's regulatory functions, and the Commission's responsibility for providing independent oversight of all ratepayer-funded programs, are incompatible with administration of any of those programs or contracts on a long-term basis."[54]

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[53] City and County of Oakland Opening Comments, p. 2.

[54] Assigned Commissioner's Ruling Proposing Direction and Scope For Further Rulemaking, July 3, 2003, p. 13.

We now turn to the threshold issue on administrative structure in this proceeding.

5.1. Threshold Issue: Who Should Perform the Program Choice and Portfolio Management Functions?

We concur with the observations of our Strategic Planning Division and the Regulatory Assistance Project that there is no *single* best model for how energy efficiency programs should be administered, particularly with respect to the Program Choice and Portfolio Management functions. One size does not "fit al": The best administrative structure depends on each state's particular context.[55] We believe that these questions should be carefully considered within the specific context of California, beginning with the goals for energy efficiency that we have established in the Energy Action Plan.

As discussed in Section 3, energy efficiency has been a component of energy planning in California since the mid-1970s, but the focus and goals have shifted over time. Prior to the Collaborative era, energy efficiency programs were developed outside the IOUs' resource planning process. As a result of the Collaborative and subsequent DSM rulemaking, energy efficiency was recognized as an integral component of utility resource procurement and an important means of achieving the Commission's goal of "reliable, least-cost, environmentally sensitive electricity service."[56]

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[55] See: Reporter's Transcript (March 17, 2004 Workshop) in R.01-08-028, pp. 72-74, p. 160-161, *Energy Efficiency Administration Structures Overview*, p. 7.

[56] D.92-02-075, Attachment 1, Rule 1.

This focus shifted dramatically in 1996 to reflect the competitive framework that this Commission and Legislature envisioned for the electric services industry at that time. Ratepayer investments in energy efficiency were undertaken to develop a fully competitive market in energy efficiency services so that customers could seek and obtain these services in the private sector. The goal was to provide ratepayer funding for this purpose for a transitional period only (through December 2001), at which time all ratepayer funding of non low-income energy efficiency programs would cease.

Today, the Energy Action Plan has placed energy efficiency back at the forefront of resource procurement activities in California. In particular, the plan establishes a loading order of energy resources that requires California to first optimize "all strategies for increasing conservation and energy efficiency to minimize increases in electricity and natural gas demand" before turning to supply-side resources.[57] With the return of the IOUs to resource procurement and the policies articulated in the Energy Action Plan, the focus of energy efficiency in California has returned to resource acquisition. Consistent with that shift in focus, in D.02-10-062 we directed the IOUs to optimize electric energy efficiency investments in their resource plan portfolios for our consideration, regardless of the limitations of funding through the PGC mechanism. Based on our consideration of those projections, we increased energy efficiency funding to

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[57] *Energy Action Plan*, 2003, p. 3. A copy of the plan is available on the Commission's website at www.cpuc.ca.gov.

over $800 million for the 2004-2005 funding cycle, or an average of approximately $400 million per year. In addition, we recently augmented natural gas energy efficiency funding for PG&E, SDG&E and SoCalGas on an expedited basis, in order to expand current program offerings for the 2004 / 2005 winter season.[58] By D.04-09-060, we established aggressive natural gas and electric savings goals by IOU service territory through the year 2013, subject to updates for 2009 and beyond. As described in that order:

> "For the three electric IOUs, today's adopted savings goals reflect the expectation that energy efficiency efforts in their combined service territories should be able to capture on the order of 70% of the economic potential and 90% of the maximum achievable potential for electric energy savings over the 10-year period, based on the most up to date study of that potential. These efforts are projected to meet 55% to 59% of the IOUs' incremental electric energy needs between 2004 and 2013.
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> For natural gas, our adopted savings goals are designed at this time to capture approximately 40% of the maximum achievable potential identified in the most recent studies of that potential. This level of expectation recognizes the fact that natural gas program funding levels have dropped substantially over the last five years, and that ramping up those efforts to meet the full savings potential may take more time than on the electric side. It also recognizes some uncertainty over the level of achievable savings in the non-core sector. Nonetheless, today's adopted natural gas savings goals represent substantial "stretch goals" by anyone's standards: They reflect an increase in savings by 244 Mth over the 210 Mth in savings that would be achieved if current funding levels and program effectiveness (therms per dollar) remained constant. In other words, today's adopted goals for natural gas energy efficiency represent a

[58] See D.04-12-019.

116% increase in expected savings over the next decade, relative to the status quo.“[59]

No state has ever placed energy efficiency at the forefront of energy policy in this manner, or has committed the level of resources that California has to meet the goal of optimizing energy efficiency investments. It is therefore imperative that we adopt an administrative structure that is capable of mobilizing the resources and efforts needed to meet the goals of the Energy Action Plan, without uncertainty or delays that could undermine California's ability to recover from energy crisis and move its economy ahead with "reasonably priced and environmentally sensitive energy resources."[60]

To this end, our options for energy efficiency administration should be considered in the context of California's regulatory framework for resource procurement as it exists today and for the foreseeable future. As described in previous Commission decisions,[61] the energy crisis of 2000 and 2001 changed the regulatory landscape in a profound way for California. The Commission and the Legislature responded to the crisis in 2002 with direction to the IOUs that they were to resume responsibility for procuring resources to meet customer demands, subject to Commission oversight and approval.[62] In contrast to Texas and other states that have implemented full retail competition, California IOUs are required once again to plan for and acquire both supply-side and demand-

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[59] D.04-09-060, pp. 2-3.

[60] *Energy Action Plan*, p. 1.

[61] See, for example, D.02-10-062 and D.04-01-050.

[62] Pub. Util. Code § 454.5 provides the statutory direction for the return of the IOUs to the procurement role. Commission decisions issued in the Procurement Rulemaking, R.01-10-024, establishes the market structure and regulatory requirements.

side resources for a large portion of their natural gas customers and all of their electric customers. Even under the core / non-core structure for electric customers currently under consideration, the IOUs would remain responsible for resource procurement for a sizeable level of electric load.

This is very different from the approach taken in Texas, for instance, where the IOUs are not allowed to participate in planning or delivering energy services (supply- or demand-side) within their service territories, except to oversee standard contracts with third-party providers. In Texas and other states that have implemented full retail competition, decisions concerning the optimal levels of energy efficiency and supply-side resources are determined entirely by the private market.

In California, these decisions will now be made in the resource planning process undertaken by the IOUs, subject to our oversight and approval. In this context, establishing an independent administrator (or administrators) for program choice and portfolio management means that all of the program selection and day-to-day management decisions are "handed down" to the IOUs to incorporate into their resource plans and resource adequacy projections (TURN / ORA Coalition), or left to the private market to determine (WEM / SESCO Coalition). While this may not be an issue in other states where the IOUs are not as involved--or not involved at all--in resource procurement, we believe it is an unworkable approach to integrated resource planning in California. In particular, as we stated in D.04-01-050, California IOUs should not be required to adopt the forecasts and resource plans of others -because "[w]e strongly believe that the utilities themselves must be responsible and accountable for providing their customers reliable service and just and reasonable rates; this is the utilities' statutory obligation to serve."[63] And, as discussed below, our experiences in California have left us unwilling to rely solely on competitive market solutions to meet customers' energy needs.

Even if the IOUs were not responsible for resource procurement, we would have significant concerns about the degree of control we could exert over third parties under an independent administrative structure. The Commission has broad regulatory authority to ensure and enforce the IOUs' compliance with our policy rules and requirements based on current statute and Constitutional authority.[64] In contrast, the proposals for independent administrators in this proceeding rely on contractual authority. This form of authority is potentially weaker, more complex, and less flexible than relying on our regulatory powers. In particular, we would have limited recourse in the event that the programs do not deliver the requisite energy savings or the program administrator fails to perform in other ways. As NRDC points out, the remedies for breach of contract are much more limited than our regulatory authority under current law:

> "If a contracting party fails or refuses to discharge his / her contractual obligation, a 'breach' of contract occurs. However, the standard as to whether there was in fact a breach in contractual performance is much higher than a CPUC regulatory determination. In order to recover for damages for a breach of contract, a breach has to be 'material.' Material breach occurs if the defect in the promisor's performance

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[63] D.04-01-050, p. 127. We note, however, that in developing the IOU long-term plans for resource procurement we do closely coordinate with the CEC's biennial integrated resource planning process in order to avoid duplication in our proceedings. *Ibid.*, p. 175.

[64] Pub. Util. Code §§ 701, 761, 2101, 2107, and the California Constitution Article 12.

> *seriously* disappoints the reasonable expectation of the aggrieved promisee. The burden of proving that this 'impact is serious' is on the promisee who claims the privileges accorded to the victim of material breach. And when it is found that a party breached a contract, the Government agency is limited to usual remedies for breach. [Footnote omitted.] These remedies include restitution and monetary damages. Remedies for a breach of contract do not include punitive or exemplary damages. In addition, in most instances, specific performances are not available. On the other hand, the CPUC's regulatory authority allows it to order specific performance, and / or impose fines and penalties if the utilities do not perform."[65]

TURN and CCSF argue that "there is ample opportunity and authority for the Commission to exercise any degree of control it desires over a non-utility administrator through a contract.[66] While the Commission can and does exercise control of contractors by defining the terms and scope of work, entities that sign contracts with the Commission do not by that fact alone become subject to the Commission's regulatory jurisdiction. In fact, according to the presumed contract terms under the TURN / ORA Coalition proposal, the only expedient remedy for unsatisfactory performance is the termination of the program administrator's contract.[67] Any other remedy could require us to litigate the matter in Superior Court, which is time consuming, expensive and uncertain, and less satisfactory than direct regulation.[68] In either case, we would be forced

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65 NRDC Opening Comments, p. 11.

66 TURN / CCSF Reply Brief, p. 3.

67 TURN / ORA Coalition Proposal, p. 8.

68 See, e.g., PG&E v. CPUC, 118 Cal. App. 4th 1174, 1211 ("requiring the PUC to bring a contract action to enforce conditions would enmesh the superior court in the CPUC's performance of its duties.")

to assign an interim administrator, a scenario that could be highly disruptive and costly. In order to meet our goals for energy efficiency, we must have the authority to hold the administrator(s) fully accountable for delivering energy savings without recourse to litigation. We believe that this authority is clearly established with our regulatory oversight of the IOUs, but considerably less certain under the proposals for independent administration in this proceeding.

Returning the IOUs to the program choice and portfolio management roles for energy efficiency is also a logical corollary to the market structure we have recently adopted for supply-side resource procurement. It is instructive that the debate over this issue in our Procurement Rulemaking focused in large part on the same threshold issue in this proceeding: The role of IOUs as both the "program choice / portfolio manager" and a potential "implementer" of supply-side resources, e.g., through dispatch of existing IOU resources or IOU construction of new power plants. Parties to our Procurement Rulemaking lined up on different sides of this issue, as they have in this proceeding.

For example, TURN, the Independent Energy Producers Association (IEP) and the Western Power Trading Forum (WPTF) expressed many of the same concerns about the potential for conflicts of interest discussed by TURN, ORA, WEM, SESCO and others in this proceeding if the IOU selects and manages the portfolio of supply-side resources and also "contracts with itself" for power production from existing or new generation. To address this issue, TURN, IEP, WPTF recommended two alternatives. First, that there be "independent administration" of the bid preparation and selection process if IOUs are allowed to participate in the solicitation with IOU-owned and / or IOU-constructed new plant. In the alternative, these parties recommend that the IOUs be required to administer an open competitive solicitation with third-party market generators but not be allowed to compete in the solicitation with IOU proposed new plant.[69] Third-party developers supported this position by arguing (as proponents for independent administration do in this proceeding) that separating IOUs from resource selection process coupled with the discipline of an open competitive solicitation is the best way to ensure lower costs and risks to ratepayers.[70]

In contrast, SDG&E and the IOUs recommended a supply-side market structure that would allow the IOUs to directly participate in resource selection as well as in the ownership of new generation facilities. In doing so, they presented many of the same arguments that the IOUs, NRDC, LIF and others present in support of their preferred energy efficiency administrative structure in this proceeding. These include: (1) the stability and permanence of a regulated utility; (2) the ability of the Commission to directly regulate the price, terms and quality of the generation service provided by the utility; and (3) the availability of a proven high-quality workforce (both management and labor).[71]

In weighing the arguments on market structure for long-term supply side procurement, the Commission concluded that California "should not rely solely on competitive market theory and the behavior of market generators", noting that our State has "a long history of reliable service being provided by utility-owned and operated generation plant and a recent painful history of rolling blackouts and high price spikes from reliance on third-party generators in a

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[69] D.04-01-050, *mimeo.*, p. 58.

[70] *Ibid.*, p. 59.

[71] D.04-01-050, *mimeo.*, pp. 57-58.

poorly designed competitive market."[72] In view of these overriding concerns, and in recognition of certain benefits of allowing IOUs to participate in owning new generation facilities, the Commission rejected proposals to either (1) remove IOUs from the role of resource selection or (2) allow the IOUs to select supply-side resources but not to participate as implementers. Instead, the Commission determined that IOUs should participate in both functions "in order to have the assurance of more state control over resources and an effective check against competitive market manipulations and abuses."[73]

Accordingly, in D.04-01-050, the Commission established a market structure that placed the California IOUs in the role of program choice and portfolio manager of supply-side resources (including dispatch decisions for IOU-owned generation plant), but also allowed them to directly participate as supply-side implementers by owning and/or building new generation facilities. In setting the market structure and rules for long-term procurement, the Commission recognized that it would need to be vigilant in overseeing "that no perceived bias occurs in selecting, or dispatching the resources, especially when the current cost recovery mechanisms favor the rate-based power plants." To this end, the Commission put in place important safeguards to "provide assurance to the third-party generators that we see a meaningful role for them in California's energy future."[74] The Commission found that third-party generating

[72] D.04-01-050, *mimeo.*, p. 60.

[73] *Ibid.*, p. 71.

[74] *Ibid.*, p. 62.

capacity, "if contracted properly,…holds a number of advantages for California ratepayers."[75]

More specifically, to address concerns that IOUs would rather rely on their own existing resources than on those that come from the market, the utilities are monitored for their patterns of dispatch to assure that the operations are undertaken in a least-cost manner.[76]

In addition, the Commission directed the IOUs to solicit future long-term generating capacity resources from non-IOU suppliers through a formal RFP process as a "standard procedure."[77] The Commission established Procurement Review Groups (PRGs) comprised of eligible non-market participants to consult with the IOUs in the design of the RFP and the evaluation of bids on a quarterly basis.[78] At the same time, however, the Commission recognized that IOU-owned and / or built projects should not be discouraged "where they are cost-effective and appropriate."[79] Accordingly, IOUs were permitted to present such projects for the Commission's consideration outside of the RFP process with evidence and justification for why IOU ownership structure is preferable, and how cost containment would be addressed.[80]

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75 *Id.*

76 *Ibid.*, p. 61.

77 *Ibid.*, p. 63.

78 For a description of these advisory groups, see D.02-08-071, p. 24; D.02-10-062, pp. 3-4, D.03-12-062, pp. 44-46 and D.04-01-050, p. 64.

79 *Ibid.*, p. 63.

80 *Id.*

The language of D.04-01-050 is instructive on how the Commission viewed the need for safeguards in the IOUs relationship with third-party implementers on the supply-side, and the best way to put such safeguards in place:

> "WPTF argues for a specific structure for capacity procurement that puts procurement via contract on an equal footing with utility-built options. WPTF's proposal is that prior to its issuance, an RFP must be approved by the Commission or an independent third party to verify that it is not tilted in favor of the utility or its affiliate's bid. Second, bids should be evaluated by an independent third party, such as an accounting firm, consultant, or specially convened review panel. Finally, the third party will select a winning bid which, if it meets the criteria presented in the RFP, the utility must accept.
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> "WPTF's proposal would result in a cumbersome process, and one that would be difficult for any utility to endorse, especially as it reserves final choice of contracting partner to a party other than the utility itself. But its need derives from the perception that without the involvement of independent parties in the development of the RFP, the evaluation of the bids, and the ultimate selection of the winning bidder, the utility would have an incentive to act in ways that would bias the process in favor of itself.
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> "The Commission currently has in place safeguards to address WPTF's concerns. First, each utility has a Procurement Review Group (PRG) that consults with the utility in the design of the RFP and the evaluation of bids. Next, the Commission will review all long-term commitments that result from an RFP through its formal process which allows notice to all parties and an opportunity for public review and comment. Based on our continuing review of the RFP process, we will adopt additional safeguards if we find it is necessary."[81]

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[81] *Ibid.*, p. 64.

As an additional means of addressing potential bias in this structure, the Commission endorsed the concept of creating a procurement incentive mechanism:

> "The utilities have an opportunity to invest and earn a return from generation assets; a similar opportunity for profit should be provided for selecting and managing well all other procurement products."[82]

> "The goal of this effort is to motivate the IOUs to procure least-cost supply-side resources and make cost-effective demand-side investments, taking into account the environmental costs (or benefits) of various resource options. Our challenge will be to create an overall procurement incentive framework that aligns the interests of utility investors, management and ratepayers such that the proper balancing of these preferred resources occurs in the procurement of power from existing and new resources."[83]

In sum, placing IOUs in the role of program choice and portfolio management, as proposed by the IOUs' Coalition and the NRDC / LIF Coalition, is consistent with the "hybrid" market structure we established in the Procurement Rulemaking for supply-side resource acquisition. This structure consists of both IOU and non-IOU market participants in the ownership and construction of supply-side resources. Project selection is the responsibility of the IOUs as part of their overall resource procurement obligations. The process is subject to Commission oversight and the safeguards described above to ensure against IOU bias in the selection process.

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[82] D.04-01-050, *mimeo.*, p. 61.

[83] Order Instituting Rulemaking 04-04-003, issued April 1, 2004, p. 16.

In contrast, the independent administrative structure proposed by TURN / ORA Coalition would create a new organization (and in the case of WEM / SESCO, several competing organizations) to perform the corollary functions of program choice and management for energy efficiency, while leaving the IOUs responsible for those same functions for all supply-side resources. We do not see any clear advantage to creating this dichotomy in the context of California’s current resource procurement structure. As discussed above, we rejected the principle that no entity should be allowed to assume both the program choice / portfolio management function and implementation function in our Procurement Rulemaking for supply-side resources. While TURN, ORA, SESCO, Ecology Action, WEM and other proponents of independent administration clearly consider this principle to be paramount, we do not view it to be an end unto itself. Returning the IOUs to these administrative functions has other advantages, as discussed above. Moreover, we believe there are significant impediments to putting independent administration in place that will introduce considerable delay and uncertainty into the process, thereby undermining California’s ability to achieve the Energy Action Plan goals.

Our unsuccessful attempts to shift to independent administration during electric industry restructuring created over two years of uncertainty in the administration of energy efficiency programs, an experience that we cannot afford to repeat at this critical juncture for energy procurement in California. That experience persuades us that we should carefully consider the potential legal and implementation challenges inherent in moving to the independent administrative structure proposed by the TURN / ORA Coalition or the WEM / SESCO Coalition, even without a “CBEE” type board overseeing the RFP solicitations. In their April 8, 2004 filings, both the TURN / ORA Coalition and the WEM / SESCO Coalition appear to contemplate the transfer of ratepayer funds from the IOU to the independent administrator(s). For example, the TURN / ORA Coalition states that since the Legislature directed the Commission to oversee the expenditure of PGC funds collected for energy efficiency purposes, the Commission may "order the utilities to collect the PGC energy efficiency funds and to transfer them to an independent entity."[84] The WEM / SESCO Coalition echoes this argument and concludes that no legislation would be needed to implement their proposed administrative structure.[85]

This was also our position in 1998 regarding our authority to oversee PGC funds collected pursuant to Section 381, as well as the telecommunication public purpose funds, which were collected from the IOUs, kept in trust accounts and spent under the Commission's ultimate authority. As described in Section 3.2, the Department of Finance and the Attorney General rejected this position. Both the Attorney General's and the Department of Finance's representatives stated that the ratepayer money such as the PGC is public money that can be held by the IOUs and spent under Commission direction, but in the absence of specific legislation, cannot be moved to an outside trust account or bank account.[86] Thus,

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[84] TURN / ORA Coalition Proposal, p. 30. See also, p. 13 ("The IOUs will act as the fiscal agent responsible for collecting and dispersing electric energy efficiency funds to the PA…based on the budget approved by the Commission.") and p. 24 ("The IOUs will maintain their responsibilities as the fiscal agent, however, they will only be required to transfer funds to the PA.").

[85] WEM / SESCO Coalition Proposal, p. 27.

[86] The Department of Finance was not persuaded that Section 2881(d) of the Public Utilities Code, which stated that the "commission shall establish a fund and require a separate accounting for each of the programs [for deaf and disabled telephone

Footnote continued on next page

if funds are not held by the IOUs, they must be held in a treasury account, or other account specifically authorized by the Legislature.[87]

The WEM / SESCO Coalition proposes that the System Director (which would be the CPUC, or its consultant, or a non-profit) accept applications from potential administrators, which would then contract with program implementers using a standard offer system.[88] The proposal states that the Commission "might allow IOUs to temporarily hold the funds, then pay them to the System Director and / or Administrators."[89] The WEM / SESCO Coalition further argues that "The Legislature has made the CEC the fiscal agent for some renewable resource funds collected by the IOUs, and we see no barrier to a CPUC order directing the IOUs to pay the funds, as collected, to the CEC or other governmental entity…"[90] The barrier is that the Legislature must authorize such a transfer, as it did for PGC funds for renewable resources.[91] During oral argument and in the subsequent

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subscribers] implemented in this section" authorized establishment of a trust fund outside the state treasury. (Emphasis added.)

[87] Section 270 created treasury funds for six public purpose telephone funds. Sections 275, 276, 277, 278, 279, 280 directed telephone corporations to submit the money collected in rates to fund the public purpose programs to the Commission, and directed the Commission to transfer that money to the treasury fund created for that purpose.

[88] CCEE proposal, pp. 1-2.

[89] *Id.*, p. 13.

[90] *Id.*

[91] Section 399.6(e) provides that money collected for renewable energy shall be transferred to the Renewable Resource Trust Fund of the Energy Commission, to be held until further action by the Legislature; Section 399.7(b) authorizes the transfer of money collected for public interest energy research and development (PIER). Commission Resolution E-3792, December 17, 2002 implemented the process for transferring the PGC funds for the renewable and PIER programs.

briefs, the TURN / ORA Coalition and WEM / SESCO Coalition proposes that the IOUs pay the program administrator(s)' bills at the direction of Energy Division, rather than actually transferring IOU funds to program administrators. As these parties note, we have authorized Energy Division to enter into contracts for EM&V and other specialized energy efficiency-related activities (e.g., audits) for which the IOUs pay the contractors directly.[92] We anticipate that Energy Division will enter into future contracts for EM&V that will be similarly managed and funded, consistent with today's adopted EM&V administrative structure. (See Section 5.3.) This payment arrangement does not appear to raise the same concerns that troubled the Attorney General and Department of Finance in 1998, since ratepayer funds are not moved to an outside trust fund or bank account, but are held by the utilities, and then expended for approved expenses.

In considering this approach to funding a non-IOU program administrator or administrators, it is important to understand that such contractual arrangements require Energy Division to review and approve each invoice submitted by the contractor. After that review, if the invoices are found to be reasonable based on the scope of work and work product, Energy Division sends a letter informing each IOU of its share of the contractor's bill, which the IOU then pays directly to the contractor. While this arrangement has functioned well

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[92] See, for example, D.03-04-005, Ordering Paragraph 10, and D.03-08-067 at pp. 20-21, which directed the Energy Division to enter into contracts for a PGC audit, an avoided cost and externality update, and an independent verification of savings and milestone achievements associated with the Annual Earnings Assessment Proceeding, for up to a total of $4.1 million. D.03-08-067, at p. 18, authorized the Energy Division to execute a contract for a contractor to oversee and consolidate evaluation efforts. That contract has been funded for approximately $1 million to date.

for the specialized contracts authorized to date, we do not believe it is feasible or desirable to extend this approach to program administrators, given the magnitude and broad range of tasks associated with the Program Choice and Portfolio Management functions.

Effective staff contract management requires that the contract manager review monthly invoices to ensure that expenses are reasonable and within the approved scope of work, prior to authorizing payments. Requiring our Energy Division staff to extend this type of contract management to a program administrator (or multiple administrators) responsible for an annual budget of over $400 million raises the same issues of resource allocation we discussed earlier. While we will need to closely oversee the administration of energy efficiency programs under any administrative structure, returning the Program Choice and Portfolio Management functions to the IOUs does not require Energy Division to approve monthly invoices in order to maintain effective oversight of program expenditures. Instead, this Commission (with support of its staff) can review reports on program accomplishments and other EM&V documents, and make adjustments for unreasonable program expenditures in our regulatory proceedings, as appropriate.

In sum, even if we desired to pursue a model that transfers funds from the IOUs to an outside entity, we would first need to seek legislation similar to the provisions that authorize the transfer of telecommunication public purpose funds to treasury accounts, or PGC funds to the CEC treasury accounts. This would delay our ability to move forward with a permanent administrative structure for energy efficiency until the Legislature (and Governor) enacted a statute. Moreover, the outcome of that process would be highly uncertain. We note that once those funds are in the state treasury, then state contracting rules apply.[93] Once in the state treasury, the funds would also be more easily available for "borrowing" for other purposes. Our own experience in California, and the experience of other states, indicates that the resulting funding uncertainty could be significant. [94] For the reasons discussed above, requiring the IOUs to pay the bills of non-IOU program administrator(s) subject to Energy Division review of invoices does not, in our opinion, represent a viable alternative to transferring IOU funds to an outside administrator, absent statutory authority.

The administrative structure proposals presented by the TURN / ORA Coalition and WEM / SESCO Coalition, both of which contemplate the Commission entering into contracts with outside entities to perform energy efficiency functions, also face the risk of legal challenge as being inconsistent with Government Code § 19130(b). This section requires that civil servants perform the work of the State. To date, the contracts for specialized energy efficiency activities, such as EM&V, have generally involved very specialized

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[93] The California Public Contract Code, beginning at Section 10335 and regulations promulgated by the Department of General Services set the requirements for contracts entered into by a state agency for services, including inter alia, securing at least three competitive bids for each contract by means of an RFP process, following specific statutory evaluation and selection procedures for awarding the contract to the responsible bidder, allowing public inspection of bids and obtaining approval of the Department of General Services for state contract for services that exceed a dollar threshold.

[94] See a discussion of this issue at the March 17, 2004 Workshop, Reporters Transcript, p. 44, p. 76 and p. 13 of *Energy Efficiency Administrative Structures Overview*. In California, the Legislature has already borrowed money from the California High Cost Fund B Administrative Committee Fund, the California Teleconnect Fund Administrative Committee Fund and the Public Interest Energy Research Fund.

expertise and have not been challenged. However, the magnitude, broad scope and nature of administrative tasks performed by the program administrators under TURN/ORA Coalition proposal—requiring 25 professional employees, which we believe is a conservative estimate—will make it a more likely target for legal challenge.

TURN and CCSF argue that this is a legal challenge we could win. [95] They note that, while the SPB Executive Director ruled against the Commission with respect to independent administration during the late 1990s, the matter was settled before the full SPB ruled on the matter. In their view, the Commission could prevail on this issue before the full SPB by successfully arguing that the work of the independent administrator(s) falls within at least one exemption from the Government Code § 19130(b) requirement. However, even if we were to prevail on a challenge to our contract with the program administrator(s), the delay and uncertainty associated with any challenge would interfere with our ability to aggressively deploy energy efficiency programs and meet our energy efficiency savings goals for 2006 and beyond. Moreover, despite TURN and CCSF's confidence, we cannot be certain of a favorable SPB ruling.

In addition to the legal risks described above, the administrative proposals recommended by TURN/ORA Coalition and WEM/SESCO Coalition create other substantial implementation challenges. Developing and overseeing the

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[95] They also argue that allowing the IOUs to perform program administrator functions could raise similar legal challenge. We disagree. On its face, Government Code § 19130(b) applies to personal services contracts, not activities that have been traditionally performed by utilities regulated by the Commission. Therefore, placing responsibility for program choice and portfolio management with the IOUs would not raise the same risk of challenge under § 19130(b).

RFP for program administrator (or multiple RFPs under the WEM / SESCO Coalition proposal) is a significant and time-consuming task. During restructuring, our effort to develop an RFP for an administrator of market transformation programs (which would not be transferable to today's resource procurement environment and energy efficiency goals) took many months to accomplish and involved Commission staff, CBEE board members and a team of technical and administrative contractors. Moreover, that effort of start-up involved a program of considerably smaller size and scale—approximately half the level of annual funding that we currently authorize. We would expect at least that amount of time would be needed to develop an RFP and solicit bids for administrator(s) under the TURN / ORA Coalition and WEM / SESCO Coalition proposals, and another three to six months for Commissions staff to evaluate the proposals, select the winner(s) and obtain Commission approval of the selection.

Start-up of this structure would also be an expensive undertaking. The TURN / ORA Coalition proposal estimates that independent administration of the Program Choice and Portfolio Management functions would require 25 full-time professional staff. We concur with the assessment of ICF Associates that experience in other states indicates that this estimate is extremely conservative. The Energy Trust of Oregon, for example, operating within a structure very similar to that proposed by TURN / ORA Coalition, currently employs approximately 28 staff to administer an energy efficiency program 1 / 10th the size of California's programs.[96] Although there certainly will be economies of scale, it

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[96] The program for 2004, including administrative costs, is roughly $59 million for the three participating IOUs. The energy efficiency portion is roughly 75% of the total, or $44.2 million in 2004. The Energy Trust budget narrative reports a full staffing level of

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is difficult to comprehend how this structure could be developed and managed with 25 staff, particularly within the substantially larger and more diverse program environment in California. This problem is magnified when multiple entities are performing the administrative functions, as proposed by the WEM / SESCO Coalition. Not only would each administrator require staffing to oversee the standard offer contractors and perform general administrative duties and responsibilities required by the Commission (e.g., tracking expenditures and performance, reporting requirements), but the Commission would need to increase its staff to oversee contracts with potentially dozens of individual administrators throughout the state.

Moreover, each of these proposals fails to recognize the huge fiduciary responsibility that would need to be assumed by the program administrator or administrators. These entities would be responsible for management of over $400 million annually. The required level of fiscal control and the business systems needed to support that control are complex and expensive. As ICF Associates points out, there are few, if any existing non-IOU organizations with an understanding of the energy efficiency business that have managed anywhere near that level of funding. Even if organizations responding to the RFP for program administrators demonstrated the required level of fiscal control and business systems, we are skeptical that they could accomplish these functions with a total staffing of 25.

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37 to support both energy efficiency and renewable energy activities. Applying the same percentage above (75%) yields an estimated staffing level of approximately 28 for energy efficiency administration. Source: Regulatory Assistance Project, Richard Sedano; ICF Associates Opening Comments, p. 7.

This brings us to a critical question concerning independent administration: Are entities of sufficient capability and experience to administer energy efficiency likely to respond to the RFP? The ORA/TURN Coalition proposal places a great deal of emphasis on having the administrator be a “single-purpose” entity, in order to ensure that energy efficiency is the core focus of the administrator. We interpret this to mean that the single organization or partnership of firms forming the administrator would be disqualified if they were engaged in any businesses that create a conflicting financial interest. However, as NRDC points out, many of the entities in California that are most qualified to form the administrator under the ORA/TURN Coalition model engage in multiple activities in the energy industry. Thus, while a “single purpose” entity sounds simple and appealing in theory, we expect that it could be very difficult to implement in practice, unless the entity is started from scratch. We agree with NRDC that this is unlikely to occur given the need for a speedy transition as well as the short contract terms offered to the administrator under the ORA/TURN Coalition proposal.

We also have no guarantees under the WEM/SESCO Coalition proposal that bidders will provide the statewide coverage for energy efficiency activities that are needed to meet the Commission’s energy efficiency goals. As discussed above, the choice of what measures to install (and where) is left to the competitive market, based on the geographic region or market(s) that the various competing administrators propose to cover and the assessment of costs and risks by implementers competing to operate under standard offer contracts. While the proponents of this approach consider competition and de-centralized decision making to be an advantage, we see clear disadvantages to relying exclusively on this administrative model to meet our aggressive energy savings goals in

California. We note that standard offer programs have never been used to support energy appliances or building standards, which are cornerstones of California's energy policies.

The experience in Texas to date reinforces our concerns. While supporters of the WEM/SESCO Coalition proposal contend that it is a great success in Texas, we need to view that success in proper perspective. In particular, the goals of the program are extremely modest by California standards. The Texas statutes require that distribution-only IOUs in that state achieve savings equivalent to only *10% of the electric utility's annual growth in demand* by January 1, 2004, and each year thereafter. The standard offer programs in Texas, which is the only type of energy efficiency program offered by the IOUs in that state, met this goal for 2004 by contracting for approximately 150 megawatts (MWs) and 400 gigawatt hours in savings. To put this amount in perspective, 150 MWs represents the equivalent in usage for roughly 38,000 homes in Texas.[97] California's energy goals for energy efficiency will require a much more aggressive and comprehensive commitment to deferring or displacing more costly supply-side alternatives.

We are not persuaded that reliance on a standard offer program, as the WEM/SESCO Coalition envisions, can achieve these goals. Under this model, statewide programs (other than a 5% proposed budget for education and information) could cease to exist entirely, as there is no apparent coordination between the multiple administrators and no assurance that each administrator would select the statewide program for its service territory. In fact, the

[97] Assuming four killowatt peak/home.

administrative model proposed by the WEM / SESCO Coalition would make coordinating different programs very difficult, if not impossible. Customers would be faced with multiple and sometimes overlapping programs that invite customers to participate in more than one program intended to achieve the same energy savings. Having an uncoordinated group of implementers design and implement a variety of uncoordinated programs will not achieve the program synergies and leveraging necessary to optimize savings from energy efficiency, as required by the Energy Action Plan.

Moreover, experience to date also suggests that standard offers may not be well suited to tapping the full potential of cost-effective energy efficiency, particularly large commercial and industrial installations. According to staff at the Texas Public Utilities Commission, coverage of those sectors has been lacking because standard offers may not provide the flexibility needed for the more complicated, but large savings potential, applications.[98] We believe that the WEM / SESCO Coalition proposal is even less likely to produce better results in this regard, since it relies exclusively on the "deemed savings" standard offer. In Texas, this type of standard offer is considered suitable only for limited applications, primarily residential and small commercial. More elaborate approaches to verifying program savings, including metering, billing analysis or computer simulation, are required under the Texas standard offers for most

[98] Source: Calendar year 2003 program results, program standard offers and other program information based on the Texas Commission website, and communications between the assigned ALJ and Texas Commission staff. See also the program results and administrative costs presented in Comments of Quality Conservation Services, pp. 3, 8.

other applications.[99] While we can support the general concept of performance-based contracting, we do not believe that the "one size fits all" version of this approach proposed by the WEM / SESCO Coalition is appropriate for California. As an implementation strategy, standard offer programs may have a place; however, it is not a strategy that can wholly replace other, more appropriate, administrative models.[100]

Based on the above, we find that the administrative proposals recommended by ORA / TURN Coalition and WEM / SESCO Coalition would introduce significant start-up costs, uncertainty and delays in the future administration of energy efficiency programs. Moreover, by relying on a competitive RFP process for the selection of administrators, these approaches introduce the additional risk that the solicitations will not produce administrators with the requisite experience and capability to manage California's large energy efficiency program and meets the goals of the Energy Action Plan. As discussed above, the WEM / SESCO Coalition proposal magnifies this risk by delegating the role of program choice to individual implementers competing among themselves to operate under standard offer contracts.

In contrast, returning the IOUs to a lead role in program choice and portfolio management will not create the legal risks described above or require

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[99] *Id.*

[100] It should be noted that the IOUs "Statewide Standard Performance Contract Program" targeting larger energy uses is a standard offer program. In developing the program portfolio for post-2005 energy efficiency, the IOUs and advisory groups (see below) may consider the appropriate role of other standard offer programs based on experience with them in California as well as in other states.

statutory changes. Transitioning from staff to IOU responsibilities would involve a relatively short transition period, and could be accomplished at an orderly pace that would not disrupt program delivery. Based on our experience with utility administration during the pre-restructuring (Collaborative) era, we are confident that the IOUs have the requisite expertise and capability to administer energy efficiency consistent with the Energy Action Plan and the savings goals we establish in this proceeding. That experience has demonstrated to us that IOUs can meet aggressive savings goals under an administrative structure that holds them directly accountable for program results. As we reported in D.03-10-057, we estimate that IOU administrators during the Collaborative produced $1.4 billion in net benefits to ratepayers (savings minus costs, including shareholder incentives) for programs implemented or initiated over the 1994-1997 period.[101]

In their comments, several parties argue that IOU administration brings with it inflated administrative costs and other inefficiencies that justify placing a different entity or entities in the Program Choice and Portfolio Management Role.[102] We believe that these arguments could equally apply to any

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[101] D.03-10-057, *mimeo.*, p. 29; Finding of Fact 9. As noted in this decision, the estimates of net benefits presented above have already been verified in our AEAP, with respect to program participation, program costs and first-year load impacts. We are in the process of verifying the persistence of program savings over time in our pending AEAP, as Energy Division completes its independent verification of the utilities' retention and persistence studies. Therefore, these numbers are subject to modification based on the results of this final verification, but do represent our best estimate at this time. They are intended only to illustrate the general point that IOU administration in the past has been a successful approach to achieving substantial resource savings to the benefit of ratepayers. *Ibid.*, p. 28.

[102] See, for example, TURN Opening Comments, p. 13.

administrative structure in which administrative costs and overall program and portfolio performance were not adequately and accurately monitored. They raise a broader issue, namely, how to ensure that the program results, both costs and benefits, being reported by the IOU administrators, IOU implementers and non-IOU implementers are credible, particularly for resource planning purposes. We concur with Rich Sedano of the Regulatory Assistance Project that the specifics of who performs the program choice or portfolio management function are not relevant to this question. Rather, what is relevant is the structure of the monitoring and verification program, or what we refer to as EM&V.[103] We discuss that structure in Section 5.3 below.

In their comments, the CCSF and WEM argue that an administrative structure that places the IOUs in the role of Program Choice and Portfolio Management is inconsistent with the statutory requirements of AB 117. We disagree. AB 117 added sections to the Public Utilities Codes that permit cities and counties that have registered with the Commission as "Community Choice Aggregators," to buy and sell electricity on behalf of utility customers in their jurisdictions.[104] AB 117 contained provisions, codified at Section 381.1(a) that required the Commission to establish procedures by which anybody, including CCAs, can apply to become administrators of energy efficiency programs established pursuant to Section 381. We have interpreted our decisions that allow CCAs and other third parties to apply for PGC funds as consistent with this requirement while at the same time recognizing that, as the procedures for

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[103] Reporter's Transcript, pp. 87-88.

[104] Pub. Util. Code §§ 218.3, 331.1, 366.2, 381.1, and 394.25.

allowing CCAs to begin serving customers evolve, we may need to revisit the issue.[105]

WEM construes the requirement that any party be allowed to apply to become an administrator of energy efficiency programs as meaning that such entities must be allowed to assume the responsibility for portfolio selection and management.[106] The City of Berkeley expresses similar concerns.[107] WEM argues that none of the proposals, except the one put forth by the WEM / SESCO Coalition, complies with AB 117. We reiterate our interpretation of "administrator" for purposes of AB 117 as meaning "any entity implementing an energy efficiency program that is the subject of Section 382, which authorizes the expenditure of certain funds on energy efficiency programs."[108] We believe this is consistent with the competing interests articulated in Section 381.1 as well as the requirements for handling ratepayer money, as discussed above.

At the same time, we have recognized that "we may ultimately find that CCAs are appropriately independent agencies that should have considerable deference to use Section 381 funds" and have reserved broader issues about CCAs role and discretion for later determination.[109] We are currently establishing the procedures required by AB 117 before CCAs begin serving customers, including obligations of CCAs, recovery of IOU costs, and required

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105 D.03-07-034, *mimeo.*, p. 10; D.03-08-067; D.04-01-032.

106 WEM Opening Comments, pp. 14, 17.

107 City of Berkeley Opening Comments, p. 4.

108 D.03-07-034, *mimeo.*, p. 7, fn. 2.

109 *Ibid.*, p. 10.

reports to the legislature.[110] Once those details are resolved, we may revisit the issue of allocating electric energy efficiency PGC funds to CCAs in the context of their role in delivering electricity to their customers. Stated another way, we may revisit the question of whether CCA customers should be relieved of their responsibility for energy efficiency PGC and procurement surcharges if the CCA elects to take over these functions. Nothing in this decision prevents us from modifying the process for allocating PGC funds to CCAs in the future.

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[110] See R.03-10-003, Order Instituting Rulemaking to Implement Portions of AB 117 Concerning CCA.

CCSF argues that there will be no meaningful opportunity for other implementers to compete under an administrative model that puts the IOUs in the role of program selection. It therefore follows, in CCSF's view, that the IOUs Coalition and NRDC / LIF Coalition proposals are inconsistent with AB 117's requirements.[111] As discussed in this decision, we believe that with quality control measures, the IOUs can both select and sponsor programs without bias.

During oral argument and in its subsequent reply brief, WEM argues that using the CPUC's definition of administrator to mean "implementer," Pub. Util. Code § 381.1(a) would require that the Commission retain the program choice function.[112] According to WEM, "the statute requires the Commission to 'weigh the benefits of the proposed program,' not delegate the weighing to other entities."[113] We believe that today's decision, which holds the IOUs responsible for assembling a portfolio of programs pursuant to the Commission's overall policy guidelines and energy savings goals, and for submitting recommendations to the Commission for ultimate approval, is entirely consistent with the language of § 381.1(a). Nothing in today's decision is intended to delegate that ultimate approval to the IOU administrators. We note that even when Energy Division staff has performed the program choice function by selecting program proposals using the Commission-adopted criteria, the Commission has approved or disapproved the recommendations of staff.

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[111] CCSF Opening Comments, pp. 3-4. See also October 18, 2004 Comments of TURN / CCS, p. 9.

[112] WEM Reply Comments, October 25, 2004, pp. 8-9.

[113] *Ibid.*, p. 9.

In conclusion, we find that returning the IOUs to the lead role in program choice and portfolio management will best meet California's goals for integrated resource procurement, for several reasons. First, this approach is the most effective way to hold the IOUs accountable for the responsibilities they have been assigned by both the Legislature and this Commission to procure demand-side and supply-side resources to meet Energy Action Plan goals. It is also the logical corollary to the market structure we have established in R.01-10-024 for procuring supply-side resources. In addition, in contrast to proposals for independent administration, it is an approach that can be put in place without new statutory authority, and without substantial start-up costs, uncertainty or delays.

At the same time, we realize that returning IOUs to these roles will also require us to institute appropriate safeguards, as part of our overall approach to quality control. We discuss those safeguards in the following section.

5.2. Quality Control Measures For Program Choice and Portfolio Management

Irrespective of what entity or entities fulfill the role of Program Choice and Portfolio Management, we need to adopt quality control measures to ensure that program administrators select programs and manage them in a manner that is consistent with our objectives. We believe that the measures discussed below, in combination with our regulatory and policy oversight, are necessary to ensure that IOUs integrate an optimal mix of energy efficiency programs into their resource plans as they perform these functions.

Before turning to that discussion, we first respond to a related issue raised by the TURN / ORA Coalition. In its April 8, 2004 filing, the TURN / ORA Coalition recommends that the Commission reject the notion of adopting performance incentives to motivate the performance of administrators—irrespective of whether the administrator is the IOU or a third-party.[114] In its April 26 comments, NRDC argues that at least some part of the administrator's earnings should be based on performance—no matter who the administrator—to ensure that ratepayers get the most for their investments in energy efficiency and do not pay no matter what the level of performance.[115] We concur with NRDC and others that we need to consider a risk / reward mechanism for energy efficiency program administration in this proceeding. As indicated in prior rulings and decisions, we intend to do so in careful coordination with the development of an overall procurement incentive framework:

> "In D.02-10-062, we expressed our preference to adopt a uniform incentive mechanism to provide an opportunity for utilities to balance risk and reward in the long-term procurement process…The goal of this effort is to motivate the IOUs to procure least-cost supply-side resources and make cost-effective demand-side investments, taking into account the environmental costs (or benefits) of various resource option. Our challenge will be to create an overall procurement incentive framework that aligns the interests of utility investors, management and ratepayers such that the proper balancing of these preferred resources occurs in the procurement of power from existing and new resources."
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> "As discussed in D.03-12-062 and D.04-10-050, any incentive mechanisms being considered in resource-specific proceedings (e.g., energy efficiency) must be consistent with the overall procurement incentive framework we adopt in this proceeding.

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[114] TURN / ORA Coalition Proposal, p. 16, 25. We note that the TURN / ORA Coalition subsequently modified this position. See TURN / ORA Coalition Reply Comments, pp. 7-8.

[115] NRDC Opening comments, p. 12.

> [footnote omitted] Accordingly, we intend to adopt an overall framework for procurement incentives *before* we make our final determinations on resource-specific incentive mechanisms. Nonetheless, some work on resource-specific mechanisms may proceed concurrently, since several key aspects of those mechanisms (e.g., performance basis and measurement protocols for energy efficiency) will need to be developed irrespective of the overall procurement incentive structure. We will also consider, on a case-by-case basis, issuing interim decisions in resource-specific proceedings on aspects of incentive design, as long as doing so will not prejudge our determinations in this proceeding."[116]

Accordingly, we will address the issue of a risk / reward mechanism for IOU administrators during a subsequent phase of this proceeding, consistent with the direction in R.04-04-003. With or without an incentive mechanism, however, we recognize the need to adopt measures to address potential bias in the program selection and portfolio management process. For this purpose, we adopt a minimum requirement for competitive bidding and an advisory group structure for the Program Choice and Portfolio Management functions**.** In addition, we ban all affiliate transactions between the IOUs and program implementers, as discussed in Section 5.2.3 below.

5.2.1. Competitive Solicitations.

With regard to program selection, we believe that competitive solicitations can provide an important safeguard against bias in that process. Most importantly, competitive solicitations can help to identify innovative approaches or technologies for meeting savings goals with improved program performance

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[116] Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning (R.04-04-003), *mimeo.*, pp. 17-18.

that might not otherwise be identified during the program planning process. As the NRDC / LIF Coalition points out, however, not all program activities lend themselves to a competitive solicitation. It would be counterproductive to require open bids in instances where, for example, partnerships between IOUs and local governments can take advantage of the unique strengths that both partners bring to the table, or a combination of partnerships and bilateral contracting arrangements can deliver effective statewide initiatives, such as a statewide public awareness campaign or an upstream lighting program.[117]

As discussed above, the Energy Action Plan has placed energy efficiency back at the forefront of resource procurement activities in California. All program implementers—IOU and non-IOU alike—need to be selected and evaluated based on their ability to best meet our resource procurement goals, including the specific savings targets we establish in this proceeding. We also note that a large portion of IOU-implemented programs are already delivered through non-IOU third parties. For example, data provided by Energy Division indicates that PG&E and SCE each contract out approximately 40% of the energy efficiency program dollars that they implement to non-IOUs via both competitive bidding and sole source contracts. Thus, it appears that non-IOUs are already actively involved in program implementation. In our view, decisions on whether non-IOUs should be program implementers responsible for designing and delivering the program (rather than working to implement IOU-designed programs) should be made based on an evaluation of whether the program

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[117] "Upstream" refers to market segments (e.g., manufacturers and retailers) that are not the product users.

designs and delivery mechanisms proposed by non-IOUs are superior to those currently being implemented or planned for the future.

In other words, competition in energy efficiency procurement should focus on soliciting good, new program ideas to achieve (or exceed) Commission goals, rather than allocating a specific percentage of program funding to particular implementers. We will accomplish this in the future as follows: For each program planning cycle, the IOUs will propose a portfolio of programs (with input from the advisory groups described below) that reflects the continuation of successful IOU and non-IOU implemented programs and new program initiatives designed to meet or exceed the Commission's savings goals with cost-effective energy efficiency.

As part of that process, the IOUs will identify a minimum of 20% of funding for the entire portfolio that will be put out to competitive bid to third parties *for the purpose of soliciting innovative ideas and proposals for improved portfolio performance*. With input from the advisory groups described below, the IOUs will specify the portion(s) of the portfolio to put out to bid (for example, they could be sector-specific, could focus on peak savings, etc.), as well as the proposed bid evaluation criteria. The portions to put out to bid could encompass programs currently designed and delivered by a combination of IOU and non-IOU program implementers. The bid solicitation should be designed to improve performance of the portfolio in terms of producing the most cost-effective energy savings that meet or exceed our savings goals. Any current program or group of programs (IOU or non-IOU designed and implemented) that can be improved upon in this way may be subject to open bids to replace, augment or otherwise enhance current efforts. However, as discussed above, open bids should not be required in instances where current or potential future partnerships between IOUs and local governments can take advantage of the unique strengths that both partners bring to the table to deliver cost-effective energy efficiency services, or where combination of partnerships and bilateral contracting arrangements with private or public entities can deliver effective statewide initiatives that enhance portfolio performance. Such activities should be funded out of the 80% (maximum) core portfolio that is not put out to competitive bid. The proposed portfolio of programs, portions to put out to bid and the bid evaluation criteria will be filed by the IOUs in their program plan applications for each funding cycle, and subject to Commission approval. (See Section 5.2.4 below.)

To facilitate the review that will be necessary by the advisory groups described below, Energy Division (or its consultant(s)) should work with the IOUs to compile all administrative and non-administrative costs and energy savings data on current programs in a standard format that will facilitate direct comparisons across programs, and make any needed refinements to the existing reporting requirements to facilitate such a comparison. This information should be made available to the advisory groups by March 15, 2005. Updated cost and savings information in the standardized format should also be submitted with the IOUs program funding applications.

We believe that a 20% minimum requirement for open bidding along the lines discussed above captures the potential benefits of competition and serves as an added safeguard against selection bias. At the same time, it provides sufficient flexibility to avoid imposing competitive bidding on program offerings that are more effectively delivered using other approaches. We will adopt the 20% minimum rerquirement for the next funding cycle, beginning in 2006, but may modify it for subsequent funding cycles, as appropriate.

In its reply comments, LIF raises a concern that competitive bidding will result in "cream skimming."[118] Cream skimming describes the situation in which only the lowest cost energy efficiency measures are designed and implemented, leaving behind other cost-effective opportunities for energy efficiency. We share LIF's concerns over cream skimming, with an important qualification. As we have stated in the past, the pursuit of the most cost-effective measures first does not, *per se*, constitute cream skimming. This approach only becomes a problem when lost opportunities are created in the process, that is, when long-lived, cost-effective savings are "lost irretrievably or rendered much more costly to achieve, if not exploited promptly."[119] Thus, in the past we have directed IOUs to "pursue the most cost-effective DSM resource programs first, if doing so does not create lost opportunities."[120] This policy should apply equally to third-party bidders and non-IOU program implementers, and should be reflected in the bid solicitation and evaluation criteria.[121]

In terms of how to develop the RFPs, evaluate the bidders and make final selections, we will use procedures similar to the ones we recently adopted for supply- side competitive solicitations in D.04-01-050, utilizing the advisory group structure we adopt today. We discuss that structure and describe the portfolio design and selection process in further detail below.

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[118] LIF Reply Comments, p. 3.

[119] See D.97-08-057, Attachment 5, Rule 3. For the discussion of cream skimming and lost opportunities that led to Rule 3, see D.92-02-075, pp. 54-57.

[120] *Id.*

[121] *Ibid.*, p. 56-57.

5.2.2. Advisory Group Structure

Based on the proposals and comments in this proceeding, we are persuaded that advisory committees or working groups can also help to safeguard against the potential for bias in program selection and portfolio management. They can do so by: (1) promoting transparency in the program administrator's decision-making process; (2) providing a forum to obtain valuable technical expertise from stakeholders and non-market participants; (3) encouraging collaboration among stakeholders; and (4) creating an additional venue for public participation. As described in this decision, we have used advisory committees and working groups extensively in the past for this purpose on the demand-side, and have recently created advisory review groups in our Procurement Rulemaking to help safeguard against selection bias on the supply-side.

However, we have also encountered legal obstacles in those instances where Commission-appointed advisory boards have been directed to manage a portion of ratepayer collections, without prior statutory authorization. In addition, we have found that some advisory committees and groups in the past have been less effective than others in fulfilling their intended purpose. We have drawn from our experience, as well as from the thoughtful comments of the parties, to develop an advisory group structure for the Program Choice and Portfolio Management functions. In our view, the result is a structure that will provide the benefits discussed above while keeping the administrative structure manageable.

In the discussion that follows, we provide general guidance and expectations for the advisory group structure, but purposefully do not specify every implementation detail. The IOUs should put together the advisory groups and implement the program design and selection process consistent with today's decision in the spirit of the collaborative approach they discuss in their filings. The ALJ, in consultation with the Assigned Commissioner, may provide additional clarification and direction on these issues, as needed. We also require Energy Division to provide the Assigned Commissioner with a written assessment of the effectiveness of the advisory group structure we establish in this proceeding, on an annual basis. Energy Division may conduct this assessment itself or hire an independent contractor for this purpose, whose costs will be paid for out of energy efficiency program funds.

For the Program Choice and Portfolio Management functions, we believe that advisory groups can be a valuable component of the administrative structure on two levels. On one level, they create the forum for an open and informative exchange of information among program administrators, industry experts and stakeholders as the IOUs develop their program selections for Commission consideration, and manage their program portfolio throughout the funding cycle. On another level, advisory groups can serve an important "peer review" function by providing an independent assessment of the IOUs' portfolio design and program selections. We believe both levels of advisory group input will be valuable under our adopted administrative structure.

To this end, we direct the IOUs to establish three "program advisory groups, or PAGs"[122] drawing from the energy efficiency expertise of both market

[122] The name "Program Advisory Group" is also used by the Joint Parties to describe the three regional advisory groups they present for the amended NRDC / LIF Coalition proposal. Although there are obvious similarities between the Program Advisory Groups we establish today and the regional advisory groups described in that filing, there are also some significant differences.

and non-market participants across the full spectrum of program areas and strategies. One PAG should be established for PG&E's service territory, one for SDG&E's service territory, and one for the combined service territories of SCE / SoCalGas. One purpose of these PAGs is to provide guidance to the IOUs regarding region-specific customer and program needs, and provide a forum for input and collaboration with the local interests and stakeholders served by the programs.

However, the PAGs must not focus exclusively on region-specific needs. In the interest of keeping the total number of advisory groups manageable, we do not specify the formation of a separate advisory group for the purpose of addressing statewide program design, selection and implementation. Nor do we establish a separate statewide group to advise us on open-ended policy and program management issues, such as the CEAC proposed by the Collaborating Parties. We agree with NAESCO that the advisory functions proposed for the CEAC appear overly broad and ambitious. We believe that the resolution of significant policy and program management issues can be better achieved through other procedural venues, including workshops, Commission-directed studies under the Analysis and Support function, as well as the solicitation of written comments from interested parties.

Nonetheless, we direct the IOUs and their PAGs to also address statewide programs and consistency issues, bringing in national expertise as appropriate to consider these issues. For this purpose, the IOUs should form a subgroup of their PAG members who will closely collaborate and coordinate on statewide programs that cut across IOU service territories. These include statewide marketing and outreach, support for building codes and standards, education and training and other activities that secure both short- and long-term energy savings and peak demand reductions by providing a consistent and recognizable program presence throughout the state. In addition, the PAGs and IOUs should collaborate on statewide program designs and implementation strategies that increasingly integrate energy efficiency with demand response and distributed generation offerings to end-users.

Moreover, we expect the IOUs and PAGs to ensure that statewide residential and nonresidential program offerings take advantage of "best available practices" and avoid customer confusion by being as uniform and consistent as possible. While we recognize that differences in climate zones and other parameters may warrant some variations in program offerings to customers, these variations should be the exception and not the rule. The IOUs are responsible for ensuring that the design of statewide programs proceeds in this coordinated manner. If the need emerges to focus on a particular market segment, the IOUs and PAGs may also establish a separate working group of industry experts and stakeholders to address that need. We prefer this approach to the Focus Plan presented by Cal-Ucons, which would create multiple Commission-appointed advisory groups for this purpose.[123] In this way, the portfolio design and program selection process can "stay current with the dynamics of the marketplace"[124] without creating an additional layer of advisory committees that would potentially be duplicative of the PAG membership and structure.

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[123] We do note that Cal-Ucons modified the Focus Plan proposal in its reply comments, and now recommends that the Focus advisory groups should be run by the IOUs. See *Reply Comments of Cal UNCONs Inc. on Joint Opening Comments of the California IOUs and on the Reaching New Heights Administrative Proposal*; May 10, 2004; p. 3.

[124] UCONS Proposal, p. 2.

Energy Division and ORA staff will be *ex officio* members of each PAG and peer review subgroup (see below) and CEC staff is invited to participate as *ex officio members as* well. The IOUs will select additional PAG members, but participation will be voluntary and there will be no formal voting rules or designation of voting and non-voting members. Each PAG member will need to devote the time necessary to meet and confer with the IOUs on program design, selection and portfolio management, and provide written comments to the IOUs as appropriate.

On an annual basis, the PAGs will provide a joint report to the Energy Division with recommendations on how the IOUs can improve their effectiveness as administrators in managing the portfolio of programs, including how the program selection process could be improved to better meet the Commission's procurement goals. If consensus on these issues cannot be reached, the report should present consensus and nonconsensus positions. Consistent with our treatment of procurement review groups on the supply-side, those parties eligible to receive intervenor compensation awards in this proceeding should be eligible to seek compensation for their work as PAG members.[125]

PAG members will provide advice and feedback to the IOUs and provide annual information to the Commission, but will not have any independent decision-making or contracting authority. The IOUs are expected to work closely with the PAGs throughout each program cycle, meeting with them at least

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[125] D.02-10-062, *mimeo.*, Finding of Fact 28. Parties eligible to receive awards of intervenor compensation in this proceeding are those parties who timely filed a notice

Footnote continued on next page

quarterly. We do not expect that all input from the PAGs will necessarily be agreed to by the IOUs (or even among PAG members), but it is our hope that the forum for introducing new ideas and identifying problems specific to the IOUs' proposals will narrow the scope of differences considerably. PAG members (including those on the peer review subgroups described below) do not, in any event, relinquish their rights to participate in energy efficiency proceedings and comment on IOU filings in those proceedings.

We believe that the PAG meetings should be open to the public,[126] and the IOUs should establish a clearinghouse website for noticing these meetings and posting documents to be discussed by PAG at the meetings. However, these meetings are intended to facilitate discussion and exchange between PAG members and the IOUs. Accordingly, the IOUs should establish appropriate protocols for obtaining comment from public participants during those meetings, e.g., they may designate a specific amount of time at the end of the meeting to take comments or questions from the "floor." In addition, the IOUs are expected to conduct public workshops at least twice a year that are designed to solicit broad public input from non-PAG members concerning program design and implementation.

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of intent (NOI) to claim compensation and have received a favorable ALJ ruling on their NOI.

[126] This requirement will not, however, apply to the meetings between the IOUs and their Peer Review Groups described below, since those meetings are purposefully intended to exclude participation by individuals or organizations with a financial interest what components of the portfolio are put out to bid or in the bid selection process. However, the IOUs proposals on these issues along with written assessments by the Peer Review Groups will be made part of the public review process during each program planning cycle. See Section 5.2.4 below.

The IOUs are required to provide advisory group members with comprehensive information on program implementation activities and proposed program changes, and take other steps to ensure that members have an opportunity to review the information and work with them to improve program implementation. It is the IOUs' responsibility to provide notice for all advisory group meetings and public workshops, arrange for meeting space and conference call dial-in numbers, reproduce and distribute meeting materials and provide other administrative support to the advisory groups (and subgroups described below), as needed.

Within each PAG, the IOU will also identify and select a subgroup of non-financially interested members with extensive energy efficiency expertise that are willing to serve as peer reviewers in this process, along the lines of the Independent Observer described under the initial NRDC / LIF Coalition proposal. We refer to these subgroups as "Peer Review Groups, or PRGs." On the supply-side, advisory group membership was put together by a combination of the IOU (1) sending out notices to non-market participants it identified on the service list and (2) taking requests from parties asking to be including in the membership. The IOUs may utilize these and other informal approaches for selecting members for each PAG and its PRG subgroup of non-financially interested peer reviewers. The IOU administrators should notify the Assigned Commissioner and ALJ by letter of the individuals that are selected to serve on the PAGs and PRGs.

We define a non-financially interested member for the purpose of serving on these PRGs as follows:

> A financially interested party is any person who engages in the purchase, sale or be marketing of energy efficiency products or services, or who is employed by a private, municipal, state or federal entity that engages in the purchase, sale or marketing

energy efficiency products or services, or who provides consulting services regarding the purchase, sale or marketing of energy efficiency products or services, or an employee of a trade association comprised of entities that engage in the purchase, sale or marketing or energy efficiency products or services.

> Energy efficiency services include among other things, performing energy audits and advising clients and potential customers about potential energy savings they can achieve, but does not include evaluating, measuring and verifying the installation and / or results of energy efficiency products or services, or research to develop new energy efficiency products or services.

Members of each PRG will be expected to participate in the ongoing PAG process. In addition, they will be expected to review the IOUs' submittals to the Commission and assess the IOUs' overall portfolio plans, their plans for bidding out pieces of the portfolio per the minimum bidding requirement, the bid evaluation criteria utilized by the IOUs and their application of that criteria in selecting third-party programs. The three PRGs are also expected to meet and assess the statewide portfolio (represented by the combination of the four IOUs separate portfolios) in terms of its ability to meet or exceed short and long-term savings goals in compliance with the Commission's policy rules. Energy Division will chair the PRGs, and also take an active role in the PRG process on a substantive level.[127] Energy Division may hire an independent consultant or consultants to assist in its own assessments of these issues, which will be paid for out of energy efficiency program funds. The IOUs will be required to include the PRG assessments with their Commission filings for approval of program plans and final programs.

Finally, in order to ensure that the advisory groups are organized and managed in the most effective fashion, we recommend that the IOUs define a

[127] Energy Division is not required to moderate or facilitate all of the PRG meetings, even though it serves as the chair. Energy Division has the option of delegating that responsibility to the IOUs, sharing that responsibility with others in the group, or hiring an outside moderator for that purpose.

charter or mission statement for the PAGs and PRGs and ask them to review, discuss and adopt the mission in their own words. These mission statements should include sunset provisions. The IOUs should also assign contact person(s) in their organizations for the advisory groups, and clearly define the nature of written or oral produces expected. We also suggest that the sponsoring IOU meet with the chairs of these advisory groups and Energy Division on a regular basis to discuss how the process can be improved. Above all, we emphasize that advisory group members must be treated with respect and courtesy.

5.2.3. Affiliate Transactions

In response to opening comments, the TURN / ORA Coalition clarifies its position that, under the "Efficiency California" proposal, an organization that has a parent company, affiliate or subsidiary implementing energy efficiency programs in California would not be eligible to serve as the program administrator.[128] This raises the issue of how affiliate transactions should be handled in the context of today's adopted structure for energy efficiency, i.e., with the IOUs in the Program Choice and Portfolio Management roles. The Assigned Commissioner solicited further comment on this issue in her October 7, 2004 ruling.

ORA, TURN, CCSF and Cal-Ucons urge the Commission to completely ban affiliate transactions for energy efficiency implementers, arguing that the potential for cross-subsidies between IOUs and their affiliates and anti-competitive conduct is no less present on the demand-side than it is on the supply-side, for which the Commission adopted a complete ban on affiliate

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[128] TURN / ORA Coalition Reply Comments, p. 20.

transactions in early 2004. SESCO and WEM specifically argue that no IOU or affiliate effort should be allowed within the 20% competitive minimum bid requirement.

The IOUs, on the other hand, argue that prohibiting affiliates from competing to provide energy efficiency services is unwarranted because, by its open and competitive nature, the energy efficiency program market presents much less potential for self-dealing than sources of generation. Moreover, the IOUs contend that excluding utility affiliates could unfairly put additional pressure on them to meet already stringent energy savings goals. They posit that the affiliate transaction rules adopted by D.97-12-088 provide ratepayers with adequate protection against cross-subsidies and anti-competitive conduct in the context of the program select process envisioned by this decision.

We disagree for the reasons presented by TURN, ORA and CCSF:

> "[W]hile the Commission has not yet adopted an incentive structure for energy efficiency program implementers, the utilities may well end up with a clear financial rationale for preferring their affiliates as program implementers. They may have the opportunity to earn profits directed from the programs they implement and indirectly from those implemented by their affiliates. The [decision's] strongest quality control mechanism is the advisory group structure. The Peer Review Groups in particular are intended to eliminate utility bias in the program selection process during the competitive solicitation. They are also supposed to monitor the utilities' portfolio design decisions, such as what portion to put out to bid and which partnerships to form. This is an enormous task to assign a group of volunteers assembled by the utilities, and it is a much larger task than that assigned to the supply side counterpart. The supply side Procurement Review Groups have significantly fewer bids to review than the volume the Peer Review Groups will face. Moreover, the Procurement Review Group workload tends to be spread through the year, whereas the Peer Review Groups will be

asked to look for manifestations of bias or other problems in a lump sum of proposals." [129]

Moreover, we find the IOUs argument that a ban on affiliate transactions could limit their ability to meet our energy efficiency savings goals particularly disingenuous, given the fact that IOU affiliates currently provide a very small share of energy efficiency services relative to the IOUs themselves and non-IOU affiliated third parties. [130] In fact, this is probably the best point in time to initiate such a ban, since it will enable us to avoid the types of problematic transactions that arose in the past with the emergence over the years of many new IOU affiliates under contractual relationships with the IOUs on the supply side.

For the reasons discussed above, we adopt an affiliate transaction ban between IOU administrators and program implementers for energy efficiency, without exception. This ban will apply to transactions between the IOU administrator and any implementer that is an affiliate of PG&E, SCE, SDG&E or SoCalGas. A broad ban on affiliate transactions is appropriate and reasonable in the context of energy efficiency. This is because many of our cornerstone energy efficiency efforts are designed to "transcend borders" with respect to individual IOU service territories, and provide energy efficiency services and resource savings on a statewide basis. Adopting a broad affiliate transactions ban at the outset avoids the need to revisit the issue of "who's affiliate" each time a program is deployed in more than one IOU service territory.

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[129] TURN / ORA / CCSF Reply Comments, October 25, 2004, pp. 3-4.

[130] SESCO Reply Comments, October 25, 2004, p. 4.

5.2.4. The Post-2005 Portfolio Design and Program Selection Process

Based on the above, we envision a portfolio design and selection process that will proceed as follows, beginning with the 2006 planning cycle:

1. The Commission establishes overall policy guidelines and energy savings targets for the development of post-2005 program portfolios.
2. With input from their Program Advisory Groups and the broader public, the IOUs design a comprehensive portfolio of programs to meet the long-term needs of their resource portfolios, including specific localized needs,[131] and consistent with the Commission's overall policy guidelines and energy savings targets. The portfolio should reflect the continuation of successful IOU and non-IOU implemented programs and new program initiatives designed to meet or exceed these targets.
3. During this design process, the IOUs identify what components of the portfolio they plan to bid out to third parties (minimum 20%) for the purpose of soliciting innovative ideas and proposals for improved portfolio performance, and what criteria they propose to use in evaluating bids. The Peer Review Group reviews and provides feedback on the portion of the portfolio that the IOUs plan to put out to bid, as well as the evaluation criteria. As discussed in this decision, Energy Division staff may hire independent contractors to assist in providing feedback to the IOUs on these issues. The Peer Review Group assessment should also address whether the statewide portfolio meets the Commission's policy objectives.

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[131] The IOUs' localized needs will be developed in their procurement plans, as described in our recent decision in the procurement proceeding, which calls for a "bottoms up" approach to integrated resource planning starting at the local level. See D.04-01-050, pp. 96-97.

4. At least two public workshops are held during this stage of the process to solicit broader public input on the design of the portfolio (including the bid selection criteria) before the IOUs' file their program planning applications for approval with the Commission. The applications will include a description of the portfolio composition, the pieces that will be put out to bid and the IOUs' proposed evaluation criteria. The assessments of the Peer Review Groups will be appended to the IOUs' filings. As described in this decision, the applications will also include the most up to date cost and savings information for all current programs, in a standardized format.
5. Upon receiving Commission approval of the applications, the IOUs complete the process of selecting programs and program implementers to design and deliver the programs described above. The utilities develop and issue RFPs using criteria approved by the Commission and, select a set of bids. The Peer Review Groups (including Energy Division independent consultant(s)) observe the IOUs' bid selection process to ensure that the criteria are applied properly.
6. Before finalizing their selections, the IOUs discuss the proposed results of their bid review process with the Peer Review Groups (and Energy Division's independent consultants). For this discussion, the IOUs will provide the program implementation plans, timelines and goals of the bidders in as much detail as available, along with any other bid evaluation information that the Peer Review Groups may request. This group will have an opportunity to ask questions about how the criteria were applied and provide feedback on the selection process, and otherwise help to ensure that the bid process is fair. It is the IOUs responsibility to describe in their compliance filing (see below) how they have responded to criticisms presented by the Peer Review Group (and Energy Division consultants) during this process.
7. After incorporating feedback, the IOUs make public all winning bids and submit compliance filings. If the Peer

Review Group and IOU are in full agreement on the final program plans and bid selections, this filing will be made as an advice letter. If not, the IOU files a compliance application in the program planning application docket requesting Commission approval of the final programs. Written assessments of the Peer Review Groups (and Energy Division's consultants, as applicable) are appended to the compliance filings.

5.3. EM&V and Other Administrative Structure Issues

Today's decision goes a long way in creating our post-2005 administrative structure for energy efficiency by addressing the threshold issues related to Program Choice and Portfolio Management. We have focused on these issues today because they have been the most contentious. By resolving them we can now turn to other administrative structure issues and address those in the context of our adopted structure for those two key functions.

5.3.1. EM&V Administrative Structure

The most important issue remaining is what EM&V administrative structure we should put in place to: (1) develop EM&V policies, protocols and reporting requirements for Commission consideration; (2) contract for EM&V studies, and (3) assess the results of those studies. As described in Attachment 2, the recommendations in this proceeding on EM&V administrative structure share several similarities, but there are also differences with respect to what role advisory groups, program administrators and implementers should play in EM&V contract management. On the one hand, some parties argue that program administrators and implementers should have no role in contracting for or managing EM&V studies—even with contractors approved by the Commission. Other parties take the position that contracting by program administrators and implementers is appropriate, as long as it is coupled with an independent review process overseen by a measurement advisory group, Commission staff, or a combination of both.

We are persuaded by the comments of TURN, ORA, SDREO and others that the EM&V structure within the overall administrative framework must be free of conflicts of interest that could bias EM&V results. We think that TURN puts it best:

> "EM&V serves both as the quality control mechanism for ratepayer funded energy efficiency programs and as a data input for IRP [Integrated Resource Planning] and the portfolio planning process. Rigorous, reliable EM&V is crucial to California's ability to attain its energy efficiency goals for three interrelated reasons.
>
> "First, IRP requires independent EM&V. EM&V plays a determinative role in the reliability of energy efficiency savings. For energy efficiency to be considered a reliable resource in IRP, such that EE [energy efficiency] is taken seriously along side steel-in-the-ground resource by the IOU resource portfolio planners, California must have an EM&V framework designed to generate accurate and reliable data. Conflicts of interest that encourage compromised EM&V of programs jeopardize the success of IRP.
>
> "Second, Independent EM&V ensures that ratepayers get the energy efficiency for which they pay. California needs an EM&V framework bold enough to prevent wasteful expenditures of ratepayer money on energy efficiency programs. Ratepayers should reap the benefits of the energy efficiency programs they fund. These ratepayer benefits should include well-run, effective energy efficiency programs, resultant lower customer bills, and increasing utility use of energy efficiency as a demand-side resource. Ratepayers deserve an administrative structure that gives them a reasonable assurance that their money is being wisely and efficiently expended.

> "Finally, independent EM&V enables the program selector to assemble the strongest portfolio of programs. EM&V must be as transparent and independent as possible to ensure that the best program designs are adopted and that the best program implementers are selected. An EM&V structure that does not completely shield EM&V studies from potential conflicts of interests undercuts California's ability to reach our energy savings potential."[132]

The EM&V administrative proposals presented by the IOUs Coalition, the NRDC / LIF Coalition and the Collaborating Parties fall short of ensuring the necessary independence of EM&V, in our judgment. Under the IOUs Coalition proposal, all program implementers contract directly with EM&V consultants for review of their programs, unless they opt to have the IOUs contract for EM&V in their place. The EM&V consultants are pre-approved as "independent" by the stakeholder EM&V advisory group, but as TURN points out, they nonetheless lose independence by entering into a direct financial relationship with the entity whose work they are to evaluate.[133]

The original NRDC / LIF Coalition proposal assigns program level EM&V contracting responsibility to the IOU administrator, which results in independent EM&V for non-IOU programs only. The amended version of the NRDC / LIF Coalition proposal appears to adopt the approach advocated by the IOUs Coalition.[134] The Collaborating Parties do not agree on who should have contracting responsibility for program-related studies, but still assign the IOU administrator as the technical lead manager of those contracts. In our view,

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[132] TURN Opening Comments, pp. 18-19.

[133] *Ibid.*, p. 17.

[134] See Opening Comments of NRDC et al. filed April 26, 2004, pp. 4-5.

allowing the entity that selects the programs and manages the portfolio (IOUs) or the program implementers (IOUs or non-IOUs) to manage or contract directly for EM&V of their own efforts could seriously undermine the independence of even the most conscientious EM&V consultants. Although ORA and other Collaborating Parties apparently believe that it is the contracting entity that exerts the most influence over the contractor, and not the lead technical contract manager, in our experience we have found that both roles can be influential on the progress and content of the study in question.[135] While we have allowed these arrangements for some studies in the past, we are persuaded by the arguments presented in this proceeding that we must improve upon our approach to EM&V, particularly in view of the renewed imperative that program results be credible and reliable for resource planning purposes.

At the same time, we recognize that the IOU Portfolio Managers need access to market information to perform their jobs of selecting and managing a portfolio of programs to meet the Commission's objectives. Similarly, program implementers need to access to information on a real-time basis to improve program delivery. Dictating that the only information they can receive is from studies managed and contracted for by others is counterproductive. Thus, we propose a process that allows the IOU Portfolio Managers and program implementers to manage a limited subset of evaluation studies as long as there is no potential for conflict due to the nature of the study, and as long as Energy Division has a lead role in the selection of contractors.

[135] Our recent experience with IOU contracting for LIEE impact evaluations, for example, illustrates this point. See D.03-10-041.

Accordingly, for the 2006 program year and beyond, Energy Division will assume management and contracting responsibilities for all EM&V studies that will be used to: (1) measure and verify energy and peak load savings for individual programs, groups of programs and at the portfolio level (including load impacts, useful measure life, savings retention and persistence studies), (2) generate the data for savings estimates and cost-effectiveness inputs, (3) measure and evaluate the achievements of energy efficiency programs, groups of programs and/or the portfolio in terms of the "performance basis" established under Commission-adopted EM&V protocols and (4) evaluate whether program or portfolio goals are met. For purposes of this discussion, we refer to this category of studies as "program and portfolio impacts-related" studies.

More specifically, Energy Division will be responsible for: (1) allocating Commission-authorized funding for program and portfolio impacts-related EM&V among the individual studies, (2) developing the work scope for each study consistent with our adopted EM&V protocols, (3) writing RFPs and selecting the contractors, and (4) managing and contracting for the work. Consistent with the working relationships we have already established with the CEC in this proceeding, we anticipate that the CEC staff can be called upon to provide Energy Division with technical input and, if needed, staffing support for these functions.

Public participation in the development of these studies will be provided in several stages. First, the development of the EM&V protocols that determines the scope of these studies is being conducted via workshops in this proceeding, to be followed by further opportunity for public input via written comments before the Commission issues a final decision. Second, the overall EM&V plans, budget and the allocation of funding levels to program and portfolio impacts-related studies will be addressed during each program planning cycle, beginning with the 2006 cycle next summer. (See Section 6.) Third, as discussed further below, study results will be made available for public review and comment while in draft form, with a brief teleconference workshop scheduled as part of this process. Once the program and portfolio impacts-related studies are finalized under Energy Division's management, the studies will once again be made available for public review. The forum for review may be this rulemaking, a pending Commission proceeding (e.g., the AEAP) or a future Commission proceeding in which resource planning assumptions are being developed. The appropriate forum for this review will be established by Assigned Commissioner's ruling.

In carrying out the functions described above, Energy Division should utilize ad hoc review committees of technical experts, as appropriate. We recommend that Energy Division draw on the experience of the CEC with ad hoc committees under the Public Interest Energy Research (PIER) program in creating such committees for its own purposes. We also encourage Energy Division to take advantage of the EM&V expertise of IOUs and the field experience of implementers by inviting them to participate on these review committees as the issues may warrant.

We believe that a flexible, ad hoc technical committee approach is more valuable to the EM&V administrative structure we adopt today than the formal standing measurement advisory groups proposed by various parties. (See Attachment 2.) Review committees created on an as-needed basis can best provide Energy Division with flexibility in securing the EM&V technical expertise it requires for the particular task or issue at hand. This approach also creates much less of a burden on individual technical experts, who would be called on only as needed to review and provide input on a specific EM&V issue or work product. Based on the CEC's experience with the PIER ad hoc committees, we are confident that there exists a pool of EM&V experts in California and other states who are willing and able to periodically review written products and provide Energy Division with technical feedback at very little or no cost to ratepayers.

In addition to taking advantage of technical expertise through the formation of committees on an as-needed basis, as described above, Energy Division is directed to set up a team for each evaluation that includes the relevant implementers and administrator(s) and accomplishes the following objectives:

a. Implementers and administrators have an opportunity to provide input on study scope and priorities;

b. Implementers, administrators and evaluation contractors work together to develop data requirements to ensure a representative sample of customers and optimal data gathering, including a plan to ensure that the evaluator obtains all data needed for the evaluation in an expeditious manner; and

c. Implementers and administrators have opportunities to review and comment on evaluation methodology and results before the study results become final.

Providing the opportunity for public input into the initial study design process and opportunities for implementers, administrators and evaluators to share information and concerns during the evaluation process should go a long way toward minimizing the number of disputes that may need to be resolved. In addition, we agree with TURN, ORA, CCSF, NRDC and others that all stakeholders, including program implementers and administrators, should be given the opportunity to review and comment on each program and portfolio impacts-related study while in draft form. As proposed by members of the *Reaching New Heights* Coalition, a brief teleconference workshop should be scheduled as part of this process.

If disputes concerning the study findings remain after these informal review opportunities, the administrators, implementers or interested parties should seek Commission resolution. We intend to establish a set schedule for resolving all disputes for each program cycle as part of our EM&V protocols, which are being developed in a separate phase of this proceeding. In the meantime, we believe it is premature to adopt an automatic placeholder for alternative dispute resolution, as NRDC and other members of the *Reaching New Heights* Coalition recommend. Instead, the assigned ALJ will determine the need for evidentiary hearing or other approaches to dispute resolution on a case-by-case basis, as warranted by the factual basis of the complaint.

The EM&V administrative structure outlined above for studies that address program-related impacts will ensure a clear separation between "those that evaluate" and "those that do," i.e., IOU Portfolio Managers and both IOU and non-IOU implementers. However, we also acknowledge that there are EM&V studies that are designed to inform the Portfolio Manager about the overall performance of groups of program types working together, and that suggest changes in program design or mix as a result. There are also certain types of studies that provide program implementers with information needed on a real -time basis to improve program delivery. For example, process evaluations are undertaken to improve the design and efficacy of a particular program or set of programs while the programs are operating. "Best Practices" studies evaluate which energy efficiency programs or program features should be incorporated into future program designs. Other studies may be undertaken to review the effectiveness of training, audits or media campaigns. Still others may be designed to track efficiency "sales" for individual or groups of programs, or provide other accurate market information to help the Portfolio Manager and implementers fine-tune and improve energy efficiency procurement strategies. For this discussion, we refer to this second category of studies as "program design evaluation and market assessment."

Due to the focus and purpose of these studies, we believe that allowing the IOU Portfolio Managers or program implementers to directly contract for (and serve as technical lead in managing) program design evaluation and market assessment studies would not present a conflict of interest. The IOUs' performance will be evaluated based on their ability to meet the Commission's resource procurement goals for energy efficiency. It is in their best interest to objectively evaluate and fine-tune their portfolio as the programs are underway and obtain accurate market information for this purpose. Similarly, program implementers require some of this same information to enhance program delivery.

Moreover, it makes sense from a functional standpoint for the IOU Portfolio Managers to be responsible for managing studies that provide them with information needed for day-to-day management of the portfolio, for communicating timely feedback to their implementers and for improving portfolio performance over time. Having the IOU program administrators, and for some studies program implementers, manage these types of EM&V contracts also utilizes their in-house expertise in this area, thereby allowing us to focus Energy Division staff efforts on other priorities.

For similar reasons, we believe that the IOUs, rather than Energy Division staff, should take the lead in allocating Commission-authorized funding for this category of EM&V across individual studies, develop the scope of work for each study and prepare the RFP. The IOUs should solicit input from Energy Division, the CEC and program implementers during this process, and they may also continue to utilize CALMAC as a forum for obtaining technical input, at their option. As we have stated previously, CALMAC is not a Commission-created advisory group.[136] In any event, the IOUs must also provide opportunities for public input on the program design evaluation and market assessment studies as they are being developed and, once finalized, report the findings to the Commission and hold public meetings to discuss the findings of the studies. These opportunities for public input may be part of the public PAG meetings discussed above, or may be separately scheduled.

In addition, as discussed above, interested parties will also have an opportunity to participate in the development of the overall EM&V plans, funding levels and budget allocations across study categories during each program planning cycle. We envision a process whereby the Portfolio Managers and Energy Division, working with CEC and an ad hoc technical advisory group established for this purpose, develop a joint proposal on these issues. The joint proposal is then discussed in public workshops to obtain feedback before it is finalized. It is then submitted with the IOUs program plan applications during each planning cycle, for additional public review.

[136] See Section 3.3.

In their program plan applications, the IOUs should also describe each type of study (including general scope of work) they or their program implementers plan to manage and / or directly contract for under the program design evaluation and market assessment category. This will provide all interested parties a further opportunity to consider whether any of those proposed studies would, in their view, create a conflict of interest if the IOU Portfolio Managers or program implementers managed and directly contracted for them.

We believe that our adopted two-track approach to EM&V administrative structure balances the need to facilitate effective feedback to the IOU program administrators and program implementers, so that they can make mid-course changes to increase the effectiveness of the programs, with the need to protect against potential conflicts of interest. By splitting the responsibilities for EM&V administrative along the lines described above, this approach addresses two major concerns that various parties have raised. First, that an entity other than the one standing to profit from inflated program achievements should be responsible for substantiating program performance. Second, that Portfolio Managers and program implementers should be able to guide evaluation activities in order to make sure that those results can be used to improve the program and portfolio design while the programs are running, and when future portfolio and program plans are being developed.

However, there are two remaining issues we must address before being satisfied that this balance has been achieved. The first issue relates to potential conflicts of interest when EM&V consultants (or their firms) are also involved in energy efficiency program delivery, either as a subcontractor under IOU-implemented programs or as program implementers themselves. NAESCO, WEM, SESCO and Cal-Ucons urge us to address this issue by prohibiting entities from performing EM&V studies of any type at the same time they are under contract for program delivery work. In their view, the credibility of energy efficiency programs and associated savings would be compromised without establishing this strict "firewall" between implementers and evaluators. In particular, they argue that without such a policy, the IOUs could reward (or appear to reward) EM&V contractors for favorable study results by bestowing upon them contracts to implement energy efficiency programs. The IOUs, NRDC and other members of the *Reaching New Heights* Coalition, on the other hand, contend that creating such a firewall is less effective than requiring those parties bidding to become evaluators to fully disclose any potential conflicts, and for the Energy Division to use a transparent process to score bids on a case-by-case basis according to the degree of potential conflicts, as part of the overall bid evaluation process.

We believe that all parties commenting on this issue have raised relevant concerns for our consideration. We are persuaded that the two-track approach jointly presented by ORA, TURN and CCSF best addresses these concerns without compromising the principle guiding our choice of EM&V administrative structure, i.e., that of ensuring non-biased program evaluation results. Specifically, we will prohibit entities from performing any *program and portfolio impacts-related studies* at the same time they are under contract for program delivery work. As defined in this decision, these are the types of studies that are designed to produce findings (that may be favorable or unfavorable) on program or portfolio accomplishments. These findings, in turn, are likely to be considered in the program selection process during future funding cycles, may affect program payments to implementers, and may also result in program penalties or rewards depending upon the Commission's determinations on an energy efficiency risk / reward mechanism or overall procurement incentives. Therefore, a firewall between implementers and evaluators is most appropriate in this context. We note that other states have successfully used such a firewall approach, including Wisconsin, New York and Oregon.[137]

On the other hand, as TURN, ORA and CCSF point out, a firewall between program delivery and program evaluation is much less relevant for the subset of EM&V studies that we refer to as *program design evaluation and market assessment*. This is because these studies are designed to provide information feedback to administrators and implementers to improve program performance, rather than to produce findings related to program accomplishments. Therefore, excluding these types of studies from the firewall will mitigate some of the practical concerns raised by parties regarding a complete firewall, without undermining the EM&V structure.

We recognize that the limited firewall we adopt today may still force some market participants to limit their practices or reorganize their business structures. The *Reaching New Heights* Coalition raised concerns that this would result in fewer qualified firms bidding on evaluation projects, thereby compromising the quality of those studies. While we seek to soften the impact of the firewall by limiting its scope, we are persuaded by the arguments of TURN / ORA / CCSF that the quality of impact evaluation studies will not suffer as a result of a firewall. In particular, the experience and skills of individuals do not become lost while firms reorganize to meet market needs.

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[137] TURN / ORA / CCSF Opening Comments, October 18, 2004, pp. 5-6; TURN / ORA / CCSF Reply Comments, October 25, 2004, p. 5.

In fact, as TURN, ORA and CCSF point out, there is a well established pool of evaluation specialists to meet the demands of many other states where evaluators are prohibited from undertaking implementation activities.[138] Additionally, we are concerned by the prospect of a case-by-case review and scoring process related to potential conflicts for all types of evaluation studies because of the impact on Energy Division. This type of review would be very burdensome to undertake, especially since the RFPs for most program evaluations will likely go out around the same time. Such case-by-case review should be the exception, rather than the norm.

In their comments on this issue, NRDC and other members of the *Reaching New Heights* Coalition lament that a firewall approach could unfairly foreclose many firms and contractors from doing evaluation even if they are engaged in unrelated implementation activities. One such situation they pose is that of a mechanical engineering professor at U.C. Berkeley who assists in the implementation of an air conditioning program. They raise the question of whether a statistics professor at U.C. Berkeley would then be foreclosed from assisting in the evaluation of that program. We believe that such individual circumstances can be effectively addressed, and have been in other states, without abandoning the firewall approach. For example, the Wisconsin Department of Administration has established a firewall between program delivery and evaluation "unless the Department of Administration determines that there is no conflict of interest" prior to commencement of the bidding

[138] *Id.*

process.[139] We leave it to Energy Division to develop bidder guidelines consistent with today's decision and to make the determinations it deems appropriate to address questions that may arise concerning the eligibility of a particular evaluator, based on the specific circumstances.

Finally, in recognition of the potential practical implications of any firewall, we adopt the TURN / ORA / CCSF proposal for a narrow exception to the firewall between implementers and program and portfolio impacts-related evaluators. We will permit Energy Division to lift the firewall and use a case-by-case review along the lines proposed by the *Reaching New Heights* Coalition only in the event that there are inadequate bidders for an evaluation project. Under such circumstances, Energy Division should issue a separate round of RFPs to include firms with potential conflicts. We believe that this is an unlikely scenario, however, given the well-established pool of evaluation experts both in-state and out-of-state. In all instances, with or without the firewall, bidders will be required to provide full disclosure of any potential conflicts of interests, including conflicts that may arise from non-implementation utility work.

We also clarify, in response to comments, that structurally separate non-IOU affiliates can separately perform EM&V and program implementation work without violating the firewall prohibition if they sign non-disclosure agreements that forbid contacts between the structurally separate firms on the contracted matters.[140] This serves to provide a clear demarcation as to what either business entity has been hired for and creates an effective firewall between the affiliated

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[139] See TURN / ORA / CCSF Reply Comments, October 25, 2004, Appendix A.

[140] See: December 20 2004 Opening Comments of Quantum (pp. 11-12) and Reaching New Heights Coalition (p. 8.)

companies when performing work. We also clarify that the firewall will begin with a "clean slate" in the 2006 program cycle so that all current implementers and evaluators of the 2004-2005 programs may choose which option to pursue for the 2006 program cycle.

Although we believe that the pool of eligible consultants for EM&V studies will not be significantly affected by the firewall we establish today, we do recognize that many of the same EM&V contractors that perform program design evaluations and market assessments are the same ones that conduct program and portfolio impacts-related studies. This raises an additional concern, namely, that even the most conscientious EM&V consultants may feel pressured to "tread lightly" in presenting the results of program and portfolio impacts-related evaluations, knowing that the IOU Portfolio Managers (and program implementers) will be selecting contractors for other evaluation studies.

To address this concern, we will require that Energy Division make the final selection of any contractors hired by the IOUs or program implementers to perform program design evaluation and market assessment studies. For this purpose, we require Energy Division to solicit input from an ad hoc technical committee that includes the IOU Portfolio Manager(s) and program implementers that will be contracting for the study.[141] Energy Division may structure the committee in any way that it believes will best enable it to make an independent determination of the most qualified bidder.

We recognize that under most circumstances the managing and contracting entity would also select the contractor. However, we believe that this exception is warranted and necessary given the circumstances. If the IOU Portfolio Managers (or program implementers) decline to manage and contract

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[141] By definition, any program design evaluations or market assessments that the IOU portfolio manager or implementer wanted to undertake "in house" (i.e., without contracting out the work) would not be subject to this requirement. Nonetheless, they would have to be identified, described and subject to public review during the program planning process described above.

for program design evaluation and market studies for which they do not select the contractor, then Energy Division will assume responsibility for managing and contracting for these studies as well. In any event, the IOUs are required to promptly pay the contractor invoices for all EM&V studies managed by Energy Division, upon approval of those invoices by the staff contract manager. All EM&V studies will continue to be funded through PGC collections.

Today's decision provides clear direction on the EM&V administrative structure and process for developing EM&V program plans and budgets that we envision for the future, beginning with the 2006 program planning cycle. Nonetheless, we recognize that some of the implementation details will need to be further delineated, such as more specific lists and definitions for the studies that fall under the two EM&V study categories, as well as for the research and analysis activities discussed in the following section. To this end, Energy Division and CEC should jointly develop an implementation roadmap for EM&V and Research and Analysis consistent with today's decision, and hold public workshops to solicit input from the IOU Portfolio Managers, program implementers and other interested parties prior to finalizing that document.

The assigned ALJ will issue the roadmap for the 2006 program planning cycle by ruling, after considering written responses of interested parties to the Energy Division / CEC final proposal. The ALJ make provide additional clarification and direction on these issues or make modifications to the roadmap during the program planning cycle, as needed.

5.3.2. Research and Analysis in Support of Policy Oversight

With respect to Research and Analysis in support of our policy oversight responsibilities, we believe that the best approach is to have our Energy Division take the lead in this area as specific needs arise. As described in Attachment 1, this involves: (1) performing research and developing recommendations to assist in developing energy efficiency policy goals and priorities, program performance goals and funding levels, (2) evaluating the remaining potential to achieve additional energy or peak savings in both the short- and long term, and (3) performing other research, as needed, related to procurement and PGC funded activities.

Examples of activities that fall under this area of responsibility include: savings potential studies, assessments of net-to-gross ratios and updates to the Database for Energy Efficiency Resources (DEER). We place these activities under the management of regulatory staff because they involve judgments that can influence either the development of performance targets or the measurement of program achievements. For example, in both DEER and net-to-gross ratio work, judgments need to be made about what specific energy savings numbers from which studies will be used to estimate energy savings for specific measures. Due to the conflict-of-interest concerns discussed above, the IOU Portfolio Managers would not be the appropriate entities to manage or directly contract for this type of work.

We will also explore creating a more formal arrangement with the CEC for collaboration in this area and in EM&V, building on the working relationship we have established in this proceeding. For this purpose, we direct our Executive Director to contact his counterpart at the CEC with the goal of developing of an interagency memorandum of understanding (MOU) for CEC staff participation in EM&V and Research and Analysis in Support of Policy Oversight. In addition, we will continue to collaborate with the CEC at both the staff and Commissioner level on a broad range of energy efficiency issues, as we have during this proceeding under Commissioner Kennedy's and CEC Commissioner Art Rosenfeld's leadership.

We decline, however, to involving one or more policy advisory groups in this area of responsibility on a standing basis, as some parties propose. We find this approach to be far more structured and potentially cumbersome than we believe is necessary. In performing the Research and Analysis functions, Commission and CEC staff should have full flexibility to obtain input from various sources, including working groups of experts or hired consultants, as they deem appropriate to the circumstances.

5.3.3. Quality Assurance and Policy Oversight

As part of our overall Quality Assurance and Policy Oversight responsibilities, we will perform a number of functions necessary to ensure that program results are accurate and that ratepayer funds are being spent and managed in a responsible and productive manner. The discussion that follows highlights some of those functions, but is by no means exhaustive of our oversight authority.

The Energy Efficiency Policy Manual 2, and subsequent versions of the manual and related policy rules as adopted by the Commission, will continue to govern the development, management and evaluation of ratepayer-funded energy efficiency programs.[142] As indicated in Section 6 below, one of the first priorities for the coming months is to update those policy rules.

EM&V protocols and procedures, cost-effectiveness methodologies and energy savings assumptions will continue to be approved and prescribed by this

[142] This document can be viewed at:

Footnote continued on next page

Commission. In some instances, we may establish a process for reviewing and approving case-by-case exceptions to these parameters that does not require a formal Commission decision. However, we expect that Commission staff would have a lead role in that process.

As needed, financial audits of the IOU administrators and their program implementers (IOU or non-IOU) will be conducted by Commission staff, or by consultants under contract to the Commission. The Commission will determine and prescribe what action is to be taken by the IOUs in response to audit findings and recommendations. Energy Division will also continue to be responsible for monitoring administrative and other costs, at both the program and portfolio-level, and for recommending adjustments as appropriate for Commission consideration. We may establish the frequency of these financial audits and cost monitoring reports as part of the 2006 program planning process, by Assigned Commissioner's ruling, or by other means, as appropriate.

The design and oversight of program-specific, portfolio-level and financial reporting requirements will remain the responsibility of the Energy Division. In order to assist Energy Division in fulfilling this responsibility, in a previous decision we authorized the expenditure of PGC funds for the creation of a data management system, now known as the Energy Efficiency Groupware Application (EEGA). The purpose of this system is to ensure that energy efficiency reporting is organized, accurate, consistent and useful to the public, the Commission and others charged with ensuring that California's energy needs are met.

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http://www.cpuc.ca.gov/static/industry/electric/energy+efficiency/rulemaking/resource4.pdf

As part of each program planning cycle, we require that the IOUs continue to reserve a portion of energy efficiency funding for the purpose of maintaining and expanding EEGA, as it will be a valuable tool for both the Commission and the IOUs in monitoring and assessing program and portfolio performance. The IOU Portfolio Managers will be responsible for reporting portfolio and program-level information using the standardized reporting formats, definitions, timelines and narratives established by the Energy Division, as updated from time to time. We will use these reporting formats to track savings, cost-effectiveness results and to support our resource planning and goal setting activities.

The IOUs should present proposed funding for EEGA as a separate budget line item in its 2006 and subsequent program planning applications. Energy Division, or its contractor, will perform the work to maintain and expand EEGA, and the IOUs will submit the necessary portfolio and program-level data in the format and frequency that Energy Division requires. The IOUs should forward all program implementation plans to Energy Division, as they are received, along with any other program or portfolio data that Energy Division may require in order to monitor program performance. Energy Division will be responsible for determining the final scope of work for any maintenance and enhancements of EEGA. In the interest of time, Energy Division may choose to use the existing contracting structure for EEGA.

In addition, we may continue to require a standard contract for agreements entered into by the IOUs with their own contractors or with non-IOU program implementers. As part of the 2006 program planning process, the IOUs (in consultation with the PAG) should address whether the current or modified versions of standard contract agreements with non-IOU contractors and implementers should be retained.

Finally, nothing in today's decision prohibits Energy Division from monitoring and evaluating the scope and quality of inspections done by the IOUs on their own programs or those they implement by contract. Moreover, identifying deficiencies in IOU program administration, and taking appropriate actions to rectify those deficiencies, will continue to be a function of this Commission and our staff.

In their comments on the draft decision, several parties urge us to take immediate steps to ensure that Energy Division is adequately staffed to address the energy efficiency responsibilities required by today's decision. As discussed in this decision, we will continue to work collaboratively with the CEC to utilize their staff expertise in energy efficiency, as appropriate, and have also authorized Energy Division to hire consultants for EM&V and PRG review functions. However, we agree with ORA and others that reallocation or augmentation of Commission staff resources to work on energy efficiency matters is likely to be required in order to fulfill the Energy Division responsibilities described in today's decision. We therefore direct our Executive Director to address these energy efficiency staffing matters with the management team and reallocate or augment staff resources on energy efficiency, as needed, without delay.

6. Next Steps in Preparation for the 2006-2008 Program Implementation and Funding Cycle

By D.04-09-060, we established natural gas and electric savings goals by IOU service territory through the year 2013, subject to updates for 2009 and beyond. In that decision, we also extended the current program implementation and funding cycle ("program cycle") from two to three years, and directed that

the next program cycle would cover program years (PY) 2006 through PY 2008.[143] We have been proceeding on several fronts to prepare for this next cycle, pending the outcome of today's decision. They include: (1) updating avoided costs for the evaluation of program savings; (2) developing the performance basis for energy efficiency programs that defer or avoid more costly supply-side resources, and (3) updating EM&V protocols to measure program performance.[144] All of these tasks need to be completed before the next program cycle begins, i.e,
by January 1, 2006. In addition, the portfolio design and program selection process described in Section 5.3 must also be completed before the end of 2005. We also intend to address the issue of risk/reward mechanisms for energy efficiency, as well as for the overall procurement framework, before the end of 2005.

The proposals and comments in this proceeding also highlight the need to update the Energy Efficiency Policy Rules adopted in D.01-11-066 so that they conform to the discussion of policy goals in this decision, the administrative structure we have adopted for energy efficiency and the current resource procurement framework in California. Consistent with the Energy Action Plan, our approach to energy efficiency will be to ensure that the optimal level of cost-effective energy efficiency is integrated into the IOUs resource procurement plans. While we will seek some balance in the portfolio of programs selected

[143] See D.04-09-060, *mimeo.*, pp. 37; Ordering Paragraph 1.

[144] See Assigned Commissioner's Ruling Establishing Schedule For Addressing High Priority Issues During 2004 and Notice of Workshop on Administrative Structure, February 6, 2004.

(e.g., between residential and non-residential applications, retrofit and new construction, statewide and local initiatives) our focus for spending ratepayer dollars will be to capture the most cost-effective demand-side resources as possible over both the short- and long-term. We believe that focusing our efforts in this way is the most equitable way to distribute program benefits: By keeping IOU resource procurement costs as low as possible through the deployment of cost-effective energy efficiency, *all* customers will share in the resource savings from energy efficiency programs.

We also believe that program efforts to meet energy efficiency savings goals must recognize the important role for program innovation and commercialization of promising new energy efficiency technologies. Otherwise, we may find ourselves lacking the technologies and program designs that will enable us to meet our aggressive longer-term energy efficiency goals. Our policy rules and EM&V practices will need to address how best to achieve balance within the program portfolio so that while we pursue the best practices and technologies available today, we also fund a reasonable level of program designs and technologies that are promising for the future.

As soon as practicable, the Assigned Commissioner and ALJ should establish a procedural schedule and process for updating our Energy Efficiency Policy Rules (Rules) that reflect today's discussion. In addition to articulating our broad policy objectives for energy efficiency, the Rules will provide policy direction on portfolio balance during each funding cycle and, where appropriate, provide guidelines on funding allocations among programs to achieve that balance. The Rules will also articulate funding-shifting and other rules for portfolio management in-between program funding cycles. We also anticipate that the Rules will articulate our expectations for future partnership programs, in terms of the respective roles of the IOUs and non-IOU partners (e.g., local governments) in program design, development and implementation. We will also update the Rules on cost-effectiveness, avoided costs and EM&V based on the results of our consideration of these issues in these (and related) proceedings.[145]

Completing all the remaining tasks in time for the 2006 funding cycle will require an ambitious schedule during 2005. We call on all the stakeholders to put past differences aside and work collaboratively in the months ahead. Working together, all stakeholders will benefit from the result of these efforts: The full recognition of energy efficiency as a viable resource that can be relied upon to reduce the demand for energy in California.

7. Comments on Draft Decision

The draft decision of Commissioner Kennedy 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 December 20, 2004 by the City of Berkeley, CCSF, SDREO, Reaching New Heights Coalition, WEM, SBW Consulting, Inc., Robert Mowris and Associates, South Bay Cities Council of Governments, Staples Marking Communications, Inc., TURN, ORA, Runyon, Saltzman and Einhorn, Inc. and Sempra Energy Global Enterprises (SEGE).[146] Reply comments were filed on

[145] We will update the Rules regarding avoided-costs to reflect the findings in R.04-04-025, which was opened to develop avoided costs on a consistent basis across all resource-related proceedings.

[146] SEGE is a "parent company of several business units with an interest in the California retail market for energy-related products and services … and an interest in participating in the programs under consideration in this proceeding. With its

Footnote continued on next page

December 28, 2004 by American Synergy Corporation, CCSF, County of Los Angeles, NRDC, PG&E, Robert Mowris and Associates, Intergy Corporation, SDG&E and SoCalGas (jointly), SCE and WEM.

In response to comments, we have made several clarifications and corrections to the draft decision, particularly with respect to the EM&V firewall and the 20% minimum bid requirement. In doing so, we have also added language to emphasize that the composition of the IOUs energy efficiency portfolios for program year 2006 and beyond must reflect our focus for spending ratepayer dollars: Namely, to capture the most cost-effective demand-side resources as possible over both the short- and long-term that will meet or exceed our adopted savings goals. Some of the comments regarding what to put out to bid (and what not to put out to bid), and how to consider program selections that address different market sectors suggest to us that the draft decision was not clear enough in articulating this focus. We have strengthened that language, while clarifying our intent regarding partnership programs and the competitive bid minimum requirement. However, none of these modifications represent

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December 20, 2004 comments on the draft decision, SEGE has filed a motion to intervene in this proceeding stating that it was only recently aware of the issue of affiliate transactions being considered in this proceeding. We will grant SEGE's motion, but remind SEGE and other business entities interested in energy efficiency issues to participate earlier in proceedings relevant to their interests. We note that the issue of banning affiliate transactions between program administrators and implementers was raised during the debate over alternative administrative structures (see TURN / ORA Coalition May 2004 comments, p. 20), that the Assigned Commissioner issued an earlier draft of the decision for discussion purposes at the September 30, 2004 oral argument that clearly identified this issue for Commission resolution, and that she also solicited further written comments from all interested parties on whether or not affiliate transactions should be banned on October 7, 2004.

substantive changes in the administrative structure proposal presented for our consideration in the draft decision.

We note that CCSF and TURN ask us at this juncture (with the filing of their opening comments on the draft decision) to consider fielding a "pilot" of administrative processes to be designed by Energy Division and interested parties in the months following our final administrative decision. The overall thrust of the pilot would be to test an independent administration structure involving local government entities in a limited geographic region. The proposal provides few details, other than to note that it would be an "entirely different approach," that would move beyond the "program-by-program approach," and would be limited to the San Francisco Bay Area and / or San Diego area. [147]

For the policy and legal reasons fully explored in the draft decision, there are substantial drawbacks to delegating program choice and portfolio management administrative functions to a third-party administrator, whether on a permanent or pilot basis. In our view, the pilot proposal presented by TURN and CCSF at this late date is simply a thinly veiled attempt to circumvent the major conclusions of the draft decision. Moreover, contrary to TURN's assertions that it would have a "minimal disruptive impact"[148], such a pilot would be highly disruptive to our goal of providing much-needed certainty to the energy efficiency industry. The issue of portfolio administration has been a source of great uncertainty for California's efficiency industry for more than the past half decade. After a long period of public debate and discussion, the draft decision chooses the "fork in the road" that leads *away* from independent

[147] TURN Opening Comments, p. 13; CCSF Opening Comments, p. 5.

administration for a number of policy and legal reasons. By asking us to approve a “pilot” for independent administration in combination with the administrative structure proposed in the draft decision, TURN and CCSF are essentially asking us to prolong the uncertainty surrounding administration.

We agree with NRDC and others that it is time to put this debate behind us. Based on the extensive record before us in this proceeding, we adopt the draft decision with the minor modifications and clarifications described herein. We find that the administrative structure presented for our consideration by Assigned Commissioner Kennedy and CEC Commissioner Rosenfeld provides the most workable approach to achieving the aggressive energy efficiency savings goals we have established for energy efficiency programs in the years to come.

8. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Meg Gottstein is the assigned ALJ in this phase of the proceeding.

Findings of Fact

1. The current administrative structure for energy efficiency was put in place as a rapid response approach during the energy crisis.

2. Placing responsibility on this Commission to make the initial selections of energy efficiency programs and to oversee the portfolio management of those selections puts the Commission in the position of both judge and jury.

3. Commission staff involvement in Program Choice and Portfolio Management stretches limited staff resources between those functions and the

[148] TURN’s Opening Comments, p. 14.

Quality Assurance and EM&V responsibilities that should be the primary focus of staff efforts.

4. Many innovative programs may not be discovered through an application and review process at a regulatory agency.

5. There is no single best model for how energy efficiency programs should be administered. The best administrative structure depends on each state's particular context.

6. As described in this decision, California has experienced three distinct eras of energy efficiency administration with respect to program choice and portfolio management. During "pre-restructuring / collaborative era" (1990-1997), the IOUs assumed these functions and procured energy efficiency to displace or defer more costly supply-side resources in their resource plans. During the "restructuring era" (1997-2000), with the move to full electric retail competition and privatization of energy efficiency services, the Commission attempted to shift to independent administration of energy efficiency, but without success. In the "current era," which began with the Summer 2000 Initiative, Commission staff selects programs subject to Commission approval, and plays a lead role in day-to-day portfolio management.

7. With the return of IOUs to resource procurement and the policies articulated in the Energy Action Plan, the focus of energy efficiency in California has returned to resource acquisition.

8. In California, decisions concerning the optimal levels of energy efficiency and supply-side resources will be made in the resource planning process undertaken by the IOUs, subject to Commission oversight and approval. In contrast, in Texas and other states that have implemented full retail competition, these decisions are determined entirely by the private market: IOUs are not

allowed to participate in planning or delivering energy services (supply- or demand-side) within their service territories.

9. Requiring the IOUs to accept forecasts and resource projections from a third-party administrator, as proposed by the ORA / TURN Coalition, is incompatible with an integrated resource planning approach that places full accountability and responsibility with the IOUs themselves.

10. Adopting an administrative structure that relies solely on the competitive market to meet customers' energy efficiency needs, as proposed by the WEM / SESCO Coalition, would ignore the Commission's expressed concerns over California's painful history with retail competition and reliance upon competitive market theory.

11. In D.04-01-050, the Commission rejected the principle that no entity (i.e., the IOUs) should be allowed to assume both the program choice / portfolio management and implementation function for supply-side resource acquisition.

12. Placing IOUs in the role of program choice and portfolio management, as proposed by the IOUs Coalition and the NRDC / LIF Coalition, is consistent with the hybrid market structure established by the Commission in the Procurement Rulemaking for supply-side resource acquisition. In contrast, the ORA / TURN Coalition and WEM / SESCO Coalition proposals create a dichotomy between supply-side and demand-side resources in terms of the role of IOUs in portfolio selection and management.

13. The ORA / TURN Coalition and WEM / SESCO Coalition proposals presented in their April 8, 2004 filings contemplate the transfer of ratepayer funds from IOUs to independent administrator(s). Based on past rulings from the Attorney General and the Department of Finance, such transfers require statutory authority. Seeking such authority would introduce delays and

uncertainty into the process, and render program funding vulnerable to borrowing by the Legislature.

14. The ORA / TURN Coalition and WEM / SESCO Coalition propose in their October 2004 legal briefs that the IOUs pay the bills of independent administrator(s), which would be subject to Energy Division review and approval of invoices. This would place an enormous contract management burden upon Energy Division staff, given the magnitude and broad range of tasks associated with the program choice and portfolio management functions and large funding levels (over $400 million per year) involved. As discussed in this decision, this approach also faces the risk of legal challenge as being inconsistent with Government Code § 19130(b).

15. Government Code § 19130(b) applies to personal services contracts, not activities that have been traditionally performed by utilities regulated by the Commission. Therefore, placing responsibility for program choice and portfolio management with the IOUs would not raise the same risk of challenge under § 19130(b).

16. The administrative proposals recommended by TURN / ORA Coalition and WEM / SESCO Coalition create other substantial implementation challenges, including significant start-up costs and transition time, as well as the challenge of finding third-party administrator(s) capable of assuming the huge fiduciary responsibilities associated with over $400 million in annual program funding.

17. There is no guarantee under the ORA / TURN Coalition proposal that a single organization or partnership of firms capable of administering energy efficiency in California will emerge as truly "single purpose," i.e., free from conflicting financial interest with respect to energy efficiency.

18. Under the WEM / SESCO Coalition approach to independent administration, statewide programs (other than a 5% proposed budget for education and information) could cease to exist entirely, as there is no apparent coordination between the multiple administrators and no assurance that each administrator would select the statewide program for its service territory.

19. The administrative model proposed by WEM / SESCO Coalition would make coordinating different programs very difficult, if not impossible. Customers would be faced with multiple and sometimes overlapping programs that invite customers to participate in more than one program intended to achieve the same energy savings. Having an uncoordinated group of implementers design and implement a variety of uncoordinated programs will not achieve the program synergies and leveraging necessary to optimize savings from energy efficiency, as required by the Energy Action Plan.

20. The Texas standard offer program, after which the WEM / SESCO Coalition proposal is modeled, is designed to meet a relatively modest energy efficiency savings goal of 10% of the electric IOUs annual growth in demand. To meet this goal for 2004, the program contracted for 150 MWs in savings, which is the equivalent in usage to roughly 38,000 homes in Texas.

21. Experience to date in Texas suggests that standard offers may not be well suited to tapping the full potential of cost-effective energy efficiency, particularly large commercial and industrial installations.

22. The WEM / SESCO Coalition proposal relies exclusively on standard offers that use “deemed savings” calculations to estimate per measure savings. In Texas, this approach to verifying savings is considered suitable only for limited applications—primarily residential and small commercial.

23. While a standard offer program (along with other pay-for-performance approaches) may have a place in California as an implementation strategy, it does not represent a strategy that can wholly replace other, more appropriate, administrative models.

24. Returning the IOUs to a lead role in program choice and portfolio management is the most effective way to hold the IOUs accountable for the responsibilities they have been assigned by both the Legislature and the Commission to procure demand-side and supply-side resources to meet Energy Action Plan goals.

25. Returning the IOUs to a lead role in program choice and portfolio management will not create the legal obstacles experienced during the "restructuring era" and will not require statutory changes.

26. Transitioning from staff to IOU responsibilities would involve a relatively short period, and could be accomplished in an orderly pace that would not disrupt program delivery.

27. IOU administrators during the pre-restructuring / collaborative era produced an estimated $1.4 billion in net benefits to ratepayers (savings minus costs, including shareholder incentives) for programs implemented or initiated over the 1994-1997 period.

28. The IOUs have the requisite expertise and capability to administer energy efficiency consistent with the Energy Action Plan and the savings goals we establish in this proceeding.

29. Who performs the program choice or portfolio management function is not relevant to the issue of how to ensure that reported program results are credible. What is relevant is the structure of monitoring and verification, or EM&V.

30. Irrespective of what entity or entities fulfill the role of program choice and portfolio management, the Commission needs to adopt quality control measures to ensure that program administrators select programs and manage them in a manner that is consistent with Commission objectives.

31. TURN / ORA Coalition's recommendation to reject the notion of adopting performance incentives to motivate the performance of energy efficiency administrators is inconsistent with Commission direction in prior rulings and decisions. Per those directions, the issue of risk / reward mechanisms for energy efficiency should be considered in a subsequent phase of this proceeding in coordination with the development of an overall procurement incentive framework.

32. Competitive solicitations can provide an important safeguard against bias in the program selection process. Most importantly, competitive solicitations can help to identify innovative approaches or technologies for meeting savings goals with improved program performance that might not otherwise be identified during the program planning process.

33. Competitive, open bid solicitations should be designed to improve performance of the portfolio in terms of producing cost-effective energy savings that meet or exceed our savings goals. Any current program or group of programs (IOU or non-IOU designed and implemented) that can be improved upon in this way may be subject to open bids to replace, augment or otherwise enhance current efforts as part of the minimum competitive bidding requirement. However, as discussed in this decision, not all program activities lend themselves to a competitive solicitation.

34. In particular, it would be counterproductive to require open bids in instances where, for example, current or future partnerships between IOUs and

local governments can take advantage of the unique strengths that both partners bring to the table to deliver cost-effective energy efficiency services, or a combination of partnerships and bilateral contracting arrangements with private or public entities can deliver effective statewide initiatives that enhance portfolio performance, such as a statewide public awareness campaign or an upstream lighting program. Such activities should be funded out of the 80% (maximum) core portfolio that is not put out to bid.

35. Non-IOUs parties are currently involved in program delivery either as implementers of programs that they have designed themselves or under contract with IOU implementers for IOU-designed programs.

36. All program implementers—IOU and non-IOU alike—need to be selected and evaluated based on their ability to best meet our resource procurement goals, including the specific savings targets the Commission establishes in this proceeding.

37. Decisions on whether non-IOUs should be program implementers responsible for designing and delivering the program (rather than working to implement IOU-designed programs) should be made based on an evaluation of whether the program designs and delivery mechanisms proposed by non-IOUs are superior to those currently being implemented or planned for the future, based on the Commission's goals for energy efficiency.

38. Competitive bidding in energy efficiency should focus on soliciting good, new program ideas to achieve the Commission goals of procuring cost-effective energy efficiency savings to meet or exceed adopted savings goals, rather than allocating a specific percentage of program funding to particular implementers.

39. A 20% minimum requirement for open bidding, as described in this decision, captures the potential benefits of competition and serves as an added

safeguard against selection bias. At the same time, it provides sufficient flexibility to avoid imposing competitive bidding on program offerings that are more effectively delivered using other approaches. This 20% minimum requirement should apply for the next funding cycle, beginning in 2006, but may be modified for subsequent funding cycles, as appropriate.

40. Cream skimming only becomes a problem when lost opportunities are created in the process, that is, when long-lived, cost-effective savings are lost irretrievably or rendered much more costly to achieve, if not exploited promptly.

41. IOUs and non-IOU implementers should pursue the most cost-effective energy efficiency resource programs first, if doing so does not create lost opportunities. This policy should also be reflected in the competitive bid solicitation and evaluation criteria.

42. IOUs should develop the portfolio plans, identify components of the plans to put out for bid, develop bid evaluation criteria and RFPs for these bids, evaluate the bidders and make final selections with working group input, as described in this decision.

43. Advisory groups can help to safeguard against the potential for bias in program selection and portfolio management by: (1) promoting transparency in the program administrator's decision-making process; (2) providing a forum to obtain valuable technical expertise from stakeholders and non-market participant; (3) encouraging collaboration among stakeholders and; (4) creating an additional venue for public participation.

44. For the program choice and portfolio management functions, advisory groups can be a valuable component of the administrative structure on two levels. On one level, they create the forum for an open and informative exchange of information among program administrators, industry experts and

stakeholders as the IOUs develop their program selections for Commission consideration, and manage their program portfolio throughout the funding cycle. On another level, advisory groups can serve an important "peer review" function by providing an independent assessment of the IOUs' portfolio design and program selections.

45. The advisory structure adopted in today's decision can deliver the benefits described above while keeping the administrative structure manageable.

46. In addition to considering region-specific customer and program needs, the IOUs and their PAGs should closely collaborate and coordinate on statewide programs that cut across IOU service territories, as discussed in this decision. In addition, they should collaborate on statewide program designs and implementation strategies that increasingly integrate energy efficiency with demand response and distributed generation offerings to end- users. The IOUs and PAGs should also ensure that statewide residential and nonresidential program offerings take advantage of "best available practices" and avoid customer confusion by being as uniform as possible. The IOUs are responsible for ensuring that the design of statewide programs proceeds in this coordinated manner.

47. The Focus Plan presented by Cal-Ucons would create an additional layer of advisory committees that would potentially be duplicative of the PAG membership and structure.

48. Participation in the PAGs, including the PRGs described in this decision, makes a significant contribution to effective implementation of this decision and parties eligible to receive intervenor compensation awards in this proceeding should be eligible to seek compensation for their work in these groups.

49. A ban on affiliate transactions in the context of energy efficiency recognizes that the IOU administrators may have a clear financial rationale for preferring their affiliates as program implementers, depending on the Commission's determinations regarding incentive structure. Moreover, the task of monitoring the IOUs energy efficiency portfolio design decisions is a much larger task for the PRG than that assigned to the supply-side counterpart, without the added complication of trying to assess potential conflicts of interests associated with affiliate transactions.

50. The most direct and effective means to avoid any potential conflict of interest between IOU administrators and their current or future affiliates is to simply prohibit the transactions. A broad ban on affiliate transactions is appropriate and reasonable in the context of energy efficiency. This is because many of the cornerstone energy efficiency efforts are designed to "transcend borders" with respect to individual IOU service territories, and provide energy efficiency services and resource savings on a statewide basis. Adopting a broad affiliate transactions ban at the outset avoids the need to revisit the issue of "who's affiliate" each time a program is deployed in more than one IOU service territory.

51. The EM&V administrative proposals presented by the IOUs Coalition, the NRDC / LIF Coalition and the Collaborating Parties fall short of ensuring the necessary independence of EM&V, for the reasons discussed in this decision.

52. Today's adopted two-track approach to EM&V administration effectively balances the need to facilitate effective feedback to IOU program administrators and program implementers, so that they can make mid-course changes to increase the effectiveness of the programs, with the need to protect against potential conflicts of interest.

53. By splitting the responsibilities for EM&V administrative, the adopted approach addresses the two major concerns that various parties have raised. First, that an entity other than the one standing to profit from inflated program achievements should be responsible for substantiating program performance. Second, that Portfolio Managers and program implementers should be able to manage a limited subset of program design evaluations and market assessments as long as there is no potential for conflict due to the nature of the study, and Energy Division has a lead role in the selection of contractors.

54. Allowing EM&V consultants (or their firms) that perform program and portfolio impacts-related studies to also be involved in energy efficiency program delivery--as either a non-IOU program implementer or as a subcontractor to IOU implementer(s)--creates conflict-of-interest problems. These problems can be effectively addressed by prohibiting entities from performing these types of EM&V studies at the same time they are under contract for program delivery work. As discussed in this decision, excluding program design evaluation and market assessment studies from this strict firewall and allowing the narrow exception that TURN, ORA and CCSF propose, will mitigate some of the practical concerns raised by parties regarding a firewall without compromising the principle guiding our choice of EM&V structure, i.e, that of ensuring non-biased program evaluation results.

55. Allowing structurally separate non-IOU affiliates to separately perform EM&V and program implementation work if they sign non-disclosure agreements serves to provide a clear demarcation as to what either business entity has been hired for and creates an effective firewall between the affiliated companies when performing work.

56. It is reasonable to begin today's adopted firewall with a "clean slate" in the 2006 program cycle, so that all current implementers and evaluators of the 2004-2005 programs may choose which option to pursue for the 2006 program cycle and beyond.

57. For the reasons discussed in this decision, technical review committees created on an as-needed basis by Energy Division will be more valuable and effective under our adopted EM&V administrative structure than the formal standing measurement advisory groups proposed by various parties.

58. Providing the opportunity for public input and the opportunity for implementers, administrators and evaluators to share information and concerns during the evaluation process, as described in this decision, should go a long way toward minimizing the number of disputes over evaluation study results that may need to be resolved by the Commission.

59. As described in this decision, the adopted approach to energy efficiency administration provides significant opportunities for public input throughout the process of planning, designing, funding and evaluating the results of individual programs and the overall energy efficiency portfolio.

60. In order to further delineate the implementation details associated with EM&V and Research and Analysis, such as more specific lists and definitions for the studies that fall under the two EM&V study categories and those to be undertaken under Research and Analysis, Energy Division and CEC staff should jointly prepare an implementation roadmap, consistent with today's direction.

61. Creating one or more standing policy advisory groups to the Commission, as recommended by some parties, would be a far too structured and cumbersome approach to obtaining research and analysis in support of policy decisions. Instead, Energy Division and CEC staff should take the lead in this

role, as discussed in this decision, and solicit input from working groups of experts or hired consultants, as they deem appropriate to the circumstances.

62. To meet the Energy Action Plan goals for resource procurement, the focus for spending ratepayer dollars should be to capture the most cost-effective demand-side resource as possible over both the short- and long-term that can meet our exceed our savings goals. Focusing efforts in this way is the most equitable way to distribute program benefits: By keeping IOU resource procurement costs as low as possible through the deployment of cost-effective energy efficiency, all customers will share in the resource savings from energy efficiency programs.

63. This phase of the proceeding is not the forum for evaluating the performance of either IOU or non-IOU implemented programs during 2003. SESCO's evaluation of the IOUs performance as implementers during 2003, presented in its May 6, 2004 reply comments, is selective and does not comprehensively consider all of the performance attributes we established for that program year.

Conclusions of Law

1. Returning IOUs to the lead role in program choice and portfolio management will best meet California's goals for integrated resource procurement.

2. With the quality control measures adopted in this decision, the IOUs can both select and sponsor programs without bias.

3. In order to ensure the necessary independence of portfolio and program-related EM&V, EM&V studies should be managed and contracted for under the two-tiered EM&V administrative structure adopted by this decision and subject to the firewall described herein.

4. For the reasons discussed in this decision, it is reasonable and appropriate to ban affiliate transactions between IOU administrators and program implementers.

5. As discussed in this decision, the Energy Efficiency Policy Rules should be updated as soon as practicable.

6. Our interpretation of "administrator" for purposes of AB 117, as articulated in D.03-07-034 and reiterated in this decision, is consistent with the competing interests articulated in Section 381.1 as well as the requirements for handling ratepayer money. Nothing in today's decision prevents the Commission from modifying the process for allocating PGC funds to Community Choice Aggregators in the future, or revisitng the question of whether CCA customers should be relieved of their responsibility for energy efficiency PGC and procurement surcharges if the CCA elects to take over these functions.

INTERIM ORDER

IT IS ORDERED that:

1. As described in this decision, 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), collectively referred to as the investor-owned utilities (IOUs), shall assume the program choice and portfolio management functions for post-2005 energy efficiency programs. Those functions are described in Attachment 1. The administrative structure for Evaluation, Measurement and Verification (EM&V), Research and Analysis in Support of Policy Oversight, Quality Assurance and other administrative functions described in today's decision are adopted for post-2005 energy efficiency programs.

2. As discussed in this decision, transactions between the IOUs and any program implementer that is an affiliate of PG&E, SCE, SDG&E or SoCalGas are prohibited, without exception. This ban becomes effective for the 2006 program year and beyond.

3. The IOUs shall put together the advisory groups and implement the program design and selection process consistent with today's decision. The assigned Administrative Law Judge (ALJ), in consultation with the Assigned Commissioner, may provide the IOUs with additional clarification and direction on these issues. The Assigned Commissioner, ALJ or Energy Division may request periodic informational submittals from the IOUs describing the composition of the advisory groups, planned schedule for public workshops and other implementation tasks that the IOUs are responsible for under today's adopted administrative structure, as needed. The IOU administrators shall

inform the Assigned Commissioner and ALJ by letter of the individuals selected to serve on the Program Advisory Group and Peer Review Groups (PRGs).

4. Energy Division may hire an independent consultant or consultants to assist in its PRG, EM&V and related responsibilities, which shall be paid for out of energy efficiency program funds. Energy Division shall convene technical review committees as needed to assist in its EM&V responsibilities, the cost of which shall also be paid for out of energy efficiency program funds.

5. Energy Division, or its consultant(s), shall work with the IOUs to compile all administrative and non-administrative costs and energy savings data on current programs in a standard format that will facilitate direct comparisons across programs, and make any needed refinements to the existing reporting requirements to facilitate such a comparison. Energy Division may convene a workshop with interested parties to discuss this format, as it deems appropriate. This information shall be made available to the advisory groups no later than March 15, 2005, and shall be updated in the applications filed by the IOUs pursuant to Ordering Paragraph 6.

6. The IOUs shall file applications by June 1, 2005 for Commission approval of energy efficiency program plans and funding levels via the public goods charge and procurement rates for the three-year program implementation and funding cycle beginning January 1, 2006. The applications shall include a description of the portfolio composition, the components that will be put out to bid consistent with today’s adopted minimum requirement, and the IOUs’ proposed evaluation criteria. The written assessments of the PRGs shall be appended to these filings. The IOUs shall also provide in these applications all information required by Decision (D.) 04-09-060, Ordering Paragraph 4.

7. The energy efficiency applications described in Ordering Paragraph 6 shall include EM&V plans, funding levels and budget allocations across study categories that are jointly developed by the IOUs and Energy Division after obtaining input from the public and the California Energy Commission (CEC), as directed in this decision. The applications shall include a description and scope of work for studies that the IOUs or program implementers plan to manage and / or directly contract for under the program design evaluation and market assessment category. As directed in this decision, they shall include proposed funding for the Energy Efficiency Groupware Application as a separate line-item, and address whether the current or modified versions of standard contract agreements with non-IOU implementers should be returned. The applications shall be filed and served in accordance with the Electronic Service Protocols appended to the Assigned Commissioner's December 22, 2003 ruling in this proceeding.

8. The IOUs shall promptly pay the contractor invoices for all EM&V studies managed by Energy Division upon approval of those invoices by the staff project manager. All EM&V studies shall continue to be funded from public goods charge collections.

9. For 2006 and beyond the IOUs shall submit compliance filings for Commission approval of final programs and make public all winning bids, as described in this decision. Written assessments of the PRGs shall be appended to these filings. If the PRG and IOU reach consensus in support of the proposed compliance plans, the IOU may file an advice letter. If consensus is not reached, the IOUs shall file supplemental compliance applications in the same docket that they filed their program planning applications. The IOUs shall file these compliance filings as soon as practicable after the Commission issues its

approval of program plans and after completion of the peer review process described in this decision. The compliance filings shall be served in accordance with the Electronic Service Protocols appended to the Assigned Commissioner's December 22, 2003 ruling in this proceeding.

10. Energy Division shall provide the Assigned Commissioner and assigned ALJ with a written assessment of the effectiveness of the advisory group structure on an annual basis. Energy Division may conduct this assessment itself or hire an independent contractor for this purpose, whose costs will be paid for out of energy efficiency program funds. The first Energy Division assessment shall be due 14 months from the effective date of this decision, and every year thereafter unless otherwise directed by the Assigned Commissioner. The Assigned Commissioner may direct the assigned ALJ to serve the Energy Division assessments on the parties, issue them for comment, or take other steps as appropriate with this information.

11. The Program Advisory Groups established in today's decision shall provide an annual, joint report to Energy Division with recommendations on how the IOUs can improve their effectiveness as administrators in managing the portfolio of programs, including how the program selection process could be improved to better meet the Commission's procurement goals. The first joint report shall be submitted to Energy Division no later than March 15, 2006, and annually thereafter unless otherwise directed by the Assigned Commissioner. The Energy Division, in consultation with the Assigned Commissioner and assigned ALJ, may serve the reports on the parties, issue them for comment, or take other steps as appropriate with the information.

12. As described in this decision, Energy Division shall perform research and analysis in support of the Commission's policy oversight of energy efficiency

(Research and Analysis), as specific needs arise. This Commission shall also explore creating a more formal arrangement with the CEC for collaboration in this area and in EM&V, building on the working relationship established between the two agencies in this proceeding. Accordingly, we direct the Executive Director to contact his counterpart at the CEC with the goal of developing an interagency memorandum of understanding for CEC staff participation in EM&V and Research and Analysis, as described in this decision. As described in this decision, we also direct the Executive Director to address energy efficiency staffing issues with the management team without delay, and to reallocate or augment Commission staff resources as needed to fulfill Energy Division's responsibilities for energy efficiency.

13. As soon as practicable, the Assigned Commissioner and ALJ shall establish a procedural schedule and process for updating the Energy Efficiency Policy Rules.

14. Consistent with the direction in today's decision, Energy Division and CEC staff shall jointly prepare an implementation roadmap for EM&V and Research and Analysis for the 2006 program planning cycle and hold a public workshop to obtain input before finalizing the roadmap for the ALJ's consideration. The joint roadmap shall be submitted to the ALJ within 60 days from the effective date of this decision. A final roadmap for the 2006 program planning cycle will be adopted by ALJ ruling, after interested parties have an opportunity to provide written comments on the Energy Division / CEC joint proposal. The ALJ may provide additional clarification and direction on EM&V and Research and Analysis administrative issues, or make modifications to the roadmap during the program planning cycle, as needed.

15. The Commission shall perform quality assurance and policy oversight functions necessary to ensure that program results are accurate and that ratepayer funds are being spent and managed in a responsible and productive manner, including, but not limited to, the functions described in Section 5.3.3 of this decision.

16. The Assigned Commissioner or ALJ may, for good cause, modify the due dates established by this decision.

17. This proceeding remains open to address ongoing issues related to energy efficiency policies and programs.

18. The Motion to Intervene filed by Sempra Energy Global Enterprises on December 20, 2004 is granted.

This order is effective today.

Dated January 27, 2005, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I will file a concurrence.

/s/ MICHAEL R. PEEVEY
President

I will file a concurrence.

/s/ GEOFFREY F. BROWN
Commissioner

I reserve the right to file a concurrence.

/s/ SUSAN P. KENNEDY
Commissioner

Comr. Gruenich recused herself
from this agenda item and was not
part of the quorum in its consideration.

ATTACHMENT 3

List of Acronyms

Page 1

AB	Assembly Bill
AEAP	Annual Earnings Assessment Proceeding
ALJ	Administrative Law Judge
CADMAC	California DSM Measurement Advisory Council
CALMAC	California Measurement Advisory Council
Cal-Ucons	Cal-Ucons, Inc.
CBEE	California Board For Energy Efficiency
CCAs	Community Choice Aggregators
CCSF	City and County of San Francisco
CEAC	California Efficiency Advisory Council
CEC	California Energy Commission
CPA	California Power Authority
CSEA	California State Employees Association
D.	Decision
DEER	Database for Energy Efficiency Resources
DSM	Demand-Side Management
DSP	Division of Strategic Planning
EEGA	Energy Efficiency Groupware Application
EM&V	Evaluation, Measurement and Verification
ESCOs	Energy Service Companies
I.	Investigation
IEP	Independent Energy Producers
ISO	Independent System Operator
IOUs	Investor-Owned Utilities
LIEE	Low-Income Energy Efficiency
LIF	Latino Issues Forum
MEC	Measurement and Evaluation Council
MOU	Memorandum of Understanding
MW	Megawatt

ATTACHMENT 3

List of Acronyms

Page 2

NAESCO	National Association of Energy Service Companies
NOI	Notice of Intent
NRDC	Natural Resources Defense Council
ORA	Office of Ratepayer Advocates
PACs	Project Advisory Committees
PAGs	Program Advisory Groups
PG&E	Pacific Gas and Electric Company
PGC	Public Goods Charge
PHC	Prehearing Conference
PIER	Public Interest Energy Research (PIER)
PRG	Procurement Review Group
QFs	Qualifying Facilities
RESCUE	Residential Energy Service Companies' United Effor
R.	Rulemaking
RFP	Request For Proposal
SCE	Southern California Edison
SDG&E	San Diego Gas & Electric Company
SDREO	San Diego Regional Energy Office
SEGE	Sempra Energy Global Enterprises
SESCO	SESCO, Inc.
SoCalGas	Southern California Gas Company
SPB	State Personnel Board
TURN	The Utility Reform Network
UCAN	Utility Consumers' Action Network
WEM	Women Energy Matters
WPTF	Water Power Trading Forum

(END OF ATTACHMENT 3)

R.01-08-028
D.05-01-055

Commissioner Peevey, concurring:

It is my understanding that the question of who should administer the efficiency funds has been asked but not answered by this Commission for more than eight years now, following the passage of AB1890 and the first phase of electricity deregulation. Thus, I believe that we need to act now to provide some certainty to the administrative structure at least for the next program cycle.

When I came to this commission more than two years ago now, I was of the view that the utilities should not be administering energy efficiency any longer. Having worked at a utility, and then working as a competitor to them, I understand all of the obstacles and issues that are inherent in utility administration of programs. I know that utilities require any decision on a program to be vetted through multiple layers of bureaucracy and that therefore action is often extremely slow, as a consequence.
But as of the time of this vote, I do not see immediate viable options for non-utility administrators. Perhaps options can be developed, but I have not yet seen a proposal that seems to me to have a reasonable chance of success in the near term.

However, I do not wish my vote on this matter to be taken as a sign that I am not open to new and innovative approaches to this issue. I also want to put the utilities on notice that this decision today is not a guaranteed entitlement to utility administration of energy efficiency for the rest of eternity. We intend to monitor the efforts of the utilities to meet their aggressive energy efficiency goals very carefully, and the new evaluation structure included in this decision is designed in large part to make sure that review happens.

In order to meet their goals, the utilities absolutely <u>must</u> become more nimble and innovative when it comes to delivering energy savings to their customers. If this happens, then we will be on the right path. If this does not happen, I will be the first on this Commission to propose that we find a different administrative option by the end of this next three-year program cycle.

/s/ MICHAEL R. PEEVEY
MICHAEL R. PEEVEY
Commissioner

San Francisco, California
January 27, 2005

Commissioner Geoffrey F. Brown, Concurring:

There are a lot of things to like about the Proposed Decision. It continues the Commission's strong commitment to energy efficiency; California has been and should continue to be a leader in this area. It provides a level of certainty to the energy efficiency world about the question of administration. It adds important elements of independence and expertise to both the programmatic selection and evaluation processes. Overall, I believe it is better than the current method of administering energy efficiency, and an improvement upon previous experience with utility administration.

At the same time, there are some issues which continue to concern me about this decision.

I have long felt that utilities, while they have developed and implemented a number of fine energy efficiency programs, are not particularly innovative. Their overly-bureaucratic focus on the "tried and true" can discourage new ideas. This is especially true when the new ideas are "not invented here" – that is, at the utility. Historically, utilities have wanted programs to stay within their control as much as possible, even at the expense of innovation and additional energy savings.

I would like to see a system where the best programs – the most cost-effective, the highest energy savings – are implemented regardless of source. Utilities should be in the game, but they have no monopoly on good ideas. I have seen many examples of programs run by local government and private entities that are innovative and effective. I am concerned that the 80/20 allocation in the decision, and the overall utility control of the programs, will limit the explorations of new frontiers.

We must not let that happen. As the policy rules and implementation issues are worked out, we can't fall back on the easy answer of letting utilities assume full control of all aspects of the programs. My intention is to scrutinize any follow-up items from this decision to ensure an open playing field for any entity that can develop and deliver quality energy efficiency services on behalf of the ratepayers and the citizens of California.

I encourage the utilities to develop a standard contract with implementers, similar to the standard contract used when the Commission administered certain programs. Having a standard contract levels the playing field and ensures that utilities and implementers know what their expected roles are. Standard contracts can minimize the complaint that some implementers are treated more or less fairly than others. They also give utilities a basis to exercise their due diligence over all of their program implementers. Further. a standard contract imposes the same expectations across the state. Standard contracts also have proven to substantially reduce the expenses of all parties on legal work. I encourage Energy Division to help utilities work together to draft a set of standard contracts to be used statewide with all energy efficiency implementers and providers.

Administrative costs are another issue. The PUC's own consultant found a number of examples of high administrative costs for utility programs. This cannot continue. My alternate attempted to address this issue. I am now convinced that the PD will allow scrutiny of administrative costs. My desire is that we keep our eye on the ball here – ratepayer funds should go to programs, not overhead, to the greatest extent possible.

I ask that Energy Division work in their oversight of utility administration to take every step in their power to ensure that energy efficiency expenditures by the utilities and their contracted program implementers are limited to what are actually necessary to ensure productive and effective programs. If Energy Division believes administrative and overhead costs exceed prudent levels, I encourage staff to come forward and seek Commission remedial action.

I proposed a pilot program on independent administration in my alternate. The PD says this is unnecessary, duplicative and defeats the purpose of long-term stability. There is some validity to these points. However, there are also good reasons to consider a pilot. These include innovation, competitive pressures, removal of utility conflicts, and consistency with future community choice aggregation programs.

My purpose in putting forth the alternate was to allow us to use a pilot program to see if these benefits would spring forth. The PD dismisses the pilot based on policy arguments without actually seeing what would happen. I would have preferred to have a real-life experiment and find out for sure. If there are opportunities for experimentation in this area in the future, I will support such efforts.

/s/ GEOFFREY F. BROWN
Geoffrey F. Brown
Commissioner

San Francisco, California
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