BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 19M-0661EG

IN THE MATTER OF THE IMPLEMENTATION OF § 40-3-117, C.R.S. REGARDING AN INVESTIGATION INTO PERFORMANCE-BASED RATEMAKING.

Reply Comments of the R Street Institute

The R Street Institute (R Street) hereby submits these reply comments to the Colorado Public Utilities Commission (Commission) in response to initial comments submitted January 10, 2020 in the above-captioned docket. These reply comments are submitted pursuant to the schedule adopted by Hearing Commissioner John Gavan in Decision No. R19-1002-I issued December 16, 2019 in this docket.

<u>Introduction</u>

R Street is a nonprofit, nonpartisan, public policy research organization. Our mission is to engage in policy research and outreach to promote free markets and limited, effective government. We favor regulation that is transparent and applied equitably as well as systems that rely on price signals rather than central planning. At the same time, we recognize that natural monopolies and externalities are real concerns that governments must address. We offer research and analysis that advance the goals of a more market-oriented society and an effective, efficient government, with the full realization that progress takes time.

The Commission initiated this docket December 4, 2019 to explore performance-based ratemaking (PBR) attributes and submit a report to the Senate Transportation and Energy Committee and the House of Representatives Energy and Environment Committee.[1] This proceeding is to receive comments on PBR and performance incentive mechanisms (PIMs), and "will serve as a platform from which to conduct workshops and Commissioner Informational Meetings (CIMs), pose questions, discuss processes, and issue orders."[2] The December 16, 2019 decision identified a schedule for the proceeding, including the date for submission of comments and reply comments to questions raised in the decision.

R Street submitted its Notice of Participation in this docket on January 13, 2020.

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[1] *In the Matter of the Implementation of § 40-3-117, C.R.S. Regarding an Investigation into Performance-Based Ratemaking*, Decision No. C19-0969, Proceeding No. 19M-0661EG (issued Dec. 4, 2019).

[2] *In the Matter of the Implementation of § 40-3-117, C.R.S. Regarding an Investigation into Performance-Based Ratemaking*, Decision No. R19-1002-I, Proceeding No. 19M-0661EG (issued Dec. 16, 2019).

Initial comments were submitted by fifteen parties in this docket on January 10, 2020. R Street will not reply to all comments; however, lack of explicit response to a comment does not infer that R Street concurs with the party or the comments.

On January 23, 2020, Hearing Commissioner Gavan issued a decision rescheduling a workshop for February 21, 2020.[3] R Street anticipates participating in that workshop.

This proceeding is the result of leadership from Governor Jared Polis and the Colorado Legislature. As detailed in Governor Polis' "Roadmap to 100% Renewable Energy by 2040 and Bold Climate Action" vision document, the future for Colorado's electricity system is increasingly distributed, cleaner, and involves choices to be made by customers themselves.[4]

Reply Comments

A. Comments on Use of PBR

R Street agrees with several commenters, notably Advanced Energy Economy (AEE),[5] Western Resources Advocates (WRA),[6] Colorado Energy Office (CEO),[7] Rocky Mountain Institute (RMI),[8] and the Colorado Solar and Storage Association (COSSA) and Solar Energy Industries Association (SEIA)[9] that the distribution system—and the electricity system itself—is evolving into a cleaner and more distributed one. One of the implications of this evolution is that customers will take more control over their electricity usage by using equipment and resources from entities other than the regulated monopoly utility. Indeed, the growth of non-utility providers capable of providing technology and services directly to customers means that the utility is no longer the only entity capable of meeting the needs of customers. As COSSA notes, this has a direct impact on the traditional Cost of Service (COS) ratemaking structure that has been in place throughout the electricity sector for 100 years.[10]

Historically, utilities earned revenue via an increase in sales of their product (i.e., electricity) and a return on the construction of new facilities and equipment (i.e., capital). This model is no longer sustainable. R Street supports COSSA's comments on the increasing inadequacy of the

[3] *In the Matter of the Implementation of § 40-3-117, C.R.S. Regarding an Investigation into Performance-Based Ratemaking*, Decision No. R20-0052-I, Proceeding No. 19M-0661EG (Jan. 23, 2020).
[4] *See also* Initial Comments of the Colorado Energy Office, Proceeding No. 19M-0661EG, at 13–14 (Jan. 10, 2020) [hereinafter Initial Comments of CEO].
[5] Initial Comments of Advanced Energy Economy Institute, Proceeding No. 19M-0661EG, at 1, 19 (Jan. 10, 2020) [hereinafter Initial Comments of AEE].
[6] Initial Comments of Western Resources Advocates, Proceeding No. 19M-0661EG, at 1, 13 (Jan. 10, 2020) [hereinafter Initial Comments of WRA].
[7] Initial Comments of CEO, *supra* note 4, at 4.
[8] Comments of Rocky Mountain Institute, Proceeding No. 19M-0661EG, at 5–6 (Jan. 10, 2020) [hereinafter Comments of RMI].
[9] Opening Comments of the Colorado Solar and Storage Association and the Solar Energy Industries Association, Proceeding No. 19M-0661EG, at 1–2 (Jan. 10, 2020) [hereinafter Opening Comments of COSSA/SEIA].
[10] *Id.* at 2–3.

COS model to best meet the changing needs of Colorado's customers.[11] The Commission's consideration of the question "what comes after COS?" should compose part of the Commission's investigation here.

With the growth of new resources, such as Distributed Energy Resources (DER), customers and market participants are able to support a customer's choice of electricity options. As COSSA notes, the growth of DER in particular calls into question the historic assumptions regarding the role of the electric utility.[12] An entity is provided a monopoly when the state decides there is not sufficient competition to provide adequate choice to customers. When competition is lacking and only one service provider is available to customers, that entity can exercise monopoly power and should thus be regulated to ensure costs remain reasonable and customers are protected from the monopoly power. When adequate competition exists, it exerts pressure to keep costs low. In the electricity sector, states created regulatory bodies, such as the Commission, to ensure that the regulated monopoly does not arbitrarily increase costs and provides service at fair and reasonable rates. Increasingly this paradigm—a monopoly utility responsible for the generation, transmission, distribution, and delivery of utility services—is being upended. As such, components of the historical natural monopoly may no longer hold true.

The comments of Public Service Company of Colorado (PSCo) misread this change.[13] PSCo's comments implicate no need to change the historical role of the utility as the only provider of service and resources to customers, insisting that a few changes here and there are more than sufficient to address the question around PBR. PSCo, along with other commenters like AARP and the Office of Consumer Counsel, focus on minimal changes to the utility business model and recommend that any PBR or PIMs be focused primarily on existing or expanding the monopoly power of the utility.

R Street recognizes the important role the distribution system will and must play in the evolution occurring across the industry, which includes changes in customer preferences and an increasing amount of choice available to customers. The distribution system will be the key driver in enabling, facilitating, and realizing the benefits of those investments and resources to the customer, the market, and society. However, as COSSA and AEE observe, the existing monopoly structure is not best suited to realize these benefits once the evolution occurs. By focusing on the growth of DER and how to best extract the value of DER, there is a need to change the COS model to one based on true performance that puts the monopoly in a position that does not favor its own resources over those of others. This would be a truly performance-based model.

[11] *Id.* at 2–4.
[12] *Id.* at 5.
[13] Initial Comments of Public Service Company of Colorado, Proceeding No. 19M-0661EG, at 2 (Jan. 10, 2020) [hereinafter Initial Comments of PSCo].

In order to reach this future, R Street notes—in agreement with other parties—that there is a need to develop a pathway to that future, to identify associated policy changes to effectuate this future, and to determine clear principles and guidance. For example, multiyear rate plans and decoupling are procedural vehicles that enable the regulator and parties to ensure the utility is not over-collecting lest the utility defers or avoids the initiation of a rate case. Similarly, decoupling is a measure that tackles the monopoly's incentive to sell more electricity.

B. Process for developing PBR

R Street notes that several parties cited approvingly the process currently in place before the Minnesota Public Utilities Commission on PBR. R Street is an active party in that proceeding and offers its perspectives and guidance to the Commission on lessons learned. The Minnesota Commission is following a proposal from the state attorney general's office to engage in a deliberate and methodical approach to considering PBR.[14] In practice, the Minnesota Commission has yet to affirmatively state that Minnesota will consider a PBR mechanism; rather, the Minnesota process is collecting metrics that may or may not be used for a PBR or PIM mechanism. The result is that the proceeding lacks certainty as to whether the collected metrics will be used to implement a PBR mechanism, and parties like R Street are left uncertain as to the level of negotiation room left at this point in the process. Furthermore, the Minnesota Commission has given no sense of whether it will truly implement or consider a PBR mechanism.

R Street is not opposed to a metric collection effort on a standalone basis and would recommend that the Commission be clear on the purpose of the metric collection effort. R Street sees value in collecting metrics on all sorts of performance outcomes but, as the Minnesota process shows, there are dozens to scores of existing and potential metrics of interest to stakeholders. It remains unclear to what extent those metrics can or should be leveraged to develop the detailed metrics necessary for a PBR mechanism or the adoption of PIMs.

Considering R Street's participation in the Minnesota proceeding, R Street offers the following recommendation: The Commission should include, as part of this initial phase, the gathering of additional input on the feasibility of the current COS model for Colorado, including a determination as to whether the current monopoly structure will meet the goals of the state. These goals include reducing emissions, enhancing the efficiency of the electricity system, creating a more reliable and resilient system, supporting customer choice,[15] not infringing on the ability of customers to select their choice of product and service offerings, and adequately compensating or valuing those resources. Additionally, the Commission may want to consider

[14] *In the Matter of a Commission Investigation to Identify and Develop Performance Metrics, and Potentially, Incentives for Xcel Energy's Electric Utility Operations*, "Order Establishing Performance-Incentive Mechanism Process," Docket No. E-002/CI-17-401 (Jan. 8, 2019).
[15] See, for example, Polis Administration, *Roadmap to 100% Renewable Energy by 2040 and Bold Climate Action* 4 (May 30, 2019).

additional questions, including whether least-cost service is best provided by a monopoly, especially when customers are increasingly using their own funds to purchase and install distributed energy resources. As AEE, COSSA, and RMI recognize, the existing utility model over-values its own resources at the expense of other resources. Since the utility has much of the information about its own system, this leads to information asymmetry between the utility, the regulator, and other stakeholders, which puts all parties at a disadvantage in developing more optimal solutions. By sending a signal that the Commission intends to consider the viability of the existing COS model, stakeholders in this proceeding can focus on metrics, models, and mechanisms to best address this evolution.

The collection of metrics, as discussed in the comments of several parties, is an important part of this process—it is valuable for stakeholders to understand what the monopoly is already providing. But with a proactive statement from the Commission on its interest in addressing the COS model, stakeholders can tailor the work on metrics to those topics that best get at the utility's interest in capital accumulation. R Street encourages the Commission to consider as few metrics linked to PIMs as possible. As PSCo notes, the Minnesota process has collected a large number of metrics for consideration in its PBR proceeding.[16] Too many metrics will send mixed messages to the utility, complicate the collection and measuring of performance, and be unlikely to accomplish broader public policy goals.

C. Proposed Metrics

R Street provides comments on several of the metrics proposed by parties in their initial comments. At a high level, R Street agrees with AEE and suggests that the Commission not focus on those metrics that reward the utility for selling more widgets.[17] R Street's suggestion is that the Commission focus its efforts on metrics that go directly to a monopoly's interest in capital by making it agnostic as to the resource but partial toward affordability, efficiency, and optimization of a system that utilizes all resources.

1. PSCo

R Street concurs with PSCo in its observation that one common set of metrics may not be appropriate for all utilities.[18] However, the underlying challenge with COS models remains regardless of the size of the utility or service territory; the question is the level of impact that the move to PBR would have on the monopoly. For PSCo, which serves a more urban part of Colorado, there may be a greater need to act than for a utility that serves a more rural part of the state. For another utility, metrics that look more fundamentally to service quality may be more appropriate.

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[16] Initial Comments of PSCo, *supra* note 13, at 37; *see also*, Comments of RMI, *supra* note 8, at 13; Initial Comments of WRA, *supra* note 6, at 3.
[17] Initial Comments of AEE, *supra* note 5, at 16.
[18] Initial Comments of PSCo, *supra* note 13, at 10.

R Street does not recommend the Commission consider using customer satisfaction metrics for a PBR mechanism.[19] Customer satisfaction is an important metric to understand, but considering that the utilities are currently monopolies, tying a performance metric to customer satisfaction may risk other outcomes or goals. For example, if customer satisfaction is tied to a reward, then the monopoly would be incentivized to leverage its monopoly power over non-utility entrants. This highlights the need for as few performance metrics as possible, as well as the need for clarity in the development of any PBR mechanism and associated PIMs. In addition, the means by which a customer satisfaction rating may be developed, such as via JD Power, is fraught with inconsistency across years and utilities, and may not provide results that can be counted on for performance. In a working group meeting for Northern States Power in Minnesota (also an Xcel utility), Northern States provided a detailed review of JD Power's methodology, and attendees (including R Street) raised substantial concerns regarding the reliability and methodology of JD Power.

It is worth noting here that in 2004, the California Public Utilities Commission investigated Southern California Edison for manipulating its customer satisfaction PBR metric. The California Commission found that Southern California Edison had indeed manipulated this metric, and it took action against the utility. As a result, Southern California Edison was forced to return previously provided performance rewards and to pay penalties, and was prohibited from implementing a PBR mechanism in the future.[20]

2. COSSA

COSSA's metrics are tied to a reframing of the monopoly as a platform provider that enables additional customer services and benefits. For example, COSSA notes that potential performance mechanisms should be related to better interconnection processes, more successful interconnection proposals, and better availability of customer data to customer-authorized third parties.[21] R Street supports the direction of COSSA's metrics toward a utility that is more welcoming of non-utility resources and services and that enables market opportunities. As a monopoly, the utility has a preference for its own resources, especially those that are capital-intensive. In making utility preferences more agnostic, it may be appropriate to reward the monopoly for enabling those choices and allowing the utility to "earn" on a basis equivalent to capital for certain performance.

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[19] *See also* Initial Comments of AEE, *supra* note 5, at 11.

[20] *Investigation on the Commission's Own Motion into the Practices of the Southern California Edison Company to Determine the Violations of the Laws, Rules, and Regulations Governing Performance Based Ratemaking, its Monitoring and Reporting to the Commission, Refunds to Customers and Other Relief, and Future Performance Based Ratemaking for this Utility*, "Decision Regarding Performance Based Ratemaking (PBR), Finding Violations of PBR Standards, Ordering Refunds, and Imposing a Fine," Decision 08-09-038, Docket No. I-06-06-014 (Sept. 23, 2008).

[21] Initial Comments of COSSA, *supra* note 9, at 11–15.

3. AEE

Similar to COSSA, AEE recommends metrics that focus on improving the efficiency of utility operations and neutralizing utility preference for capital projects and its own resources.[22] R Street supports considering metrics that better focus utility operations on efficiency, including better utilization of resources—be they utility or customer—and a focus on reducing peak demand. However, R Street cautions that the use of certain reliability metrics, like System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI), may not be appropriate for compensation under a PBR structure. Those are existing metrics, and commissions are well aware of the role and importance of SAIDI and SAIFI. The Commission needs to recognize the difference between metrics and performance that are within the existing structure of the utility and those that require significant changes to operations to fulfill the goals of the Commission and the state. For example, utilities are arguably already regulated and incentivized to address SAIDI and SAIFI issues and performance. SAIDI and SAIFI are important metrics that give us a better understanding of the overall reliability of the system, but there may be incentives—such as rewarding the utility for better and more efficient interconnection and better utilization of all resources—that result in better reliability than incentivizing the monopoly to spend its way to better reliability performance.

4. WRA

R Street agrees with many of the overarching components of WRA's comments. However, R Street disagrees with the presumption that the utility should be incentivized to invest in more infrastructure or be allowed to invest and implement more technology solutions when the market and customer choice are growing. For example, WRA rightly notes that the existing business model does not incentivize a utility to make better use of non-wires alternatives or, by extension, enhance the efficiency and optimization of the system.[23] However, R Street reads WRA's comments to conclude that utilities should therefore be incentivized to invest in non-wires alternatives. R Street would rather see PSCo identify potential locations where non-wires alternatives may be appropriate and issue a request for proposal soliciting third-party solutions to that need rather than allowing the utility to invest in technologies itself. R Street prefers the position of COSSA, which calls for utility investments to be made to enable greater utilization of non-utility resources, over that of WRA, which would essentially allow the utility to both invest in new distribution infrastructure and earn on alternatives.

D. Alignment with other processes

This Commission proceeding is one of several the Commission has opened in response to legislation passed in 2019 looking at future-oriented electricity topics. The Legislature has identified several additional public policy goals—including reduction in greenhouse gas emissions—and Governor Polis has articulated a set of goals focused on competition, beneficial

[22] Initial Comments of AEE, *supra* note 4, at 5–6.
[23] Initial Comments of WRA, *supra* note 6, at 5.

electrification, and growth of DER.[24] R Street agrees with comments from WRA, among others, on the implicit need to ensure the end product of this proceeding aligns with other proceedings, such as distribution system planning.[25] As such, R Street would recommend that the Commission consider developing some guidance or a report on how these proceedings are being organized and aligned. A common refrain among comments is the importance of developing goals in this proceeding. Goals from this proceeding should align with any goals or principles adopted by the related proceedings. For example, a PIM that focuses on greater system efficiency and use of non-wires alternatives would be difficult to meet if the distribution planning proceeding did not identify non-wires alternatives as a component of the distribution planning process. As COSSA suggests, this proceeding should look at the long term in relation to metrics and the time it will take to develop metrics.[26] Development of goals and outcomes, with a recognition that this proceeding is not operating inside a vacuum, will greatly assist stakeholders and help align the process here with processes in other proceedings.

Conclusion

R Street appreciates the opportunity to provide these reply comments. R Street commends the stakeholders in this process for their thoughtful commentary on this important topic. R Street thanks the Commission for holding this forum for conversation on PBR and looks forward to continuing the discussion throughout this proceeding.

Respectfully submitted January 31, 2020.

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[24] Polis Administration, *Roadmap to 100% Renewable Energy by 2040 and Bold Climate Action*.
[25] Initial Comments of WRA, *supra* note 6, at 5, 7–8.
[26] Initial Comments of COSSA, *supra* note 9, at 17.