

March 6, 2018

Daniel P. Wolf, Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, MN 55101

**RE: CENTER FOR ENERGY AND ENVIRONMENT’S REPLY COMMENTS IN THE MATTER OF A COMMISSION INVESTIGATION TO IDENTIFY AND DEVELOP PERFORMANCE METRICS AND, POTENTIALLY, INCENTIVES FOR XCEL ENERGY’S ELECTRIC UTILITY OPERATIONS
DOCKET No. E-002/CI-17-401**

Dear Mr. Wolf:

Center for Energy and Environment (CEE) appreciates the opportunity to provide Reply Comments in the Matter of a Commission Investigation to Identify and Develop Performance Metrics and, Potentially, Incentives for Xcel Energy’s Electric Utility Operations. We thank the Minnesota Public Utilities Commission (Commission) for opening a docket to discuss this important topic, as well as all the parties who submitted Comments. While we will not respond to each Commenter in our response, we believe that each party who submitted Comments represents an important stakeholder in this discussion and appreciate everyone’s engagement with this topic.

For our Reply Comments, we will first discuss our support for a performance-based compensation model. We will then address the proposed performance incentive mechanism (PIM) design process included in the Office of the Attorney General—Residential Utilities and Antitrust Division’s (OAG) December 21, 2017 *Comments* in this docket. We will then discuss how the e21 Initiative’s performance-based compensation work can inform the PIM design process and CEE’s suggested starting point for determining goals. Next, we will address the Department of Commerce, Division of Energy Resources’ (Department) recommendation that the Commission retain an outside consultant to assist in the development of performance metrics for Xcel Energy. Finally, we will respond to Xcel Energy’s suggestion about re-purposing the Conservation Improvement Program (CIP) to fund and incent a reduction in peak demand or load shifting.

Performance-Based Regulation

CEE supports the integration of additional performance metrics and incentives as the next phase of the continuously evolving utility business model in Minnesota. We see the investigation of performance-based compensation for Xcel Energy as an important step in ensuring that Minnesota’s current utility business model continues to be aligned with the public’s interests and expectations. We hope and expect that the lessons learned in this investigation will inform the application of performance metrics and incentives to other utilities in Minnesota. Further, we see

significant benefits from this docket extending beyond Minnesota to other states with similar regulatory frameworks.

Today's utility cost-of-service model arose many decades ago in reaction to the market conditions at that time. The cost-of-service model was designed to reward utilities for investing in needed utility infrastructure and providing service to all ratepayers in their service territory. The model allowed the utility to recover the costs of, and earn a rate of return on, their investments through the rates they charged customers. Utilities were able to recover investment expenses while also keeping rates relatively low by increasing energy sales, over which they would spread the costs of their investments. This model worked exceptionally well to extend the benefits of electric and natural gas service to customers throughout the country.

As described in the OAG's *Comments*, over time, regulators and the public recognized that the incentives of the cost-of-service model often bumped up against other public policy goals. The cost-of-service model "encourage(s) utilities to promote electricity use and then build power plants to meet the resulting demand growth. Over time, this singular focus began to conflict with emerging concerns like energy efficiency and conservation, as well as other state policy goals."¹ To correct for these conflicting policy goals, regulators developed new regulations and policies to overlay on top of the cost-of-service model. In many cases, these explicit incentives worked well to incent utilities to take actions that support the public good, even if they do not necessarily support the utility's business model. In the case of Xcel Energy, this phenomenon is particularly apparent from their notable achievements in de-carbonizing their electric supply and their energy conservation program. This layering of regulation, as discussed at length in *Comments* filed by the OAG, while often effective, creates a tangle of implicit and explicit incentives that often pull the utility in opposite directions. This model of explicit incentives combined with cost-of-service regulation continues to work well in Minnesota today, but there are new challenges on the horizon.

In recent years the electric industry has experienced swift, disruptive changes from low load growth, the need to invest in aging infrastructure, increasing deployment of distributed energy resources, the growing demand to reduce the environmental impacts from fossil-fueled electric generation, and changing customer expectations. These recent dynamics present challenges for our current utility compensation model. We believe that an incremental shift toward a more performance-based metrics and incentives, if done carefully, could help ensure the continued alignment of the utility's financial interests with the public's interest and expectations. As stated in Fresh Energy's *Comments*, "If designed well, a performance-based system can change the motivation of utility management, aligning its focus with the public interest at a fundamental level, changing design decisions large and small to the benefit of customers."²

This realignment of the utility's financial health with the increasing customer and public policy expectations it faces is exactly why CEE, jointly with the Great Plains Institute, started the

¹ Page 6 of the OAG's December 21, 2017 *Comments* in this docket.

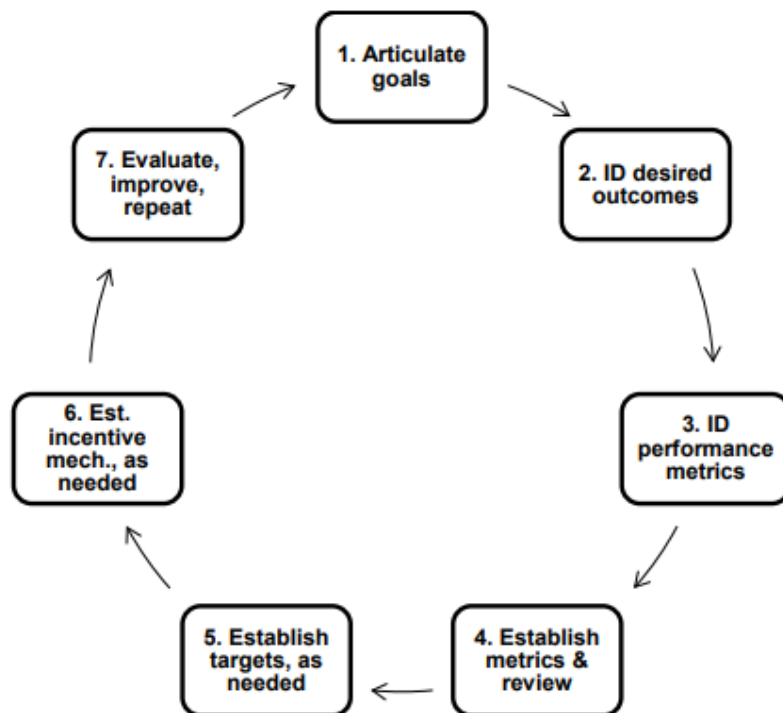
² Page 2 of Fresh Energy's December 21, 2017 *Comments* in this docket.

Minnesota e21 Initiative stakeholder conversations in 2014. Throughout the second phase of the e21 Initiative, participants explored the idea of performance-based utility regulation extensively. We are pleased that these ideas are now being considered by the Commission and hope that our work through the e21 Initiative will contribute to the process.

Office of the Attorney General’s PIM Design Process Proposal

CEE commends the OAG for taking such an active role in this docket and proposing a concrete and organized process for moving forward. Exploring a performance-based regulatory model, which represents a significant shift in the utility regulatory framework, is a monumental undertaking and will require a rigorous and collaborative process. We believe that the PIM design process, as proposed by the OAG, is well-suited to fill that need. Below, we highlight certain elements of the proposed PIM design process that we find to be particularly helpful as regulators, Xcel Energy, and stakeholders explore potential changes to Xcel Energy’s regulatory model.

In its Comments, the OAG presented and proposed the seven-step PIM design process to enable the Commission to take high-level regulatory goals and transform them into actionable performance metrics that are tied to desired regulatory outcomes. Below is Figure B³ from the OAG’s *Comments*, which depicts each stage of the PIM design model.



The OAG recommended that the Commission limit the initial phase of its investigation (Phase 1) to the first four steps of the PIM design process: the articulation of state energy goals, identification

³ Page 17 of the OAG’s December 21, 2017 *Comments* in this docket.

of desired outcomes, the identification of performance metrics, and the establishment of reporting requirements for chosen metrics. Following Phase 1, the OAG suggested an interim step, that they call “Phase 1.5,” in which stakeholders would have an opportunity to provide feedback, possibly through facilitated discussions or workshops; further research possible metrics; and develop a scorecard reporting mechanism.

CEE supports the OAG recommendation of focusing the initial work of this docket on the first four steps of the process and then pausing to give stakeholders and regulators time to assess the progress made, react to the results of the first four steps, and make adjustments if necessary. As we mention above, a performance-based regulatory model is an important evolution of Minnesota’s current utility regulatory model. Unless we work through the issues implicated by this evolution in a rigorous, focused way, regulatory paralysis or a sub-optimal outcome may be the result. CEE believes that the limited scope and the clear, sequential steps of Phase 1 of the OAG’s proposal will allow stakeholders, regulators, and Xcel Energy to make progress in identifying appropriate performance goals, outcomes, and metrics. The subsequent pause for reflection and adjustments will create an iterative process, ensuring a degree of flexibility that is critical in any regulatory shift of this magnitude. Moreover, we also believe that the collaborative nature of the proposed PIM design model is an excellent feature of the process. We see facilitated workshops and discussions as a necessary component of arriving at goals, outcomes, and metrics that appropriately align the utility’s business interest with the interest of the public they serve. We envision that the PIM design process would engage a stakeholder group made up of those who filed Comments in this docket and are currently meeting to discuss these important issues in a roundtable convened by the e21 Initiative and facilitated by the Great Plains Institute. We would further enhance the OAG proposal by recommending that, in addition to the stakeholder engagement of Phase 1.5 (at the end of step four), the stakeholder group be convened for each step of Phase 1 of the PIM design model (steps one through four) and drive the outcomes associated with each step. The e21 Initiative conversations to date demonstrate that a broad cross-section of Minnesota stakeholders are willing to commit the time and resources needed to make that degree of stakeholder collaboration in this docket a success, allowing everyone to travel the learning curve on these issues together.

In addition to proposing the PIM design process, the OAG recommended the development of a “scorecard” tool to track and report on Xcel Energy’s achievement of the identified goals, outcomes, and metrics. The Department echoed that recommendation in its *Comments*⁴ as well. The Department describes the purpose of a scorecard as “provid[ing] the Commission with a continually updated snapshot as to how a particular utility is performing relative to the goals the Commission has identified.”⁵ Similarly, the OAG highlighted the value of the scorecard, stating that “a successfully designed and implemented scorecard will present information in an accessible, clear, comprehensive, and up-to-date manner.”⁶

⁴ The Department’s *Comments* filed on December 21, 2017 in this docket.

⁵ Page 8 of the Department’s December 21, 2017 *Comments* in this docket.

⁶ Page 24 of the OAG’s December 21, 2017 *Comments* in this docket.

CEE supports the development and use of a public-facing scorecard tool. We see the scorecard as a way to increase transparency and accountability to customers, regulators, and other interested stakeholders. We recommend that the development and design of a scorecard tool take place through the collaborative PIM design process, likely in Phase 1.5, and that the implementation of the scorecard begin as soon as the utility begins tracking its performance against the identified metrics.

e21 Initiative Principles for the Selection of Outcomes and Metrics

Co-led by CEE and the Great Plains Institute, the e21 Initiative included an extensive, collaborative exploration of performance-based utility compensation. That work culminated in the *White Paper: Performance-based Compensation Framework (Performance White Paper)*, which was published as a part of the *e21 Initiative Phase II Report*⁷ and submitted in the initial round of Comments in this docket. The *Performance White Paper* includes a set of principles to guide the selection of performance-based outcomes and metrics. Several parties who submitted Comments in this docket provided a similar set of guidance, and CEE believes that these principles are critical in the development of performance goals, outcomes, and metrics as the Commission moves forward in this docket. The e21 Initiative's principles for performance-based outcomes and metrics are as follows:

Performance outcomes should:

- a. Tie back to accomplishing the e21 guiding principles⁸ and outcomes.
- b. Tie back to state and federal policy goals.
- c. Represent areas that electricity customers value and deliver benefits to all customers.
- d. Prioritize areas of performance and metrics that are most important to regulators.

Performance metrics should be:

- e. Clearly defined and transparent.
- f. Measurable and verifiable by any third party using available, high-quality data.

⁷ http://www.betterenergy.org/sites/default/files/e21_PhaseII_Report_2016.pdf

⁸ The e21 Initiative stakeholders adopted a set of ten principles early in 2014 that has guided the process and deliberations ever since. Those ten guiding principles are:

1. Align an economically viable utility model with state and federal public policy goals.
2. Provide universal access to electricity services, including affordable services to low-income customers.
3. Provide for just, reasonable, and competitive rates.
4. Align payments to and by participants on the system with the costs and benefits they impose on and provide to the system.
5. Enable the delivery of services and choices that customers value, and compensate utilities, customers and service providers for the full range of services they provide.
6. Allow for timely and predictable recovery of utilities' fixed costs that are not necessarily dependent on commodity sales.
7. Encourage and enable electricity users to take advantage of all cost-effective energy efficiency and other demand-side management opportunities.
8. Facilitate innovation, implementation of new technologies, and delivery of new energy services.
9. Assure system reliability, and enhance resilience and security, while addressing customer privacy concerns.
10. Foster investment that optimizes economic and operational efficiency of the system.

- g. Drawn from data already reported today, if possible.
- h. Reasonably within the utility's control.
- i. Simple and easy to interpret and communicate.
- j. Directly tied to the desired outcome.
- k. Agnostic on specific means to achieve the outcome.

Additional considerations could include:

- l. Bearing in mind potential trade-offs and interactions between metrics.
- m. Allowing sufficient time to understand whether or not metrics are effective in measuring performance, thereby avoiding frequent changes to the metrics.
- n. Using pilot programs to encourage, and pave the way for, exemplary performance (that is, allowing utilities to use pilot programs to explore novel ways of achieving desired performance outcomes).

CEE recommends that the e21 Initiative's guiding principles and the principles for the selection of performance outcomes and performance metrics be adopted by the Commission for use in the PIM design model in this docket. CEE also recommends that the PIM design process incorporate the conclusions of the e21 Initiative's performance-based compensation work, as described in the *Performance White Paper*.

CEE's Suggested Goals

Though we recommend a robust stakeholder discussion to arrive at the overarching goals from which to build Xcel Energy's performance outcomes and metrics, we offer the following suggested goals as a starting point for step one of the PIM design process:

- **Enhancing the Customer Experience:** As we continue to evolve to new utility business models, we need our utilities to be more customer-centric and focused on identifying and meeting their customer needs. Enhancing the customer experience should be an explicit goal for this docket.
- **Improving Utility Performance:** The cost-of-service model provides checks and balances for ensuring operational effectiveness, and we do not want the utility to lose focus on effective and efficient operations as we take incremental steps away from the cost-of-service model. As the OAG stated, "The regulatory goal of operational effectiveness requires utilities to deliver obligations of service in a least-cost manner to ratepayers. A number of regulatory tools, including integrated resource plans, multi-year rate plans, and prudence reviews are intended to promote operational effectiveness."⁹
- **Reducing Carbon Emissions:** The broad public interest requires that our utilities continue to take aggressive and cost-effective measures to decarbonize our economy. The PIM process should ensure Xcel Energy continues to reduce the carbon emissions from its own power supply and then incentivizes the use of that decarbonized electric supply in other parts of the economy when doing so displaces higher carbon fuel sources, saves customers money, and reduces energy consumed.

⁹ Pages 29-30 of the OAG's December 21, 2017 *Comments* in this docket.

Recommendation to Hire a Consultant

In its *Comments*, the Department recommended that the Commission consider retaining an outside consultant to aid the Commission in its development of additional independently calculated performance benchmarks and metrics for Xcel Energy. CEE agrees that the Commission should consider hiring a consultant to assist in the implementation of the PIM design process to develop performance goals, outcomes, and metrics. Our vision is that this consultant would help facilitate and support the robust stakeholder process we discussed above, in which stakeholders representing a variety of perspectives come together to work through each of the steps of the PIM design process. We believe that extensive stakeholder involvement in the development of a utility performance model will result in goals, outcomes, and metrics that best align with public interest. Moreover, meaningful stakeholder involvement will foster ownership and buy-in of the resulting goals, outcomes, and metrics, which will be critical to the long-term success of the model.

CEE recommends employing a third party consultant to facilitate the collaborative stakeholder process we discuss above. We encourage the Commission to select a consultant with the proven ability to facilitate a diverse range of stakeholders to consensus on complex energy issues, experience with a broad cross section of Minnesota energy stakeholders, and a deep understanding of the performance-based regulatory model as it relates to Minnesota's current regulatory framework. We believe that our e21 Initiative partner, the Great Plains Institute, would be terrific in this role. In fact, the Great Plains Institute is already facilitating a stakeholder process around this topic through the e21 Initiative; all participants in this docket have been invited and most attend these Great Plains Institute-facilitated meetings.

Xcel Energy's Suggestion to "Re-purpose CIP"

In its December 21, 2017 *Comments* in this docket, Xcel Energy rightfully touted its nation-leading energy savings achievements under the CIP, but then followed up that discussion with the following comment: "[W]e believe there are opportunities to re-purpose CIP to fund and incent the Company to develop, in conjunction with stakeholder input, next wave rate designs that reduce peak demand or shift load while leveraging new technologies."

We are unclear about what Xcel Energy means by "re-purposing CIP." CIP is a critical tool in meeting the state's energy savings policy goal, which states, "that cost-effective energy savings are preferred over all other energy resources."¹⁰ Since its origin in the 1980's, CIP has served the long-term interests of utility customers by ensuring that ratepayers are not asked to pay for unneeded utility investments. CIP is part of a broader ratepayer protection framework that includes a number of Minnesota utility processes that help to ensure that the investments a utility makes or wants to make are actually needed, and that the costs for those investments are prudent. In addition to CIP, these processes include rate cases under Minnesota Statutes 216B.16, Integrated Resource Planning under Minnesota Statutes 216B.2422, and Certificates of Need under Minnesota Statutes 216B.243. As a result of these processes, Minnesota has been able to maintain utility energy costs that are consistently lower than the national average.

Energy conservation – the reduction in energy consumption and the more efficient use of the energy consumed – results in reduced consumer costs, reduced utility capital costs, and right-

¹⁰ Minnesota Statute 216B.2401

sizing of energy loads. Those outcomes will only become more important in the coming years. To “re-purpose” away from these outcomes would undermine the state’s energy savings policy goal referenced above and undermine the program’s value to utility customers. However, CIP has constantly evolved through statutory, regulatory, utility, and implementer processes to ensure that the greatest net benefits from energy efficiency are captured for utility customers. It appears from the Xcel Energy response to an Information Request (IR) from the OAG¹¹ that, far from re-purposing CIP, Xcel Energy is committed to continuing that evolution. In that IR response – directly to the question of what the utility means by “re-purposing CIP” – Xcel Energy stated that “...as our system continues to evolve and include increasing levels of renewable resources, the time value of energy savings will become an important benefit of our CIP in the future. We believe there are opportunities to evolve CIP by leveraging innovative strategies that align with the transformation of our generation resources.”

We view the additional emphasis on the time value of energy savings in CIP as an example of how the CIP program could potentially evolve to capture greater net benefits; not as a “re-purposing” of the program. It seems to us that Xcel Energy used the phrase “re-purpose” in-artfully with respect to its intentions for CIP. We expect and believe that Xcel Energy will continue its nation-leading energy conservation programs and achievements.

Conclusion

In conclusion, CEE recommends the following.

- CEE supports the investigation of a performance-based regulatory model for Xcel Energy’s electric operations in Minnesota. We believe that additional movement toward a regulatory structure that is more performance-focused, if done carefully, could better align utility operations with the public’s interest and expectations, and accelerate the good work that Xcel Energy is doing in Minnesota.
- CEE endorses the OAG’s proposed PIM design process and recommends that the Commission adopt the PIM design model for determining performance metrics for Xcel Energy’s electric utility operations. We recommend that a stakeholder group be involved in each step of Phase 1 of the PIM design model and drive the outcomes associated with each step.
- We encourage the Commission to incorporate the e21 Initiative’s work to date on performance-based regulation, particularly the e21 Initiative’s guiding principles and principles for the selection of performance outcomes and performance metrics, into the PIM process. We offer suggested goals as a starting point for initial step in the PIM design process.
- We support the Department’s recommendation that the Commission hire a third party consultant to assist in the development of performance goals, outcomes, and metrics. We recommend that the Commission hire a qualified consultant to facilitate the robust stakeholder process we describe above.

¹¹ Xcel Energy’s December 29, 2017 response to Information Request No. 14 issued by the OAG is attached to this filing for reference.

CEE appreciates the opportunity to provide input on this docket and thanks the Commission for its consideration of our remarks.

Sincerely,

/s/

Audrey Partridge
Regulatory Policy Manager

Cc: CIP Service List

Therefore, as our system continues to evolve and include increasing levels of renewable resources, the time value of energy savings will become an important benefit of our CIP in the future. We believe there are opportunities to evolve CIP by leveraging innovative strategies that align with the transformation of our generation resources.

Preparer: Shawn White
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Telephone: 612-330-6096
Date: January 11, 2018

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AFFIDAVIT OF SERVICE

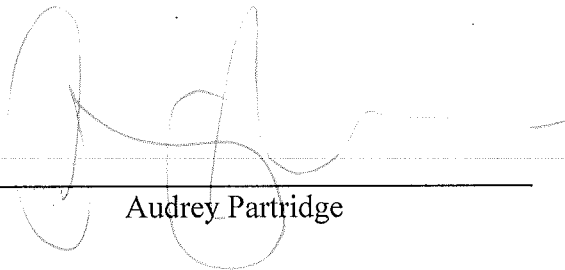
Docket No. E002/CI-17-401

I, Audrey Partridge, herby certify that on this 6th day of March 2018, I served *Reply Comments In the Matter of a Commission Investigation to Identify and Develop Performance Metrics and, Potentially, Incentives for Xcel Energy's Electric Utility Operations MPUC Docket No. E-002/CI-17-401* on the following persons on the attached Service Lists by:

XX placing such filing in envelopes, properly addressed, and depositing the same in the Post Office at the City of Minneapolis, for delivery by the United States Post Office as directed by said envelopes.

XX electronic filing





Audrey Partridge

Subscribed and sworn to before me
this 6th day of March 2018.



Notary Public

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Generic Notice	Commerce Attorneys	commerce.attorneys@ag.state.mn.us	Office of the Attorney General-DOC	445 Minnesota Street Suite 1800 St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_17-401_Official
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