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| Order Instituting Rulemaking to Create a Consistent Regulatory Framework for the Guidance, Planning, and Evaluation of Integrated Distributed Energy Resources. | Rulemaking 14-10-003 (Filed October 2, 2014) |

**COMMENTS OF CLEAN COALITION**
**ON ASSIGNED COMMISSIONER'S RULING**
**INTRODUCING A DRAFT REGULATORY INCENTIVES PROPOSAL**

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## I. INTRODUCTION

Background.

The Clean Coalition submits the following responses to the Assigned Commissioner's Ruling Introducing a Draft Regulatory Incentives Proposal for Discussion and Comment ("Proposal") and to the specific questions contained therein, in accordance with Rules of Practice and Procedure of the California Public Utilities Commission ("Commission").

The Clean Coalition is a nonprofit organization whose mission is to accelerate the transition to renewable energy and a modern grid through technical, policy, and project development expertise. The Clean Coalition drives policy innovation to remove barriers to procurement and interconnection of distributed energy resources ("DER")—such as local renewables, advanced inverters, demand response, and energy storage—and we establish market mechanisms that realize the full potential of integrating these solutions. The Clean Coalition also collaborates with utilities and municipalities to create near-term deployment opportunities that prove the technical and financial viability of local renewables and other DER.

SUMMARY:

- The Clean Coalition strongly supports the Commission in seeking to align the pathways for investor owned utilities to meet shareholder interests with California State policy goals and ratepayer interests, and supports the Proposal as a valid and appropriate step.

- The basic mechanism described in the Proposal and in the Appendices is accurate. We support moving forward with a pilot using the proposed 3.5% approximation of these values while seeking additional input on utility shareholder comparative valuation of alternatives. We identify limitations of the pilot itself, and suggest other necessary policies that will help direct the utilities' activities toward cost-effective DER sourcing.

- Additional attention is warranted regarding evolving utility business environment, appropriate business models to align incentives with ratepayer interest and other public policy goals. The incentive program described is only one piece of the much broader policy framework that is required to promote the widespread utilization of cost-effective DERs. The Commission should establish a clear IDER Roadmap including issues that should be considered as part of a necessary broader approach to addressing DER compensation and aligning ratepayer and shareholder interests and incentives.

- The Commission should set minimum participation goals for the pilot. These goals should include a minimum number of projects and the procurement of a range of grid services to encourage optimal learning from the pilot. Penalties should apply absent a sufficient showing of cause if goals are not met (need to define, recommend pay for performance based on incentive or penalty based on the degree to which the goals are exceeded or deficient).

- Consideration should be given to utilities and any utility-subsidiaries being direct participants in the provision of a percentage of DER services through this pilot.

## I. COMMENTS

### *a.* Discussion

The Clean Coalition strongly supports the Commission in seeking to align the pathways for investor owned utilities to meet shareholder interests with California State policy goals and ratepayer interests, and supports the Proposal as a valid and appropriate step.

The Proposal correctly notes that utility industry is capital intensive as the generation, transmission, and delivery of electricity requires significant investment in

assets. Traditional cost-of-service (COS) regulation provides utilities with a return of and on capital investments as an incentive to drive utilities towards building and maintaining their systems in order to provide customers with reliable and affordable service. Under traditional COS regulation, a utility is motivated to solve system reliability and customer access issues by investing capital instead of maximizing the value it can extract from existing assets.

Alternatively, a utility may focus on extracting maximum value through the efficient use of existing assets (e.g., use a customer's distributed generation system to improve distribution system reliability in lieu of expanding/upgrading the distribution network) or build incremental assets that maximize creation of value (e.g., replace aged distribution infrastructure with "smart" distribution automation technologies that has the ability to better integrate distributed generation).[1] Effective transition strategies for utilities to migrate toward increasing shareholder value through means other than a focus on capital investment can help mitigate risk to utility shareholders, customers, and third-party providers of DER services and also facilitate achievement of DER public policy goals.

The Clean Coalition recommends establishment of an IDER Roadmap leveraging past experience to include the following issues that should be considered as part of transition strategies in this or related proceedings:

- Utility roles in providing value-added services
- Market structure and asset ownership
- Planning and operational responsibilities
- Incremental changes to Cost of Service regulation
- Openness of utility networks
- Regulatory processes
- Assessing and ensuring ratepayer benefits

As the Commission is considering how value is distributed between the customer, utility, and third party service providers, it should consider how revenue streams for these

[1] See: 'A Framework for Organizing Current and Future Electric Utility Regulatory and Business Models', Andrew Satchwell, Peter Cappers, Lisa Schwartz, and Emily Martin Fadrhonc, June 2015. DOE Contract No. DE-AC02-05CH11231. Available at lbl.gov/future-electric-utility-regulation-series

projects will be identified and supported so that the DER owner's cost recovery process itself does not become a barrier to the encouragement of such projects, and the best way to leverage private investment as a component of projects in order to minimize ratepayer costs.

The shortcomings of traditional COS in providing electric utilities with incentives that are aligned with certain regulatory goals are becoming increasingly clear. COS can provide strong incentives to increase the utility rate base, while failing to provide utilities with appropriate financial incentives to address evolving industry challenges such as changing customer demands for electricity services, increased levels of distributed energy resources (DERs), and growing pressure to mitigate carbon dioxide emissions.

Performance-based regulation (PBR) of utilities has emerged as an important ratemaking option in the last 25 years. It has been implemented in numerous jurisdictions across the United States and is common in many other advanced industrialized countries. PBR's appeal lies chiefly in its ability to strengthen utility performance incentives relative to traditional cost-of-service regulation. Some forms of PBR can streamline regulation and provide utilities with greater operating flexibility, while others have proven burdensome to implement effectively. Ideally, the benefits of better performance are shared by both the utility and its customers. In addition, attention to potential new regulatory models to support the "utility of the future" has renewed interest in PBR and other more recent alternative approaches including that of a Distribution System Operator or service provider independent of the infrastructure owner. Regulators must balance consumer, utility, and other interests with the goal of achieving a result that is in the overall public interest.

Regulators and stakeholders who would like to promote improvements in utility performance should consider what areas of performance are most in need of improvement and are most critical in a high DER future. If their main concern is to improve performance in specific areas, stand-alone measures such as outlined in this Proposal might be sufficient to address these areas. If they instead seek wide-ranging performance improvements, including better capital cost management, broader measures may be better suited to these goals.

*b.* **Responses to Questions**

1. ***Is the description of the source of utility shareholder value summarized above and discussed in the Appendices accurate? If not, why not?***

The description is accurate but not complete. It is accurate to recognize that the value of a rate of return on an investment must consider not only the rate earned on the capital investment but also the cost of that capital ($r$ - $k$). It should also be recognized that the value of an investment is largely proportional to its scale, and larger investments realize greater economies of scale, including significant administrative efficiencies. A single large investment will be much more attractive than the same quantity of investment at the same $r - k$ valuation spread across several smaller investments, much less hundreds of smaller DER investments. As such, it would be more accurate to both consider the scale of the investment as a value multiplier ($r$ - $k$) × $s$, and the cost of related administration or overhead ($a$), resulting in ($r - (k + a)$) × $s$. In addition, capital investments are subject to a variety of tax considerations including depreciation schedules and credits that are not captured when only looking at the authorized rate of return on capital minus the cost of that capital ($r$ - $k$), and these factors will significantly impact utility shareholder value.

We do not necessarily recommend adjusting the approved rate of return to account for these factors, but we do recommend accounting for these factors in understanding investor behavior and designing appropriate policy and compensation mechanisms.

2. ***Would an incentive program such as that described above achieve the objective of promoting the cost-effective deployment of DERs? If not, why not?***

The proposed incentive program described, or some variant thereof, is only one piece of the much broader policy framework that is required to promote the widespread deployment of cost-effective DERs. The proposal is a helpful step in addressing disincentives utilities encounter under current practices regarding the use of third party or customer owned DER resources and will support some cost effective deployment of DER

to avoid more expensive conventional investments. However, there are several issues that may limit more widespread deployment of cost-effective DERs, and will need to be addressed by the Commission.

In many cases RFOs may prove too burdensome, and alternative sourcing mechanisms may be more appropriate in deploying cost-effective DERs. This is already indicated in utility positions reflected in the Load Modifying Demand Response Valuation Working Group Report in which project deferral value would only be considered for projects greater than $1,000,000. The Clean Coalition joins with other parties in strongly encouraging and looking forward to the exploration of tariffs or other market-based mechanisms in the next phases of this proceeding.

More broadly the Commission should consider the structural incentives of the existing utility model in which shareholders find limited opportunities for business growth and increasing value, and little incentive to decrease costs for ratepayers through improved efficiency, while facing potential conflict of interest when selecting between utility owned assets and competitive alternatives from other parties. Separating the roles of distribution planning and operation from the roles of asset owner would address this, as California has already done with regards to generation and transmission facilities. Such issues are well beyond the scope of this Proposal on regulatory incentives, but central to the fundamental issues it is seeking to address.

More narrowly, we note again that the gross rate earned on the capital investment minus the cost of that capital ($r$ - $k$) does not account for additional factors the utility or any business must consider when comparing the value of either individual investment options, or total investment. In addition to the factors mentioned in response to the above question, the Commission must also consider that larger total investment at the same rate of return will result in greater investment opportunity. While a regulated utility is under an obligation to seek the most cost effective level of investment on behalf of ratepayers, the opportunity for growth provides countervailing incentive in favor of higher levels of investment – and if the number of investments is limited, then larger investments are preferred. Regulatory oversight prevents excessive investment, however this process is burdensome on the Commission and historically has not proven to be as effective as market mechanisms for achieving the greatest efficiencies over time.

### *3. What alternative approaches should the Commission consider at this time?*

Rather than following a traditional RFP/RFO method where the utility has pre-diagnosed the solution, instead utilities should identify the problem and the market should propose solutions, leaving the utility to determine which third party proposal provides the most valuable solution. In that regard, as part of utility outreach to potential third party partners, utilities should provide sufficient data to enable market participants to propose solutions to clearly defined problems.[2] As the Clean Coalition and other parties have commonly noted, portfolios of DERs be considered during utility solicitations rather than limiting the RFOs to specific or single resource types.

As we have noted however, in many cases RFOs may prove too burdensome. This approach also results in the creation of a potentially complex system of individual contractual obligations between multiple parties. The Clean Coalition strongly recommends consideration of approaches to simplify access by grid operators to DER, and access by DER operators to grid service compensation and other value streams, such that grid capacity and all DER capabilities will be optimally utilized. The distribution grid operator manages the physical connection between all system, customer and third party resources and may be the natural intermediary to manage use of resources and compensation, including interaction with the ISO and with local aggregators or individual customers. The paper attached by the Commission to the Final Guidance on Distribution Resource Planning established an initial starting point for discussion,[3] and further consideration is warranted in this IDER proceeding. As such, we see the current proposal as a positive interim step that should be taken in conjunction with development of a

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[2] See 'MEMORANDUM AND RESOLUTION ON DEMONSTRATION PROJECTS' December 12, 2014 (p9). New York Public Service Commission, Case 14-M-0101 - Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision. See also Utility Engagement in DER - Staff Proposal 'ORDER ADOPTING REGULATORY POLICY FRAMEWORK AND IMPLEMENTATION PLAN' Issued and Effective: February 26, 2015(p62).

[3] '21st Century Electric Distribution System Operations' Lorenzo Kristov & Paul DeMartini, May 2014. See also DISTRIBUTION SYSTEMS IN A HIGH DISTRIBUTED ENERGY RESOURCES FUTURE: Planning, Market Design, Operation and Oversight' Paul DeMartini & Lorenzo Kristov, October 2015**.** Available at lbl.gov/future-electric-utility-regulation-series

Roadmap to address more fundamental evolution of utility opportunities for increasing shareholder value in alignment with ratepayer value and related State policy goals.

This may include utility investment in DER under appropriate restrictions to avoid unfair market advantage, a topic for which codes of conduct are currently being finalized in New York proceedings.[4]

4. ***Is the proposed incentive, in the range of 3.5% grossed up for taxes, approximately correct?***

Yes, 3.5% is approximately correct for ($r$ - $k$). However, as noted above ($r$ - $k$) may not be the only basis for income, and it should not be assumed that this will be effective in of itself in achieving the Commissions goals. For this reason, further consideration should be given to the realized comparative value to both shareholders and ratepayers to ensure that ratepayers are at least not negatively impacted while minimizing existing disincentives realized by shareholders.

Simply removing the existing financial disincentive does not induce any motivation for utilities to adjust their practices. Therefore, we further recommend that minimum procurement targets be established as a necessary incentive to ensure utilities utilize DER under the proposed circumstances in which they realize no financial advantage over existing investment strategies and overcome the barriers associated with new products and practices.

5. ***Are there other disincentives to the deployment of DERs that this proposal does not address that should be considered at the same time? If so, please explain.***

See response to Questions 1 & 2.

Competitive procurement through the conventional RFO framework creates a substantial burden on both the utility and DER providers. Alternative sourcing mechanisms including standard offer tariffs and compensation for a range of services, or

[4] 'STAFF'S PROPOSED GUIDING PRINCIPLES FOR REVISED UTILITY CODES OF CONDUCT' April 4, 2016. New York Public Service Commission, Case 15-M-0501 In the Matter of a Review of Utility Codes of Conduct as Impacted by Reforming the Energy Vision, and CASE 14-M-0101 Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision.

bundled procurement, is likely essential to enable participation of DER to anywhere near its full potential. These additional sourcing options should allow utilities and providers to realize the full value stack DERs can provide.

6. ***Is the suggested process for identifying and approving DER projects that would generate an incentive reasonable and appropriate? How could the process be improved?***

We ask that the Commission consider ways that third parties, in addition to utilities, can identify DER projects for procurement. Beyond this, we again note that there is little if any incentive for utilities to seek out DER alternatives under current business structures even if this Proposal is implemented as outlined. With minimum procurement targets the suggested processes would avoid inappropriate procurement, but would fail to realize much of the potential for DER contribution.

The proposed incentive will need to be accompanied by other policies that provide transparency and direct the utilities' activities toward cost-effective DER sourcing. The Commission should continue to develop a more comprehensive policy framework that provides additional transparency, accountability, and direction to utilities. Without this framework, the proposed incentive will not be sufficient, alone, to achieve the Commission's goals. In the interim the Commission should pursue more complete and transparent locational needs and potential net benefits analysis, and ensure that this information is fully accessible to parties wishing to identify net DER value.

7. ***Is there need for a limit on the number of projects or the amount of dollars that a utility could propose during this pilot program? If so, what should it be?***

We oppose limiting either the number of projects or the total value of those projects undertaken during the pilot program. Our understanding of the proposal is that customers "should always be better off paying the incentive than if the utility had just gone ahead with the planned investment,"[5] so there is little reason to limit this benefit to utility customers. It is highly unlikely that any utility will propose "too much" DER as the result of this incentive. For the reasons described above, it is more likely that

[5] Ruling page 8.

*minimum* requirements will be needed to spur activity. Thus, the Commission should set minimum requirements for procurements through the pilot program. These requirements should include a minimum number of projects and the procurement of a range of grid services to encourage optimal learning from the pilot.

8. ***Would participation in a DER solicitation by a utility affiliate require any changes to the Affiliate Transaction Rules, or any changes to the process for review and approval of proposed DER solutions?***

This warrants further review. As noted above in response to question 3, participation by utilities or their affiliates need not be prohibited but should only be allowed under appropriate restrictions to avoid unfair market advantage. Codes of conduct are currently being finalized in New York proceedings to address this specific topic.[6]

9. ***What would be the appropriate role of the IOUs themselves in the deployment of cost-effective DERs? Should direct IOU participation in DER deployment be encouraged, foreclosed, or allowed with certain caveats? Please fully explain your answer.***

There is no fundamental basis for prohibiting a utility from investing in DER resources as an alternative to investing in traditional grid upgrades. However, there are very significant concerns regarding fair competition when the utility is both proposing and selecting between utility and third party bids. As noted above, Codes of conduct are currently being finalized in New York proceedings to address this specific topic.[7]

California has already required utilities to divest generation assets to ensure a true competitive market for procurement, and must therefore be very cautious regarding utility ownership of generation assets among DER. We note that the Commission has allowed

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[6] 'STAFF'S PROPOSED GUIDING PRINCIPLES FOR REVISED UTILITY CODES OF CONDUCT' April 4, 2016. New York Public Service Commission, Case 15-M-0501 In the Matter of a Review of Utility Codes of Conduct as Impacted by Reforming the Energy Vision, and CASE 14-M-0101 Proceeding on Motion of the Commission in Regard to Reforming the Energy Vision.

[7] Ibid.

limited utility ownership of distributed generation in conjunction with required levels of third party procurement in the SPVP program, and after the utilities had difficulty delivering comparable ratepayer value they requested transferring all remaining procurement to third party contracts.

As regulation in California continues to evolve to accommodate changing utility business models, it may be appropriate in the future to reconsider whether utilities can participate directly in DER markets. This highlights the relevance of considering separation of grid operation and asset ownership, as has been established at the transmission system, and warrants consideration of DSO or IDSO approaches in the very near future.

## I. CONCLUSION

The Clean Coalition appreciates the opportunity to submit these comments on the Proposal and looks forward to working with the Commission, the IOUs, and other parties in this proceeding to advance development and implementation of new regulatory incentives and frameworks that encourage the deployment and full utilization of DERs.

Respectfully submitted,

-/s/-_____.

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