

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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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)

**OPENING COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES
ON ADMINISTRATIVE LAW JUDGE'S RULING TAKING
COMMENT ON STAFF PROPOSAL RECOMMENDING
A SOCIETAL COST TEST**

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I. INTRODUCTION

The Office of Ratepayer Advocates (ORA) respectfully submits these comments pursuant to the *Administrative Law Judge's Ruling Taking Comment on Staff Proposal Recommending a Societal Cost Test* (Ruling) issued February 9, 2017 in the Integrated Distributed Energy Resources (IDER) docket. The Ruling seeks party comment on a Staff White Paper (White Paper) recommending adoption of a Societal Cost Test (SCT), a consultant report entitled *Use of Cost-Effectiveness Tests for Evaluation of Distributed Energy Resources: A Literature Review* (Literature Review), and several recommendations from the Cost-Effectiveness Working Group report (CEWG Report).

In the discussion below, ORA recommends the following:

- The Commission should continue work to elaborate the SCT to use as a key measure of Distributed Energy Resource (DER) cost-effectiveness; and
- The Commission should adopt a set of guiding principles to orient its re-examination of the DER cost-effectiveness framework.

II. DISCUSSION

A. The Commission Should Continue Work to Elaborate the SCT to Use as a Key Measure of DER Cost-Effectiveness

ORA supports the staff recommendation in the White Paper to adopt a new Standard Practice Manual¹ cost-effectiveness test that measures the costs and benefits to society – particularly environmental costs and benefits – of ratepayer-funded programs that spur the adoption of DERs. As the White Paper notes, “California energy policy clearly and unambiguously values the environmental benefits – especially the reduction in greenhouse gases – associated with distributed energy resources.”² Environmental costs and benefits – particularly those associated with greenhouse gas (GHG) emissions reductions – are broadly distributed across society. As a result, the appropriate level of analysis to determine the cost-effectiveness of interventions with significant environmental costs and benefits is likewise societal. An SCT capable of accurately representing the net benefits that can accrue to society from programs that encourage the adoption of DERs would be an important and useful input into Commission decision-making on DER policy.

ORA reviewed the White Paper and the potential analytical approaches and estimated values ED staff proposed to quantify the societal benefits of DERs. ED staff has done yeoman’s work in proposing a variety of strategies for incorporating several difficult-to-quantify environmental benefits of DERs such as the value of marginal GHG reductions and air quality improvements. However, as the White Paper notes, regardless of the approach chosen, the Commission must undertake considerable work to arrive at

¹ The Standard Practice Manual has served as California’s official guidelines for measuring the cost-effectiveness of ratepayer-funded demand-side programs since it was published in 1983 and has been adopted in jurisdictions nationwide. The most recent version is available at: <http://www.cpuc.ca.gov/WorkArea/DownloadAsset.aspx?id=7741> (accessed March 23, 2017).

² White Paper, p. 2.

appropriate values for inputs to include in the SCT as well as the appropriate application of the new cost-effectiveness test.³

Given the difficulty of quantifying environmental benefits and the wide range of estimates ED staff presents for key environmental benefits – as well as the substantial impact such values could have on the societal benefits included in the SCT – the Commission should adopt a formal and transparent process in this proceeding for parties to develop an extensive record on the appropriate components of the test and appropriate values for those components and to resolve any disputes of fact or law.

B. The Commission Should Adopt a Set of Guiding Principles to Orient its Re-Examination of the DER Cost-Effectiveness Framework

As the Ruling notes, the scope for phase III of the IDER proceeding’s cost-effectiveness track is to improve the models and methods used to gauge the cost-effectiveness of ratepayer-funded DERs and to better align the cost-effectiveness framework with state and Commission policy, including development of an SCT.⁴ In the White Paper, ED staff recommends the Commission adopt a set of guiding principles for developing the SCT. ORA concurs with ED staffs’ recommendation that establishing guiding principles is an important first step and recommends the Commission further consider and adopt a broader set of guiding principles to orient the Commission’s re-examination of the full cost-effectiveness framework for DER, not just development of the SCT. ORA’s recommended guiding principles are below.

1. The cost-effectiveness framework should be consistent with state policy goals and objectives

Cost-effectiveness is an important part of the broader energy policy framework developed by the state to meet its energy and environmental goals. Any DER cost-

³ White Paper, p. 18.

⁴ Ruling, p. 2.

effectiveness framework developed in this proceeding needs to be consistent with those goals and the processes the state developed to meet its objectives. These include the state's greenhouse gas (GHG) emissions reduction targets established by SB 32, the doubling of energy efficiency (EE) and integrated resource plans (IRP) mandated by SB 350, the state's energy resource loading order, and the Commission's statutory mission to ensure safe, reliable service at just and reasonable rates.

2. The cost-effectiveness framework should be consistent across DERs in order to enable optimal allocation of resources

The scope for phases III and IV of the cost-effectiveness track of the IDER proceeding focuses on the Commission's ongoing attempt to create a source- and technology-neutral valuation framework that will enable optimal allocation of ratepayer funds across resources in pursuit of the state's policy objectives.⁵ Phase III focuses on improving the consistency of the cost-effectiveness framework for demand-side programs, while phase IV focuses on expanding the framework to incorporate all demand- and supply-side resources in a comprehensive all-source framework. In addition, the Commission has undertaken a broad examination of optimal resource allocation to reach state goals in the IRP rulemaking proceeding (Rulemaking (R.) 16-02-007), currently underway.

In order to support the Commission's objectives in creating a neutral valuation framework, the cost-effectiveness framework that emerges from this phase of the IDER cost-effectiveness track should be consistent across DERs. As the White Paper notes, the current cost-effectiveness framework differs substantially by resource, with EE, demand response (DR), and the Self Generation Incentive Program (SGIP) all using different cost-effectiveness tests, thresholds, and inputs in determinations of cost-effectiveness.⁶

⁵ White Paper, p. 3.

⁶ White Paper, p. 9.

These differences appear to be driven in part by “differences in policy priorities, timing, or the approach of decision-makers involved.”⁷ The Commission should take this opportunity to address these inconsistencies across DER proceedings and develop a consistent cost-effectiveness framework that can be used across resources in a commensurate fashion.

3. Ratepayer-funded DERs should broadly benefit society

Incorporation of social costs incurred in the provision of utility services could serve as key method for improving social welfare for the citizens of the state of California. The White Paper proposes to explicitly quantify societal benefits – particularly environmental benefits – and to develop the SCT as part of the DER cost-effectiveness framework. This approach is consistent with the principle that ratepayer-funded programs should create benefit for society as a whole.

4. Ratepayer-funded DERs should broadly benefit ratepayers

In addition to societal benefits, the Commission also has a responsibility to ensure that ratepayer-funded DERs benefit ratepayers and ensure just and reasonable rates. The focus on reducing rates has been the basis for the avoided cost methodology at the heart of the Standard Practice Manual (SPM) tests used by the Commission since the 1980s.⁸ By using the costs of a representative energy resource as a counterfactual in the avoided cost calculator, the SPM tests quantify the benefits of a DER alternative as the system costs ratepayers would otherwise bear. Comparing the costs of the DER and the avoided costs of the alternative energy resource determines whether the DER is cost-effective.

As the White Paper notes, “[t]here is an inherent asymmetry in the SCT between costs (born [sic] entirely by ratepayers) and benefits (accruing to ratepayers and society at

⁷ White Paper, p. 9.

⁸ See Literature Review, pp. 3-4 for an overview of the SPM tests

large).”² This asymmetry means the SCT on its own may not be sufficient to determine whether the benefits to ratepayers of DERs outweigh their costs and result in just and reasonable rates. In developing the DER cost-effectiveness framework, the Commission should adopt sufficient safeguards to ensure ratepayers are not shouldering an unreasonable burden for California’s broader societal goals.

5. Ratepayer-funded DERs should benefit program participants and non-participants

In addition to ensuring that society and ratepayers broadly benefit from ratepayer-funded DERs, the Commission should also ensure that ratepayer-funded programs promote equity between program participants and non-participants such that ratepayers benefit from DERs regardless of whether they participate in a particular program. Substantial cost shifts between program participants and non-participants undermine equity by decoupling the distribution of benefits from the distribution of costs burdening ratepayers. The public purpose and other non-bypassable charges that currently pay for most ratepayer-funded DERs are premised on the idea that system benefits of DERs are broadly distributed and therefore funding of DERs should be broadly shared through a universal surcharge on all ratepayers. However, if DER adoption results in substantial cost-shifting that forces program non-participants to be responsible for an increasing proportion of system costs, the link between costs and benefits may be broken. Non-participants should not be asked to subsidize the private benefits of program participants to the detriment of non-participants through higher costs. Rather, the Commission should strive to minimize cost-shifting among participating and non-participating customers and ensure that in all cases both participants and non-participants benefit from the expenditure of ratepayer funds.

² White Paper, p. 6.

6. The content of a cost-effectiveness test should be based on the its intended use

While any number of options for tests, methods, and values used for cost-effectiveness are theoretically defensible in the abstract, the ultimate selection of tests, methods, and values should be based on their practical value in implementing the Commission's principles for cost-effectiveness and the regulatory function that the tests will serve. For example, if the Commission intends to use a particular cost-effectiveness test to demonstrate the absolute value of DERs, then the full or average avoided cost of DERs may be appropriate. However, if the Commission intends to use a particular test to decide which resources to procure in order to achieve a predetermined end, then comparing the marginal benefit and marginal cost of different resources against one another would likely be more useful and appropriate than using the absolute value.

7. Cost-effectiveness should be evaluated prospectively and verified retrospectively

Currently, the Commission's emphasis on DER cost-effectiveness tests is largely prospective, requiring cost-effectiveness testing and applying cost-effectiveness thresholds *ex ante* as a condition of approving funding in applications. The emphasis on upfront cost-effectiveness testing is appropriate as it enables the Commission to determine, as a condition of funding approval, whether ratepayer-funding for DERs is likely to result in just and reasonable rates. However, because many of the inputs used in cost-effectiveness testing are not systematically verified *ex post*, it is possible that programs and portfolios the Commission approved as cost-effective do not result in the cost-effective expenditure of ratepayer funds in practice.

As a part of its updated cost-effectiveness framework and procedures, the Commission should begin requiring *ex post* verification of the cost-effectiveness of ratepayer-funded DERs. The purpose of such verification should not be punitive, but rather to ensure the Commission collects sufficient information to judge whether ratepayer-funded interventions are succeeding as intended and enable the Commission to direct course corrections as needed in subsequent cycles.

III. CONCLUSION

For the foregoing reasons, ORA respectfully requests the Commission adopt the recommendations contained herein.

Respectfully submitted,

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