Renovate INITIATIVE

Regulatory • Process • Innovation

Renovate Best Regulatory Practices "Toolkit" Series: Performance-Based Regulation—Part 2

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Prepared by:

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About SEPA

The Smart Electric Power Alliance (SEPA) is dedicated to helping electric power stakeholders address the most pressing issues they encounter as they pursue the transition to a clean and modern electric future and a carbon-free energy system by 2050. We are a trusted partner providing education, research, standards, and collaboration to help utilities, electric customers, and other industry players across four pathways: Regulatory Innovation, Utility Business Models, Grid Integration and Transportation Electrification. Through educational activities, working groups, peer-to-peer engagements and custom projects, SEPA convenes interested parties to facilitate information exchange and knowledge transfer to offer the highest value for our members and partner organizations. For more information, visit www.sepapower.org.

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Introduction

The Smart Electric Power Alliance (SEPA) is publishing this *Best Regulatory Practices "Toolkit" Series* as part of the Renovate Initiative. Beginning February 2019, SEPA launched the Renovate Initiative by convening a task force of regulatory commissioners, utilities, technology solution providers, legislators and consumer advocates, along with partner organizations representing a broad spectrum of stakeholders in the electricity industry. The Renovate Initiative's mission is to spur the evolution of state regulatory processes and practices to enable innovation, with a focus on scalable deployment of new technologies and operating models, to meet customer needs and increasing expectations while continuing to provide all with clean, affordable, safe, and reliable electric service.

As an initial step, the Renovate Initiative task force and partners identified four problem statements regarding the obstacles to innovation and widespread adoption of new technologies and operating practices. They are:

1. **People & Knowledge:** The steep learning curve for policy makers, commissioners, commission staff, industry, and other stakeholders in acquiring knowledge and understanding of new technologies, and the benefits and costs for customers can complicate and lengthen the decision-making process.
2. **Managing Risk & Uncertainty:** Current regulations and structures favor tried and true technologies, operations and approaches, in the name of prudence, strictly applying the "used and useful" principle. For new technologies and operating practices, there is uncertainty about the processes to identify and quantify benefits and costs, outline the full range of investment and operating options, and communicate and align incentives with agreed goals for the benefit of all customers.
3. **Managing Increased Rate of Change:** Regulatory proceedings on grid investments and customer programs often take so long that relevant technology providing customer benefit has advanced before a commission assessment can be completed or decision can be reached.
4. **Complexity of Objectives / Cross-Coordination:** Commissions have a mandate to serve the public interest, but increasingly, numerous priorities must be considered and balanced under an expanding definition of "public interest," including: reasonable rates, customer choice, customer protection, environmental protection, current system structure, evolving system structure, with both short-term and long-term perspectives.

SEPA is publishing several case studies highlighting promising practices for addressing these Problem Statements. This paper is the second of a three-part *Best Regulatory Practices "Toolkit" Series on Performance-Based Regulation (PBR)*. It is designed to equip regulators with an understanding of an approach to PBR and how they might use PBR and its elements to address the challenges of increasingly rapid changes in technologies, policies and customer expectations affecting the electricity industry. While all of the problem statements—and solutions to them—are interrelated, this paper primarily responds to the need to manage risk and uncertainty (Problem Statement #2) and to manage the increased rate of change (Problem Statement #3).

- **Part 1** of the series lays the foundation for a discussion of Performance-Based Ratemaking (PBR), reviewing recent developments and drawing conclusions about the evolving PBR landscape through the experience of Minnesota—a state leading through a comprehensive approach to PBR.
- This paper, **Part 2,** continues to use Minnesota as an example, examining its use of Multi-year Rate Plans (MRP) and other Alternative Regulation elements as a stepping stone to regulatory reform and PBR.
- **Part 3** builds on Part 2, addressing Performance Incentive Mechanisms (PIMs) as a key component of PBR, a regulatory framework that compensates utilities for achieving outcomes that deliver service that meets customer expectations and policy objectives.

Executive Summary

Many states have seen an array of legislative and regulatory activity related to PBR and Alternative Regulation in recent years to respond to changes in the electricity industry driven by technology, customers and policy. This paper highlights aspects of the Minnesota legislative and regulatory process, along with the e21 Initiative—a stakeholder-led collaborative process[1]—which stand out as "best practices." Together they are contributing to the success of Minnesota's regulatory evolution and can be used by other states as a model.

The key takeaways from the Minnesota process are:

- The Minnesota Legislature considered the Minnesota Public Utilities Commission's (MPUC or Commission) resources and capabilities in granting it authority to proceed with regulatory reform.
    - The legislature granted the MPUC an extension for ruling on Multi-year Rate Plan (MRP) rate case applications, recognizing the potential for increased administrative staff burden associated with different review requirements compared to traditional rate cases.
    - The legislature authorized the MPUC to initiate the MRP process, but did not require it to do so.
    - The legislature provided options for initiating MRPs: a utility could initiate the process with a rate application or the MPUC could initiate by ruling on the terms, conditions, and procedures for any utility MRP applications.
- Flexibility in process and procedure provided an opportunity for the MPUC to discern and discuss with stakeholders the regulatory evolution prompted by the legislation. The MPUC and stakeholders laid the groundwork for the exploration of regulatory reform, including:

[1] The e21 Initiative is a collaborative of over 30 stakeholders formed in 2014 including utilities, consumer advocates, energy technology companies and other businesses, environmental and academic organizations, and government formed outside of the traditional regulatory process. e21 has facilitated stakeholder education and collaboration in Minnesota towards the adoption of a framework for utility regulation that better aligns utility incentives with the changing industry landscape.

  - Gathering stakeholder input and feedback before beginning its investigation into MRPs through the use of a generic docket process.
  - Identifying the boundaries of the scope of the investigation up front. The MPUC determined what needed to be decided immediately in a broad investigation and what could and should be left to individual utility rate cases.

- A distinguishing feature of the experience in Minnesota was the steady and measured approach adopted by stakeholders in the e21 Initiative in their recommendations and the MPUC in its consideration of PBR and other alternative regulatory reforms, including:
  - Building on the existing industry structure and regulatory framework,
  - Taking incremental steps rather than deciding up front that major change was required, and
  - Taking advantage of the extensive amount of relevant regulatory precedent and experience in the state (e.g., the use of partially forecasted test years in ratemaking).

A New Industry Landscape

As the electricity system faces new advances in technology, coupled with society's increasing commitment to developing clean energy resources to reduce carbon emissions and customer demands for new products and services, traditional regulatory practices and processes are evolving. The recent attention to PBR[2] reflects a growing debate about whether traditional Cost of Service Regulation[3] (COSR)—the longstanding and widespread regulatory model that has been in practice for decades—is sufficient to ensure that the regulatory framework continues to drive utility actions that are aligned with the public interest.

The *Best Regulatory Practices "Toolkit" Series*, reviews recent developments and draws conclusions about the evolving PBR landscape through the experience of Minnesota—a state leading through a comprehensive approach to PBR. The Minnesota example offers regulators and electricity industry stakeholders insights on PBR that they can apply and adapt in their own states to achieve policy goals, foster regulatory innovation and facilitate the scalable deployment of new technologies to meet customer needs. This series also highlights challenges, lessons learned, and recommended best practices for public utility commissions and other stakeholders to consider when evaluating the adoption of PBR and its elements.

[2] Also referred to as Performance-Based Ratemaking.

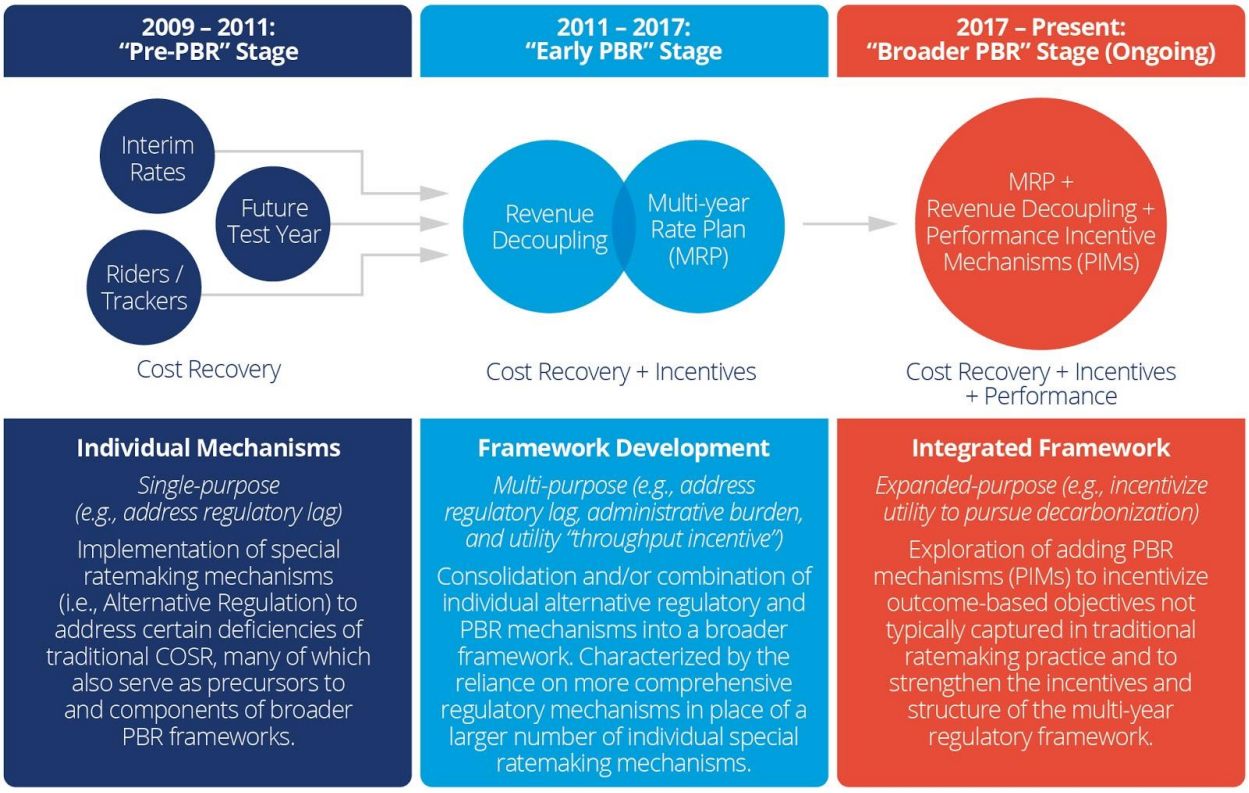
[3] Also referred to as Rate of Return (ROR) regulation.

Framing the Minnesota Experience

As introduced in Part 1 of this series, the framing of the Minnesota regulatory experience with PBR as a "Three Stage" process provides a helpful lens for better understanding:

- The motivations for considering PBR adoption;
- How PBR relates to the existing COSR framework and forms of Alternative Regulation still used in most jurisdictions; and
- How alternative regulatory mechanisms can be combined into an integrated framework that expands upon the objectives of COSR and addresses some of its shortcomings.

Figure 1: The "Three Stages" of the Minnesota Experience with PBR



Source: Smart Electric Power Alliance, 2020.

The evolution of PBR in Minnesota over the last decade can be viewed as transitions between three different stages (Figure 1). The starting point was the use of a wide array of single-purpose regulatory mechanisms to accomplish specific regulatory goals, primarily related to cost recovery ("Pre-PBR Stage").

The first transition towards a more comprehensive regulatory approach took the form of a Multi-Year Rate (MRP) Plan and revenue decoupling mechanism. This addressed the administrative burden associated with multiple individual mechanisms, as well as utility disincentives to pursue energy efficiency and adoption of technologies that reduce sales and thus revenues ("Early PBR Stage"). This stage is the focus of this paper.

The second transition—currently ongoing—consists of movement toward a new and integrated framework involving the potential adoption of Performance Incentive Mechanisms (PIMs). This stage further addresses the aforementioned challenges, and expands the capabilities of the existing regulatory approach and aligns utility incentives with the evolving policy goals and trends in the industry ("Broader PBR Stage"). (This stage is the subject of Part 3 in this series.)

In this paper, we trace the Minnesota PBR journey starting with the exploration of forms of Alternative Regulation mandated by the state Legislature. The existing regulatory framework in Minnesota at that point in time was based on a COSR model modified by the use of some alternative regulatory mechanisms, primarily special cost recovery trackers. The increasing number of special ratemaking mechanisms prompted questions as to whether they were effective for addressing the issues of regulatory lag,[4] cost control, and reducing the administrative burden associated with COSR. Growing recognition of the shortcomings of this regulatory approach helped push stakeholders in Minnesota to support the transition from a "Pre-PBR" regulatory environment to an "Early Stage" PBR environment—characterized by the adoption of an MRP and revenue decoupling mechanism.

Minnesota: Multi-Year Rate Plans as the Groundwork for a New Energy Future

"Pre-PBR" Stage (2009-2011): Establishing the Need for Reform

MINNESOTA'S "UTILITY RATES STUDY": EXPLORING ALTERNATIVE REGULATORY SOLUTIONS

As discussed in Part 1 of this series, a particular set of regulatory challenges facing regulators, utilities, and stakeholders under traditional COSR often serves as the driver for exploring alternative regulatory approaches, such as PBR. In 2009, the Legislature mandated that the MPUC conduct a "Utility Rates Study" by 2010 ("2010 Report"), evaluating forms of Alternative Regulation allowing for expenditure—

[4] "Regulatory lag" is the period of time between when a utility's rates go into effect and its next rate case, and is an important means by which traditional regulation is thought to inject discipline upon utilities similar to that arising in competitive markets. *See* Dismukes, David E., Incentives, Risk and the Changing Nature of Utility Regulation, April 22, 2015, at 11.

specific cost recovery outside of the general rate case proceeding. The report, produced by the MPUC with the assistance of the National Regulatory Research Institute (NRRI), addressed the following:[5]

- An assessment of the impact of automatic cost-recovery mechanisms on prices charged to utility customers compared to traditional cost-recovery mechanisms;
- An assessment of the impact of automatic recovery mechanisms on the level of customer understanding of utility rates compared to traditional cost-recovery mechanisms;
- An assessment of alternative forms of utility rate regulation that may be used in place of automatic cost-recovery mechanisms; and
- Methods to improve administration and customer understanding of automatic cost-recovery mechanisms.

The impetus for the 2010 Report arose from the increasing reliance by utilities in Minnesota on a growing number of special cost-recovery mechanisms, to address the timely recovery of large capital expenditures for utilities and to mitigate the financial impacts on them of new policy mandates. In addition to the Fuel Clause and Purchased Gas Adjustments (alternative regulatory mechanisms widely adopted in the 1970s and now commonly viewed as part of COSR), the 2010 Report identified 19 special cost recovery mechanisms established in statute. These are listed below in Figure 2.[6]

Figure 2: List of Existing Cost Recovery Mechanisms Cited in 2010 Report

- Conservation improvement / incentives
- Performance-based gas purchasing adjustment
- Transmission cost adjustment
- Transmission asset transfer
- Low-income electric discount
- Demand-side management financial incentives
- Natural gas utility infrastructure
- Renewable energy power purchase agreements / investment / Renewable Development Fund
- Utility-owned renewable facilities
- Settlement—Mdewakanton Prairie Island
- Emissions reduction rider
- Mercury emission reduction
- Real and personal property taxes
- Reliability administrator
- Gas Affordability Program costs
- Electric infrastructure costs
- Greenhouse gas infrastructure
- Decoupling
- Central corridor utility zone cost adjustment

Source: Adapted from the MPUC 2010 Report, with edits by Smart Electric Power Alliance, 2020.[7]

[5] Report to the Legislature: Utility Rates Study as Required by Laws of Minnesota, 2009, Chapter 110. Minnesota Public Utilities Commission. 2010, at 2.

[6] Ibid., at 6-7.

[7] Report to the Legislature: Utility Rates Study as Required by Laws of Minnesota, 2009, Chapter 110. Minnesota Public Utilities Commission. 2010.

In the 2010 Report, the MPUC concluded that the growing use of special cost-recovery mechanisms had become inefficient, and had the potential to continue increasing, rather than reducing, the administrative burden on MPUC Staff:

> The current system of numerous special recovery mechanisms has become cumbersome, raises concerns about cost control, and has constrained the Commission's primary ratemaking instrument, the general rate case. Improving the current system will require adjustments to ensure greater accountability and a sharing of benefits with ratepayers. Fundamentally, the question is whether there are better ways to incentivize utility performance to ensure public policy goals are met. There are alternatives and they each should be evaluated through further discussion and inquiry.[8]

Renovate Insights: Who Initiates the Conversation on Regulatory Reform?

In Minnesota, legislative authority is required to modify the existing regulatory framework. In 2009, the Legislature initiated the formal consideration of PBR and related regulatory mechanisms by requiring the MPUC to produce an "Alternative Regulation" study (2010 Report). Following the 2010 Report, the Minnesota Legislature granted the MPUC the statutory authority to hear and approve utility MRP proposals in 2011.

The starting point for the consideration of substantial regulatory reforms is an understanding (or in some cases, a clarification) of who has the authority to implement regulatory reforms. Not all states initiate reforms via the state legislature. In some jurisdictions, regulators possess the authority themselves to consider regulatory reforms, such as PBR. In other jurisdictions, the utility can initiate a consideration of PBR by filing an application with the regulatory authority. In both cases, a public comprehensive stakeholder process outside of the traditional regulatory process can provide a forum to set the basic boundaries for reform or for reform recommendations to the legislature.[9]

The different approaches laid out in the 2010 Report included:[10]

- Eliminate all existing trackers that cannot demonstrate extreme financial consequences, and provide for a reasonable opportunity for cost recovery for everything else through rate case proceedings.
- Consolidate all trackers (except, perhaps, fuel) into one overall tracker and develop a form of comprehensive ESM (Earnings Sharing Mechanism), including in the form of an MRP, among other options.

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[8] Ibid., at 22.

[9] SEPA. Benefits of a Comprehensive Public Stakeholder Process: the Oregon Senate Bill 978 Experience. 2019.

[10] Report to the Legislature: Utility Rates Study as Required by Laws of Minnesota, 2009, Chapter 110. Minnesota Public Utilities Commission. 2010, at 18-21.

- Substantially reduce the number of trackers to allow only those that are most commonly used, involve the largest financial impact, and incorporate the greatest accountability.

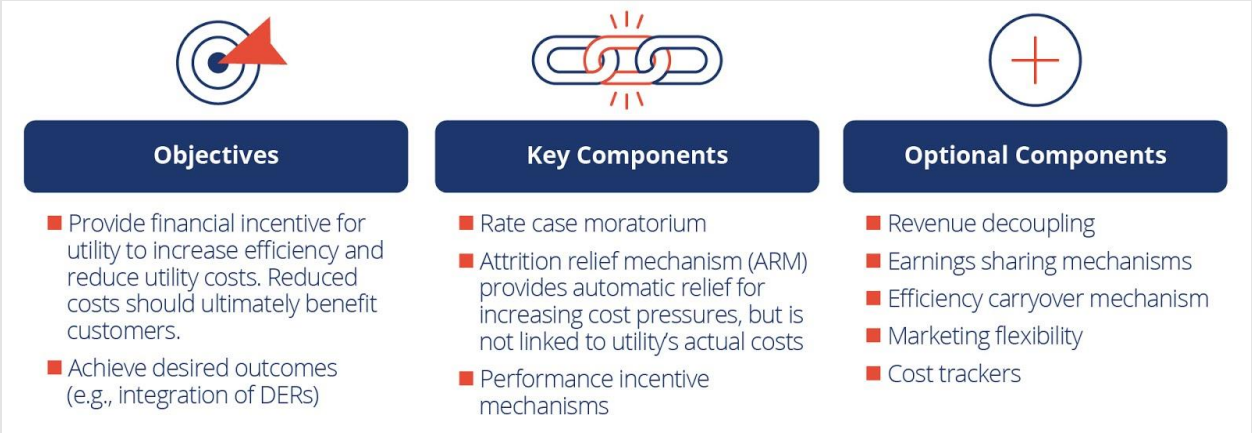
The conclusion by the MPUC that the existing regulatory framework, made up of an array of partially redundant and misaligned regulatory mechanisms, had become increasingly incompatible with recent state policy goals and emerging industry trends laid the foundation for the passage of legislation in 2011 authorizing the MPUC to approve utility MRP applications, one of several legislative and regulatory reforms to come in Minnesota over the next decade.

Renovate Insights: What is a Multi-Year Rate Plan?

MRPs are one of the most common forms of Alternative Regulation. In contrast to the typical ratemaking cycle under COSR-—where rates are generally set by the regulator based on an historical test year period and fixed until modified in a subsequent rate case—MRPs provide a regulatory mechanism for setting rates over a longer, forward-looking time horizon. They usually include mechanisms for adjusting approved revenue and rates for a multiple-year period, and offer the potential advantages of reducing administrative burden and regulatory lag, among other benefits.

MRPs can be structured in a variety of ways, but usually take the form of a broader regulatory framework incorporating different alternative regulatory elements, such as revenue decoupling mechanisms and PIMs that include not only traditional safety and reliability but also new technology metrics. An overview of MRPs highlighting their objectives and common components is provided below in Figure 3.[11]

Figure 3: Overview of Multi-Year Rate Plans (MRP)



Source: Adapted from a *Performance-Based Regulation in a High Distributed Energy Resources Future* presentation (LBNL, 2016), with edits by Smart Electric Power Alliance, 2020.[12]

[11] *Adapted from* Presentation from Lowry, Mark Newton, and Tim Woolf. Performance-Based Regulation in a High Distributed Energy Resources Future. Ed. Schwartz, Lisa C. Vol. FEUR Report No. 3. 2016. January 27, 2016. LBNL-1004130, at 9. http://eta-publications.lbl.gov/sites/default/files/lbnl-1004130_presentation.pdf

[12] Ibid.

MINNESOTA LEGISLATURE AUTHORIZES MRPS

In 2011, the Legislature authorized the Commission to approve MRPs for regulated utilities in the state. This legislation granted the MPUC the following new points of authority:[13]

- A utility may propose an MRP (not to exceed three years), which would initiate the process, and any party would have the right to petition the MPUC to adjust the plan's rates.
- The MPUC is allowed to extend the standard rate case timeline of 12-14 months by an additional 90 days to facilitate review of the utility's proposal.
- The MPUC may reject the plan, or approve the plan as proposed or as modified, but only if it finds that the plan establishes just and reasonable rates.
- While a plan is in effect, the MPUC may adjust the plan's rates to ensure that rates remain reasonable.
- The MPUC is authorized to issue orders establishing the terms, conditions, and procedures for an MRP necessary to implement this section and ensure that rates remain just and reasonable during the course of the plan.

While many states have seen an array of legislative and regulatory activity related to PBR and Alternative Regulation in recent years, aspects of the Minnesota legislation stand out as "best practices" that led to subsequent success, both inside and outside of the formal regulatory process. The Minnesota Legislature granted the MPUC authority to proceed, taking into account its resources and capabilities. For example, the legislature granted the MPUC an extension for ruling on MRP rate case applications in recognition of the increased administrative staff burden compared to traditional rate cases, recognizing that utilities could initiate the new process with an MRP application.

Another key feature was that while the legislation authorized the MPUC to initiate the MRP process, it did not require the MPUC to do so. The statute left open whether the utility would initiate the process with a rate application, or whether the MPUC would preempt any utility applications by making a ruling on the terms, conditions, and procedures for an MRP. This flexibility in process and procedure provided an opportunity for the MPUC to discern and discuss with stakeholders its role in the regulatory discussion prompted by this legislation.

[13] Minnesota Statutes 2011, section 216B.16, subdivision 19.

"Early PBR" Stage (2011-2017): Pairing Revenue Decoupling and MRPs as a Start to a Broader Alternative Regulatory Approach

MPUC MOVES FORWARD WITH MRPS FOLLOWING LEGISLATIVE AUTHORIZATION

In response to the 2011 legislation, the Minnesota Office of the Attorney General-Antitrust and Utilities Division (OAG) petitioned the MPUC to open an investigation to establish criteria and standards for utilities to follow in any request for an MRP.[14] After inviting stakeholder feedback, the MPUC officially opened a generic docket in August of 2012 to launch an investigation into the framework for utility MRP applications ("MRP Investigation").[15]

The generic docket led to many beneficial outcomes, not the least of which was a robust discussion of MRPs and related regulatory components among a large group of stakeholders. While, as Staff had anticipated in an earlier brief to the Commission,[16] the discussion was complex, and at times, difficult with disagreement over key issues, it helped to move the process forward by providing a clear framework for utilities to follow when submitting MRP applications. It also provided clarity for all stakeholders with respect to the issues that would be addressed on a case-by-case basis in individual utility rate proceedings. This reinforces that comprehensive engagement of stakeholders is helpful to advancing major regulatory initiatives and/or changes in policy direction.

In its 2013 Order, the MPUC identified the advantages and disadvantages associated with MRPs. The most important finding was that the benefits that could be achieved through a well-designed MRP outweighed the potential concerns and shortcomings identified during the investigation.[17] Administrative efficiency was a key consideration in addition to the financial and ratemaking benefits associated with MRPs. With rates and revenues set for multiple years, stakeholders in Minnesota could potentially benefit from applying the resources usually consumed in litigated rate cases to focus instead on emerging industry challenges. A summary of the considerations identified by the MPUC can be found in Figure 4.

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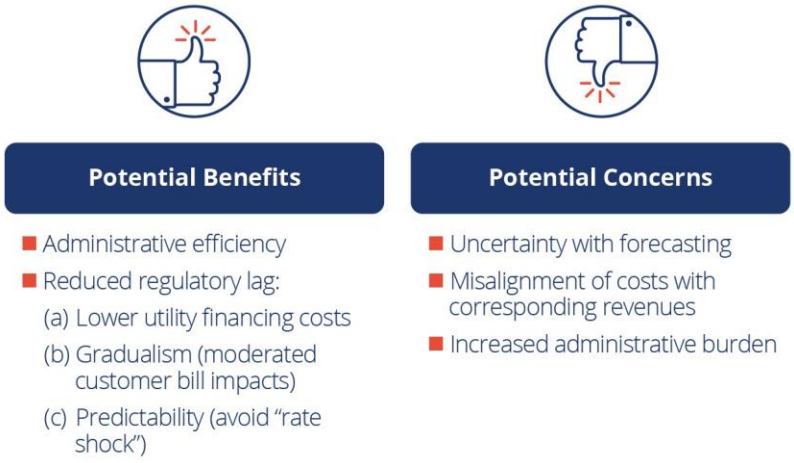
[14] In the Matter of the Minnesota Office of the Attorney General - Antitrust and Utilities Division's Petition for a Commission Investigation Regarding Criteria and Standards for a Multiyear Rate Plans under Minn. Stat. § 216B.16, subd. 19, Docket No. E,G-999/M-12-587, Minnesota Public Utilities Commission.

[15] Ibid.

[16] Staff Briefing Papers, Docket No. E,G-999/M-12-587, Minnesota Public Utilities Commission, August 2, 2012, 4-5.

[17] Order Establishing Terms, Conditions, and Procedures for Multiyear Rate Plans, Docket No. E,G-999/M-12-587, June 17, 2013, at 4-5.

Figure 4: MPUC Findings on Potential Advantages and Disadvantages of MRPs



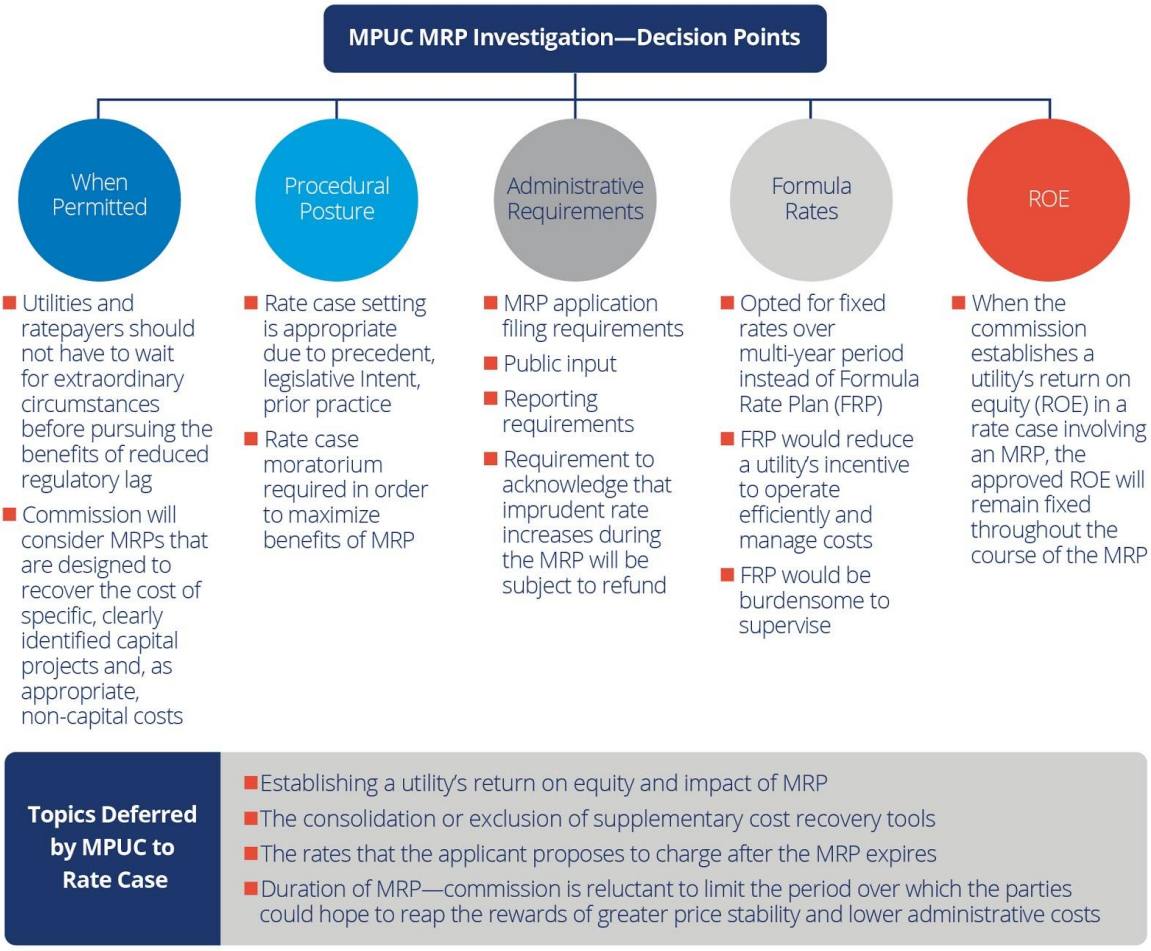
Source: Adapted from MPUC Order on Multiyear Rate Plans (2013), with edits by Smart Electric Power Alliance, 2020.[18]

One of the challenges arising from the use of a generic docket is "scope creep"—the discernment of which issues require immediate consideration and ruling, in contrast to issues that are better left to be explored and ultimately ruled on in another context, such as the rate case setting. The MPUC was deliberate in limiting the scope of its findings in the generic docket to prioritize the basic requirements, boundaries, and characteristics necessary for utility MRP applications while designating certain topics as more appropriate to be dealt with on a "case-by-case" basis in actual rate proceedings. Figure 5 provides a general summary of many of the MRP decision points deliberated and ultimately either ruled on, or deferred to a future rate case by the MPUC.[19]

[18] Adapted from Order Establishing Terms, Conditions, and Procedures for Multiyear Rate Plans, Docket No. E,G-999/M-12-587, June 17, 2013.

[19] Ibid.

Figure 5: Summary of MPUC Rulings in Generic Docket for MRP Investigation



Source: Adapted from MPUC Order on Multiyear Rate Plans (2013), with edits by Smart Electric Power Alliance, 2020.[20]

[20] Ibid.

Renovate Insights: Advantages of a Generic Docket Process

Prior to opening the MRP Investigation, the MPUC, staff, and stakeholders weighed whether an MRP investigation would be a constructive and beneficial exercise. As highlighted by the MPUC Staff, generic dockets can be a very effective tool for regulators, especially when paired with good judgment on what needs to be decided immediately and what is more appropriately settled in future company-specific proceedings. However, without a clear focus on priorities, they may risk further delaying the regulatory process and creating a greater administrative burden for a commission.[21]

Advantages include:

- Addresses stakeholder knowledge "gaps" - PBR and MRPs are complex industry topics with which not all regulators, utilities, and stakeholders are equally familiar. Even though Minnesota had prior experience with some of the issues, stakeholders expressed an interest in having thorough discussions on topics such as MRPs and PIMs. A generic docket can provide a more amenable format than the rate case setting for commissioners and stakeholders to become more educated on the topic of interest.
- Provides clarity for stakeholders and a foundation for future filings - Allows the format and substance of a major topic, such as MRPs, to be decided upfront rather than having to deal with it multiple times on a case-by-case basis with different dockets and utility applications. One of the identified purposes of the Minnesota MRP Investigation was to define the boundaries, scope, and requirements for MRP applications the utilities were planning to file.
- Increases administrative efficiency - These investigations can effectively reduce the scope of already contentious and long proceedings, such as the rate cases. In Minnesota, there was concern that the already taxing rate case environment would become even longer and more divisive by adding consideration of MRPs.
- Identifies priorities - Generic dockets can provide clarity, not only for stakeholders, but also for regulators. By conducting an investigation prior to a utility-specific proceeding or application, regulators can identify the scope of the key issues at stake. This can help them to anticipate and prepare for the questions that need to be resolved in future related filings and applications.

[21] Staff Briefing Papers, Docket No. E,G-999/M-12-587, Minnesota Public Utilities Commission, August 2, 2012, at 5.

Disadvantages include:

- Contentious environment - Although generic dockets may have a different setting and scope than a typical rate case proceeding, they are not guaranteed to be any less contentious. In fact, there is always the possibility that these investigations may become more contentious given the complexity and implications of major topics such as MRPs.
- Increased workload - While generic investigations offer the potential for streamlining future regulatory processes, they can be resource intensive in the short term. This is especially true for commission staff. Generic dockets may not necessarily be concluded more quickly than rate cases.
- Risk of "Scope Creep" - With broad topics such as PBR, the risk of trying to address too many issues may result in decision-making paralysis, confusion, bad policy, and stakeholder frustration.

One of the reasons the investigation in Minnesota proved beneficial was that the MPUC exercised careful judgment by limiting the scope of this docket to ruling on what was necessary initially to define the MRP requirements and pushing more complex or less immediate discussions to future proceedings.

Best practice recommendations include:

- Gather stakeholder feedback before deciding whether an investigation would be beneficial. Consider whether the commission should take responsibility for a topic, or whether it would be better to let stakeholder groups develop it.
- Identify the boundaries and scope of the investigation upfront. Determine what needs immediate discussion and rulings, and what is more appropriate for future proceedings.
- Plan in advance to help reduce the administrative burden, carefully taking into account scope, staffing and scheduling

XCEL'S 2013 MRP & REVENUE DECOUPLING PILOT APPLICATION

In 2013, Xcel became the first utility in Minnesota to file an MRP application to realize "more gradual rate increases and predictable bill impacts" ("2013 MRP").[22] Notably, Xcel proposed a two-year MRP (with only one "step year" adjustment to incorporate specified 2015 capital projects and related non-capital costs) rather than a full three-year MRP—the maximum duration authorized by the 2011 legislation. This "pilot" approach reflected an understanding that MRPs constituted a significant change to the existing regulatory framework and that this would be the first utility application ruled on. The "pilot" mindset would become a foundational principle for stakeholders in the e21 Initiative and reflective of the leadership position taken by the MPUC in the consideration of other regulatory reforms.

[22] In the Matter of the Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota, E-002/MR-13-868.

Xcel also proposed a revenue decoupling pilot in its MRP application, stating that its primary motivation for revenue decoupling was to "remove the Company's financial disincentive to promote conservation and energy efficiency that exists because Xcel covers most of its fixed costs through volumetric rates."[23] Under traditional COSR, which does not include revenue decoupling, the utility has a disincentive to encourage energy efficiency because it results in lower sales, which lead to lower revenue for the utility (referred to as the "throughput incentive"). Decoupling addresses this disincentive by adjusting rates to recover the difference between the actual revenue and the level of revenue approved for the utility in its most recent rate case. Therefore, the utility is not financially penalized by lower sales leading to decreased revenues nor disincentivized to promote energy efficiency.

Renovate Insights: Why MRPs are Often Paired with Revenue Decoupling Mechanisms

As described in the Administrative Law Judge Report for Xcel's 2013 MRP application: "The objective of a properly designed decoupling mechanism is to allow the utility to receive the per-customer revenue requirement the Commission has reviewed and approved—no more and no less."[24] By pairing an MRP with a revenue decoupling mechanism, regulators can better ensure that utilities are collecting the appropriate amount of revenue from customers throughout the multiple-year term of the MRP.

While MRPs offer regulators a more comprehensive mechanism to achieve multiple regulatory objectives and thus can eliminate the need for some special cost-recovery mechanisms, revenue decoupling mechanisms are usually considered an important component of MRPs. This is because an MRP alone, even with an earnings sharing mechanism (ESM), likely will not match the strength of a revenue decoupling mechanism in removing the utility's "throughput incentive."[25]

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[23] Staff Briefing Papers, Docket No. E-002/GR-13-868, Minnesota Public Utilities Commission, December 12, 2013, at 17.

[24] Office of Administrative Hearings, Findings of Fact, Conclusions of Law and Recommendations, December 26, 2014, ¶¶ 842 – 844, p. 192-193.

[25] For example, *see* the following excerpt from a 2016 report by Ken Costello of the National Regulatory Research Institute (NRRI): "An MRP can substitute for some cost trackers. As a comprehensive ratemaking mechanism, an MRP can eliminate the need for different cost trackers...The reader may ask whether revenue trackers such as revenue decoupling could also not be eliminated. One answer is that it may be preferred to continue with revenue decoupling to remove the disincentive that a utility may have toward energy efficiency, even with an MRP that has earnings sharing." Costello, Ken. Multiyear Rate Plans and the Public Interest. National Regulatory Research Institute. 2016, at 43.

The MPUC approved Xcel's 2013 proposed two-year MRP and revenue decoupling program as a three-year pilot program.[26] It recognized the need for a broader, and more integrated regulatory framework to address regulatory lag, and other emerging challenges such as aligning utility incentives with energy efficiency goals and policies[27] that under the traditional approach represented more financial risk than opportunity.

"Early PBR" Stage (2011-2017): Agreement on the Need for Reform

E21 INITIATIVE, PHASE I: RECOMMENDATION FOR A VOLUNTARY MULTI-YEAR, PERFORMANCE-BASED RATEMAKING APPROACH

As introduced in Part 1 of this series, the e21 Initiative has played an important role in facilitating the PBR stakeholder conversation in Minnesota.[28] The purpose of the group was to provide a forum outside the formal regulatory process to identify the ways the existing regulatory regime in Minnesota would need to evolve in order to adapt to a shifting energy landscape. It also provided regulators and other decision makers with consensus-based recommendations on how Minnesota's regulatory framework, and the existing utility business model, might evolve to continue to serve and protect customers and promote the public interest.

In its 2014 Phase I Report,[29] e21 stakeholders described a vision for regulatory reform to transition to a new framework under which utilities would be motivated to pursue outcomes sought by regulators, policymakers and stakeholders. A key focus of the Phase I Report recommendations—in addition to improving the efficiencies of the existing regulatory framework and its procedural predictability—was the integration of investment, rate recovery and resource planning efforts into a single comprehensive regulatory approach. The solution proposed by the stakeholders was a framework consisting of a longer term five-year MRP with PIMs, guided by an "Integrated Resource Analysis," in order to form a new regulatory approach that is "more forward-looking" and "determines what we should pay to achieve the outcomes society wants."[30] The e21 Initiative saw a longer term MRP as a necessary and foundational component to this new approach for the following reasons:[31]

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[26] Finding of Facts, Conclusions, and Order, Docket No. E-002/GR-13-868, May 8, 2015, at 97-107.

[27] Ibid., at 73.

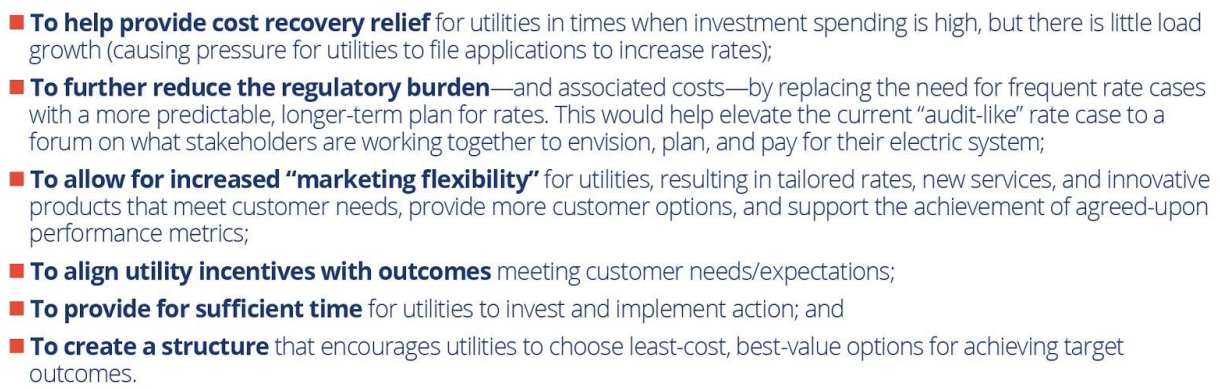
[28] *See* https://e21initiative.org/.

[29] Phase I Report: Charting a Path to a 21st Century Energy System in Minnesota. e21 Initiative. 2014.

[30] The e21 Phase I Report recommends that this new framework be based on a utility Business Plan covering up to five years, guided by a 15-year (or longer) Integrated Resource Analysis (IRA). The IRA "would replace the current Integrated Resource Plan (IRP)." *See* Phase I Report: Charting a Path to a 21st Century Energy System in Minnesota. e21 Initiative. 2014, at 3, 8-11.

[31] Phase I Report: Charting a Path to a 21st Century Energy System in Minnesota. e21 Initiative. 2014, at 3, 8-11.

Figure 6: Advantages of a Longer Term MRP



Source: Adapted from e21 Initiative Phase I Report (2014), with edits by Smart Electric Power Alliance, 2020.[32]

Another key feature of this recommendation was that utilities would opt into this new performance-based model. In other words, rather than facing a penalty or being mandated to adapt, the new framework would motivate utilities to evolve. Some of the e21 Phase I recommendations required a change in Minnesota law prior to any regulatory consideration (for example, to extend the duration of MRPs from three to five years).[33]

[32] Ibid.

[33] As described in Part 1 of this series, in Minnesota, legislation is typically required to significantly modify the regulatory process.

Renovate Insights: Importance of Trust in Developing Stakeholder-Driven Initiatives

As discussed in the Renovate Initiative's ***Benefits of a Comprehensive Public Stakeholder Process*** case study, broad public stakeholder engagement can enable changes in the regulatory process. It provides the opportunity to develop trust, strong relationships, shared knowledge, and understanding, as in the case of the e21 Initiative, that would be difficult to achieve in a traditional and more litigious regulatory setting. Donna Attanasio, an e21 Initiative member, shared "What e21 was able to do is provide a lot of education, so people who are now going to be in front of the PUC have a much broader view of the issue... I think it helped to elicit where areas of agreement and perhaps disagreement exist. It will narrow the issues before the commission."[34]

Trust, or getting each stakeholder to "buy in" to the mission of the group and recognize its value, can be a challenge. Rolf Nordstrom, co-founder/co-director of the e21 initiative, shared that it took approximately a year to recruit utilities to join e21, noting that it was the creation of a "...safe space outside of the formal regulatory process for having what is a very complicated conversation over what is happening in the electric sector with the emergence of a huge range of distributed energy technologies, flat or declining demand for electricity, and the need to innovate on an aging electric infrastructure," that eventually motivated the utilities to join.[35] With the establishment of trust, e21 was able to demonstrate to Xcel and others that their proactive involvement could help "reduce their 'transactional' costs before regulators by potentially shortening that often lengthy process."[36]

In 2015, the Minnesota Legislature modified existing statutes to allow for a number of reform measures, including the extension of MRP terms up to five years, and authorizing the MPUC to approve a PIMs framework.[35] The e21 Initiative and its consensus-based recommendations contributed to the passage of the legislative reforms.[36] As highlighted throughout this three-part series, there are a number of key characteristics of the e21 approach that have and continue to enable its positive influence in the state. They reflect the overall Minnesota approach to regulatory reform. A summary of these characteristics is provided below in Figure 7.

[34] Ibid.

[35] *See* Minn. Stat. § 216B.16, subd. 19.

[36] Jossi, Frank. Clean energy groups leading on utility changes envisioned in Minnesota's e21 Initiative. Energy News Network. May 8, 2017. https://energynews.us/2017/05/08/midwest/clean-energy-groups-leading-on-utility-changes-envisioned-in-minnesotas-e21-initiative/

Figure 7: Five Success Factors of the e21 Initiative

Source: Smart Electric Power Alliance, 2020.

The e21 experience engaged all interested stakeholders involved in or affected by regulatory reform and helped prepare them for the subsequent and parallel regulatory processes by facilitating a shared and deeper understanding of the topic of regulatory reform. Rolf Nordstrom, co-founder / co-director of the e21 initiative, emphasized the importance of starting with broad stakeholder participation with stakeholders sharing perspectives on the existing model:

> I think having everyone spend time up front sharing what they thought was working and not working about the existing system set the table for making progress, because that 'discovery process' illuminated the fact that everyone thought the system needed to evolve to keep pace with the nature and scale of the changes taking place in the energy sector. That's a good recipe for making change.

Nordstrom further added:

> ...the secret to success is that we began with a question rather than a set of answers (the question being whether and how the regulatory framework and utility business model needed to evolve, and if so how). We let the process lead to the answers, which turned out to be that the existing framework can accommodate a lot of useful changes that better align the regulatory and financial signals utilities receive with the outcomes customers and the public expect, even if eventually more significant changes may be warranted.[37]

[37] Provided in an email exchange with SEPA (2/4/2020).

Another distinguishing feature was the steady and measured approach adopted in the consideration of PBR and other potential regulatory reforms. This incremental or "pilot" approach shaped regulatory reform in Minnesota. A related factor that contributed to the feasibility and effectiveness of this approach was the extensive amount of relevant regulatory precedent and experience in Minnesota.[38] For example, the use of a future (or forward) test year period, in contrast to the use of the historical 12-month test year period associated with traditional COSR, is a foundational practice for the implementation of an MRP.[39] States such as California and New York—that have relied on MRPs for decades—demonstrate how commissioners, staff and stakeholders benefit, for example, from relevant forecasting expertise that comes from prior regulatory precedent and experience with future test year periods. The existing precedent of a partially-forecasted test year in Minnesota similarly shows how regulators benefit not only from existing legislative authority and regulatory precedent for alternative regulatory mechanisms, but also from practical insights related to their implementation.

An inclusive stakeholder process with a broad scope, the e21 Initiative, and its Phase I work helped to pave the way for legislation and the formal consideration of regulatory reforms by the MPUC. The 2015 legislation then signaled the beginning of the transition from the "Early PBR" stage to the "Broader PBR" stage (see Figure 1), authorizing the MPUC to require utilities to include PIMs as part of their rate case applications.

Conclusion

Part 2 of this *Best Regulatory Practices Toolkit* explores the legislative and regulatory process in Minnesota to develop a cohesive regulatory framework to respond to changes in the electricity industry driven by technology, customers and policy. This paper highlights aspects of the Minnesota legislative and regulatory process, along with the e21 stakeholder-led Initiative, which stand out as "best practices." Together they are contributing to the success of Minnesota's regulatory evolution and can be used by other states as a model.

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[38] For a summary of this relevant regulatory precedent in Minnesota (i.e., alternative regulatory mechanisms which may serve as precursors to MRPs and PIMs), see Working Paper: Legal and Regulatory Framework for Energy Utilities in Minnesota, e21 Initiative, February 2014.

[39] The Grid Modernization Laboratory Consortium recently elaborated on the relationship between these two regulatory mechanisms, stating "Consider also that jurisdictions vary in their regulatory traditions and human capital (the experience and the expertise of regulatory practitioners). Generally speaking, adoption of MRPs is easier for jurisdictions that have experience with the use of forward test years in rate cases" because practitioners in those states have relevant forecasting expertise. See Lowry et. al., State Performance-Based Regulation Using Multiyear Rate Plans for U.S. Electric Utilities, Grid Modernization Laboratory Consortium of U.S. Department of Energy, July 2017, at 3.11.

- The Minnesota Legislature considered the MPUC's resources and capabilities in granting it authority to proceed with regulatory reform.
    - The legislature granted the MPUC an extension for ruling on Multi-year Rate Plan (MRP) rate case applications, recognizing the potential for increased administrative staff burden associated with different review requirements compared to traditional rate cases.
    - The legislature authorized the MPUC to initiate the MRP process, but it did not require the MPUC to do so.
    - The legislature provided options for initiating MRPs: a utility could initiate the process with a rate application or the MPUC could initiate by ruling on the terms, conditions, and procedures for any utility MRP applications.
- Flexibility in process and procedure provided an opportunity for the MPUC to discern and discuss with stakeholders the regulatory evolution prompted by the legislation. The MPUC and stakeholders laid the groundwork for the exploration of regulatory reform.
    - Gathering stakeholder input and feedback before beginning its investigation into MRPs through the use of a generic docket process.
    - Identifying the boundaries of the scope of the investigation up front. The MPUC determined what needed to be decided immediately in a broad investigation and what could and should be left to individual utility rate cases.
- A distinguishing feature of the experience in Minnesota was the steady and measured approach adopted by stakeholders in the e21 Initiative in their recommendations and the MPUC in its consideration of PBR and other alternative regulatory reforms, including:
    - Building on the existing industry structure and regulatory framework,
    - Taking incremental steps rather than deciding up front that major change was required,
    - Taking advantage of the extensive amount of relevant regulatory precedent and experience in the state (e.g., the use of partially forecasted test years in ratemaking).

With this strong foundation, Minnesota is turning to the third stage of "Broader PBR." This transition is moving toward a new and integrated framework involving the potential adoption of PIMs intended to enable the expansion of the capabilities of the existing regulatory approach and the alignment of utility incentives with the evolving policy goals and trends in the industry. In the next and final part of this series (Part 3), we review the next steps taken by the MPUC to adopt PIMs and the efforts of the e21 Initiative to support the MPUC and formal regulatory process.

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