BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

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IN THE MATTER OF THE APPLICATION OF
PUBLIC SERVICE COMPANY OF COLORADO
FOR APPROVAL OF A NUMBER OF
STRATEGIC ISSUES RELATING TO
ITS DSM PLAN, INCLUDING MODIFIED
ELECTRIC ENERGY SAVINGS AND DEMAND
REDUCTION GOALS, AND REVISED
INCENTIVES FOR THE PERIOD 2015
THROUGH TO 2020; FOR APPROVAL OF A
DISTRIBUTION VOLTAGE OPTIMIZATION
PROGRAM TOGETHER WITH COST
RECOVERY AND INCENTIVES, AN LED
STREET LIGHTING PRODUCT AND
APPROVAL TO INCLUDE BEHAVIORAL
CHANGE PRODUCTS IN THE COMPANY’S
DSM PORTFOLIO AND OF THE
METHODOLOGY TO BE USED TO MEASURE
SAVINGS FROM SUCH PRODUCTS; AND
FOR COMMISSION GUIDANCE REGARDING
THE FACTORS TO BE CONSIDERED AND
APPROPRIATE LEVEL OF THE COMPANY’S
GAS DSM PROGRAM IN THE FUTURE.

DOCKET NO. 13A-0686EG

REBUTTAL TESTIMONY AND EXHIBITS OF SCOTT B. BROCKETT

ON

BEHALF OF

PUBLIC SERVICE COMPANY OF COLORADO

December 20, 2013
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REBUTTAL TESTIMONY AND EXHIBITS OF SCOTT B. BROCKETT

I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Scott B. Brockett.

Q. ARE YOU THE SAME SCOTT B. BROCKETT WHO PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.
Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I respond to the Answer Testimony of intervenors on the following issues:

- The structure and magnitude of the financial incentive mechanism that should be applied to energy efficiency projects other than the Distribution Voltage Optimization (“DVO”) project.

- The cost recovery mechanism and financial incentive that should be applied to the DVO project.

- The future role of additional or expanded pricing options in encouraging more efficient use of electric energy and capacity.

Finally, I sponsor and support revisions to the financial incentive mechanisms that I proposed in my Direct Testimony, and propose financial incentive mechanisms that should be adopted if the Commission adopts the savings goals of other intervenors. The Company’s revised incentive mechanisms are based on the same policy goals I articulated in my Direct Testimony, but are recalibrated to reflect the updated estimates of net economic benefits in 2015 and 2016 that Company witnesses Jeremy Petersen and Jim Hill sponsor in their Rebuttal Testimony.

I organize my Rebuttal Testimony by topic, in the order listed above.

II. FINANCIAL INCENTIVE MECHANISM FOR NON-DVO ENERGY EFFICIENCY PROJECTS

Q. TO WHICH WITNESSES WILL YOU RESPOND?

A. I will respond to the Answer Testimony of the following witnesses: Mr. Kevin C. Higgins on behalf of Colorado Energy Consumers (“CEC”); Mr. Chris Neil
on behalf of the Office of Consumer Counsel (“OCC”); Ms. Rachel S. Ackermann on behalf of the Trial Staff of the Colorado Public Utilities Commission (“Staff”); Mr. Howard Geller on behalf of the Southwest Energy Efficiency Project (“SWEEP”); and Mr. Tim Woolf on behalf of Sierra Club.

Q. ARE THERE ANY GENERAL OBSERVATIONS YOU WISH TO OFFER REGARDING THE FILED ANSWER TESTIMONY?

A. Yes. As I stressed in my Direct Testimony, Colorado Revised Statutes § 40-3.2-104 (5) requires that “[t]he Commission shall allow an opportunity for a utility’s investments in cost-effective Demand Side Management (“DSM”) programs to be more profitable than any other utility investment that is not subject to special incentives.” The Company has proposed an incentive mechanism that would allow our electric DSM initiatives to be profitable to the extent that we reach or exceed our goals. In other words, we have proposed an incentive mechanism that meets the statutory criterion cited above.

Regardless of whether intervenors agree with the Company’s specific proposal, they also have an obligation to demonstrate that the alternatives they have offered are consistent with Colorado statutes. Unfortunately, CEC, OCC, Staff, and SWEEP all fail to explain how their proposed incentive mechanisms satisfy this statutory requirement. Consequently, their proposals should be rejected.
Q. DO THE SIERRA CLUB’S RECOMMENDATIONS REGARDING FINANCIAL INCENTIVES SUFFER FROM THE SAME FLAW?

A. No. The Sierra Club recommends more comprehensive revenue decoupling. I will sponsor the Company’s response to this proposal later in my testimony, starting on page 18. But the Sierra Club’s proposal does, at least, recognize the importance of the negative cash flows to the utility. In this respect, the Sierra Club’s proposal does not suffer from the same fundamental flaw as the proposals of the other intervenors.

Q. WHY DO YOU ASSERT THAT CEC, OCC, STAFF, AND SWEEP HAVE NOT MET THE STATUTORY CRITERION REGARDING PROFITABILITY?

A. As I explained in my Direct Testimony, the financial impact of energy-efficiency projects—assuming the direct costs of these initiatives are recovered in a reasonable manner—is simply the gross financial incentive the utility earns minus the financial disincentive resulting from the decline in billing determinants. No incentive proposal can be deemed reasonable unless the proponent evaluates its likely net financial effects, taking into consideration both of these significant cash flows. This prerequisite does not necessarily mean that the negative cash flows must be recovered directly on a dollar-for-dollar basis through the incentive mechanism; but it does mean that these negative cash flows must be recognized when developing a financial incentive mechanism. Because CEC, Staff, OCC, and SWEEP fail to consider the net effects of their proposals, there is insufficient basis for approving them.
Q. GIVEN THIS FUNDAMENTAL FLAW IN THESE PARTIES’ ANALYSES, WILL YOU OFFER ADDITIONAL RESPONSES TO THEIR SPECIFIC PROPOSALS?
A. Yes. Although their analyses are faulty and have led them to draw incorrect conclusions, I will address some of the underlying rationale for their proposals in the following sections of my testimony.

A. RESPONSE TO CEC

Q. IN ADDITION TO YOUR GENERAL OBSERVATION PROVIDED ABOVE, DOES MR. HIGGINS OFFER ANY TESTIMONY REGARDING THE FINANCIAL IMPACTS OF ENERGY EFFICIENCY PROGRAMS ON PUBLIC SERVICE?
A. Yes. On page 27, lines 11-17, of his Answer Testimony, Mr. Higgins suggests that, despite the impact of energy efficiency programs in the Company’s service territory, the Company still forecasts growth in retail load over the foreseeable future. He concludes, based on this expected load increase, that the lack of direct recovery of lost margins would not be inequitable to the Company.

Q. DOES THE COMPANY AGREE WITH THIS ASSESSMENT?
A. No. I understand that in this section of his testimony Mr. Higgins is assessing the Company’s proposal to directly recover the financial disincentive attributable to the DVO project. However, regardless of whether the issue is to consider financial disincentives directly or indirectly, I disagree with Mr. Higgins’ assessment.
Q. PLEASE EXPLAIN.

A. As a preliminary matter, Public Service is not projecting growth in use per customer. This trend in use per customer is a more relevant measure of the Company’s ability to offset cost increases than the trend in total sales. Consequently, even if the level of overall sales were germane to this proceeding, the projected trend in such sales does not justify Mr. Higgins’ optimism.

Regardless, my more fundamental point is that trends in billing determinants other than those attributable to energy efficiency projects are irrelevant for purposes of developing a sound performance incentive mechanism. No competent business would deem a line of business as being profitable because its losses were compensated for by gains from another line. It would be far better to jettison the unprofitable line of business and retain the profitable line. In other words, the only relevant consideration under Colorado statutes is the incremental impact of energy efficiency programs on the Company’s profitability. Mr. Higgins’ observation about another projected impact on the Company’s overall profitability over the next few years is a red herring. The introduction of such irrelevant factors is not merely an academic matter, as it distracts policymakers from the fundamental (and relatively straightforward) task of properly evaluating the profitability (or lack thereof) of energy efficiency programs based on relevant cash flows. These cash flows are not affected in any respect by the trend in overall sales.
– regardless of whether these overall sales include or exclude the impacts of energy-efficiency programs.

Q. DOES MR. HIGGINS RAISE CONCERNS ABOUT THE SLIDING STRUCTURE OF THE COMPANY’S PROPOSED PERFORMANCE INCENTIVE MECHANISM FOR NON-DVO PROJECTS?

A. Yes. Mr. Higgins believes that under the Company’s proposed Performance Incentive the Company’s share of net economic benefits increases too rapidly with the increase in performance. He recommends substituting a linear incentive mechanism for the Company’s proposed mechanism, such that the Company would earn the same percentage of net economic benefits on each increment of savings and resulting net economic benefits.

Q. WHAT IS YOUR RESPONSE TO MR. HIGGINS’ CRITIQUE OF THE PERFORMANCE INCENTIVE?

A. The Company structured its proposed Performance Incentive to mirror the structure of the current mechanism and provide greater rewards as the Company’s performance improved. By the same token, the Company recognizes that a variety of different incentive structures could theoretically meet this goal.

Nonetheless, there is an important mathematical dilemma to bear in mind. Any linear incentive mechanism must be structured such that the resulting gross incentive from an increment of savings is greater than the financial disincentive attributable to the same increment. Otherwise, the Company has an incentive to achieve as little as possible after meeting the
threshold for earning the Disincentive Offset. But the same flat percentage that meets this goal might result in an incentive that is too rich at relatively low achievement levels. A graduated incentive addresses this potential problem. It does not appear that Mr. Higgins considered these nuances when developing his proposal -- perhaps because he does not consider negative cash flows when developing his proposed financial incentive mechanism.

Q. ARE YOU THEN SUGGESTING THAT THE SPECIFIC, GRADUATED PERFORMANCE INCENTIVE PERCENTAGES THAT THE COMPANY PROPOSES MUST BE RETAINED?

A. No. While a sliding scale of percentage award is preferable to the Company, the incremental increases can be adjusted. Later in my testimony I will sponsor the Company’s modified financial incentive structures. While these modifications are prompted by our updated estimates of avoided costs and net economic benefits, I will also modify the sliding scale to the extent it does not result in poor outcomes based on the policy criteria I established in my Direct Testimony.

B. RESPONSE TO OCC

Q. DO YOU WISH TO OFFER ANY ADDITIONAL RESPONSE TO MR. NEIL REGARDING THE DEVELOPMENT OF FINANCIAL INCENTIVES FOR ENERGY EFFICIENCY?

A. Yes. On Page 50, lines 15-18, of Mr. Neil’s Answer Testimony, he states the following:
The Company is proposing a substantial increase in incentives despite the fact that the programs are achieving lower savings. Because PSCo is achieving lower savings, I recommend that the Commission reject Public Service’s proposed changes if not reducing the current incentives.

I will respond to this assertion.

Q. DO YOU BELIEVE MR. NEIL HAS DRAWN THE CORRECT CONCLUSION FROM RECENT TRENDS?

A. No. The Company’s current and proposed financial incentive mechanisms do not specify a dollar amount of total incentives, but rather a fixed amount triggered by reaching a certain performance level, plus a graduated percentage of net economic benefits accrued from specific levels of performance. It is impossible to reach any conclusions about the sufficiency of any such incentive mechanism without comparing the relevant cash flows (as explained above).

If Mr. Neil wishes to recognize recent trends when recalibrating the incentive mechanism, then the more appropriate barometers are trends in the net economic benefits per kWh of savings and the financial disincentive per kWh of savings. The financial disincentive per kWh is increasing slowly, while avoided costs are declining. (Company witnesses Mr. Jeremy Petersen and Mr. Jim Hill explain the basis for and impacts of these reductions to avoided costs.) In other words, the Company’s per-unit financial losses are relatively flat or increasing, while the per-unit base on which the Company earns an
incentive is declining precipitously. Under these conditions, the equitable
response is to increase the percentage of net economic benefits the utility is
allowed to retain. Otherwise, the Company will absorb greater losses at each
performance level.

Thus, Mr. Neil is proposing a movement in exactly the wrong direction
with regard to the Company’s financial incentive for DSM.

Q. SHOULDN’T UTILITY SHAREHOLDERS SHARE THE BURDEN OF
DECREASING RETURNS FROM ENERGY EFFICIENCY MEASURES?

A. No. As I indicated above, Colorado law directs the Commission to ensure
that the Company’s energy efficiency initiatives are more profitable than other
investments that are not subject to special incentives. Accordingly, requiring
shareholders to share the burden of decreasing net benefits from energy
efficiency as Mr. Neil has proposed would be contrary to this statutory
directive. Moreover, it is patently unfair to penalize the utility for carrying out
public policy mandates. Such penalties are even less warranted when one
considers the Company’s recent success at lowering its avoided costs
consistent with its obligation to minimize its cost of delivering utility service.
While fuel prices may be largely outside the utility’s control, there are many
steps the utility can and should take to reduce the costs of procuring
incremental resources. To “reward” the utility’s success in lowering its
avoided costs by requiring it to suffer greater financial losses from providing
(mandated) energy efficiency programs is a poor way to implement public
policy.
C. RESPONSE TO STAFF

Q. DO YOU WISH TO OFFER ANY ADDITIONAL RESPONSE TO STAFF?
A. Yes. On page 31 of her Answer Testimony Ms. Ackermann suggests that the Company failed to consider our authority to collect energy efficiency program costs on a current basis when developing our proposed financial incentive mechanism. On page 32 she suggests that, since the Company has only one year of complete results under the current incentive mechanism, it should be retained until we have more experience. I wish to address both of these observations.

Q. DO YOU AGREE WITH MS. ACKERMANN’S SUGGESTION THAT THE COMPANY FAILED TO CONSIDER ITS COST RECOVERY MECHANISM WHEN DEVELOPING THE PROPOSED FINANCIAL INCENTIVE MECHANISM?
A. No. In Docket No. 07A-420E the Commission authorized the Company to expense and recover, on a current basis, the costs of our energy efficiency initiatives. The rationale for this cost recovery was discussed at great length in that proceeding, and I will not repeat that discussion. However, I believe the Commission’s approved approach offers at least the following advantages:

- Expensing (rather than capitalizing) the cost recognizes that DSM measures are different from other system investments, in that DSM measures are usually installed on the customer-side of the meter.
• Expensing the costs better enables utilities to continue offering energy efficiency programs during periods when capital is constrained.

• Current cost recovery with a true-up ensures that costs are neither under-recovered nor over-recovered.

• Expensing the costs reduces exposure to stranded costs if public policy mandates change in the future.

But this current cost recovery does not by itself yield “profits” to the utility; the utility only breaks even. Moreover, while expensing offers many advantages, it does not afford the utility an opportunity to profit by earning a return that exceeds its opportunity cost of capital. For this reason I view the cost-recovery mechanism as basically a “financial wash.” This means that the financial impact of energy efficiency programs is, as I represented in my Direct Testimony: the gross financial incentive minus the financial disincentive.

Q. DO YOU AGREE WITH MS. ACKERMANN’S SUGGESTION THAT THE CURRENT INCENTIVE MECHANISM BE EXTENDED UNTIL THE COMPANY HAS MORE EXPERIENCE WITH IT?

A. No. As a threshold issue, we can have no meaningful discussions regarding the efficacy of any financial incentive mechanism until the net financial impacts are evaluated correctly. As I explained previously, the intervenor evaluations in this proceeding are inadequate.
Assuming we do apply the correct financial criteria, maintaining the current financial incentive mechanism is a poor option. The decisions reached in this proceeding will be implemented beginning in 2015. Given the projected changes to avoided costs, net economic benefits, and energy efficiency goals between now and 2015, it makes little sense to calibrate an incentive mechanism to be effective in 2015 to actual experience in 2012 or 2013. This is an area where using forecasts is absolutely essential. Otherwise, we will develop a financial incentive mechanism that addresses past conditions but not the conditions during which the mechanism will be applied.

D. RESPONSE TO SWEEP

Q. DO YOU WISH TO OFFER ANY ADDITIONAL RESPONSE TO SWEEP’S SPECIFIC PROPOSALS REGARDING FINANCIAL INCENTIVES FOR ENERGY EFFICIENCY?

A. Yes. Mr. Geller opposes the Company’s proposed cap of $50 million on the non-DVO Performance Incentive. Instead, he recommends a cap of $35 million, which he derives by applying an inflation adjustment to the current cap of $30 million. This cap would apply to the combination of the Disincentive Offset and Performance Incentive. Mr. Geller argues that there is no justification for the Company’s proposed increase, because the Company has not previously reached the $30 million cap that is currently in effect. Again, the primary problem with Mr. Geller’s recommendation is that it is not informed by an assessment of the likely negative cash flows resulting
from the Company’s energy efficiency programs in 2015 and 2016. These negative cash flows are a function of the Company’s projected base rates and energy efficiency savings. Ultimately, the cap should be set at a level that provides the Company with an incentive to increase its performance up to some amount that the Commission deems reasonable. The Company suggested that the cap should continue to reward the utility up to achievement levels of 140 percent or more of the approved goals.

The Company acknowledges that the level of the cap is largely a matter of judgment. Nonetheless, this judgment should be informed by relevant factors such as forward-looking estimates of financial disincentives and energy efficiency goals. In contrast, the Company’s past experience with breaching the cap is irrelevant; the same conditions will not likely hold when the financial incentive mechanism approved in this proceeding is implemented. (I discuss the specific conditions that can and have changed in more detail in my Direct Testimony.)

Q. IS THE COMPANY PROPOSING A DIFFERENT INCENTIVE CAP IN REBUTTAL TESTIMONY TO REFLECT THE CHANGES IN AVOIDED COSTS AND NET ECONOMIC BENEFITS YOU MENTIONED PREVIOUSLY?

A. Yes. The Company is proposing a cap on the non-DVO Performance Incentive of $30 million in 2015 and $35 million in 2016, which are significant reductions from the cap of $50 million proposed in our Direct Case. I will discuss the Company’s modified incentive mechanism later in my testimony.
Q. DOES MR. GELLER RAISE OTHER CONCERNS ABOUT THE COMPANY’S FINANCIAL INCENTIVES?

A. Yes. On page 3 of his Answer Testimony, Mr. Geller asserts that the Company has a financial incentive to understate its energy efficiency goals given the structure of the current incentive mechanism.

Q. PLEASE RESPOND TO MR. GELLER’S ASSERTION.

A. The Company always strives to propose realistic goals commensurate with the likely results of an effective deployment strategy—regardless of the design of the financial incentive mechanism. Nonetheless, I agree with Mr. Geller that the current incentive mechanism is structured to provide greater rewards as the Company’s energy savings expressed as a percentage of our established goals increase. Consequently, all else being equal, we do have an incentive to surpass our approved savings goals.

Of course, one of the best responses to Mr. Geller’s concern is to substitute an incentive mechanism that provides for the direct recovery of the financial disincentive and a modest, flat performance incentive that the Company can achieve by attaining a minimum threshold of performance. In fact, that type of mechanism is exactly what the Company is proposing for the DVO project. The proposed DVO incentive mechanism still provides the Company with an incentive to attain higher energy savings. At the same time, the Company has little incentive to understate the savings goal, since our financial incentive is independent of the approved savings goal as long as the Company achieves a minimum performance threshold.
While Mr. Geller cites a concern with the current mechanism, he proposes no good alternative. In fact, he opposes the most straightforward solution—the direct recovery of financial disincentives.

Q. CAN MR. GELLER’S CONCERN BE MITIGATED WITHIN THE CONTEXT OF THE CURRENT INCENTIVE FRAMEWORK?

A. Yes. In fact, the Company’s modified incentive mechanism for non-DVO projects is recalibrated to reduce the benefits of achieving savings well beyond the approved goals. This modification, while not as effective as the alternative incentive mechanism I explained above, significantly weakens the link between the Company’s financial incentive and the level of the approved savings goals.

E. RESPONSE TO SIERRA CLUB

Q. DOES THE SIERRA CLUB RECOGNIZE THE FUNDAMENTAL FINANCIAL ISSUE FACING THE COMPANY REGARDING THE CONTINUED PROVISION OF ENERGY EFFICIENCY PROGRAMS?

A. Yes. On page 58, lines 21-24, of his Answer Testimony, Mr. Woolf states the following:

The Company should not be penalized financially as a result of successful implementation of efficiency programs. Without recovery of these lost revenues, the Company cannot be expected to implement comprehensive, meaningful efficiency programs…
Q. DO YOU AGREE WITH THIS ASSESSMENT?
A. Yes. It captures the utility’s fundamental financial dilemma succinctly. I hope that this common-sense assessment will be more widely recognized and ultimately used a basis to develop effective financial incentive mechanisms in Colorado.

Q. DOES MR. WOOLF THEN ADVOCATE THE DIRECT RECOVERY OF THE FINANCIAL DISINCENTIVE?
A. No. He claims that there are administrative problems with the direct recovery of the financial disincentives attributable to utility-sponsored energy efficiency programs. He adds that such a mechanism, even if implemented properly, would not address all of the utility’s disincentives to reducing customer usage.

Q. WHAT DOES MR. WOOLF THEN RECOMMEND AS AN ALTERNATIVE TO THE DIRECT RECOVERY OF THE FINANCIAL DISINCENTIVE?
A. He recommends more comprehensive revenue decoupling. He suggests that the Commission investigate revenue decoupling in either a separate docket or as part of a utility rate case.

Q. DOES THE COMPANY AGREE WITH THE SIERRA CLUB’S RECOMMENDATION?
A. Since the Company is not proposing direct recovery of the financial disincentive for the bulk of our energy efficiency programs, I will not address the alleged administrative difficulties or policy shortcomings of such an approach. Instead, I will focus on Mr. Woolf’s recommendation regarding comprehensive revenue decoupling.
When evaluating the merits and design of revenue decoupling mechanisms, it is important to consider several issues.

First, revenue decoupling goes well beyond addressing the financial impacts of energy efficiency programs. The basis for revenue decoupling is that the utility should have no incentive to increase customer usage, nor should the utility realize earnings gains or losses due to changes in customer use either within or outside its control.

Second, to account adequately for the financial disincentives due to energy efficiency programs, the revenue decoupling mechanism would need to encompass changes to both billing demands and customer usage.

Third, revenue decoupling would eliminate any ability for the utility to offset cost increases with load growth, although that benefit may already be marginal at best.

In sum, while revenue decoupling may be a valid alternative to explore, it does represent a fundamental change to current ratemaking in Colorado and would take time to develop and implement effectively.

The Company would agree to exploring revenue decoupling in a generic proceeding. However, it is unclear whether the next Phase I proceeding would be a good vehicle for that discussion.
Q. WHY WOULD THE NEXT PHASE I PROCEEDING POTENTIALLY BE AN INAPPROPRIATE VEHICLE FOR EVALUATING REVENUE DECOUPLING?

A. The Company’s current Multi-Year Plan for the electric utility expires on January 1, 2015. Absent clear authority to implement interim rates, the Company will probably file its next Phase I rate case in May 2014, which is before the date on which the Commission will issue a Final Order in this proceeding. Consequently, unless the Company was to propose revenue decoupling unilaterally as part of its Phase I application, there would be limited opportunity to explore the issue in the next Phase I proceeding.

Q. WHAT DOES THE COMPANY PROPOSE REGARDING REVENUE DECOUPLING?

A. The Company suggests that the Commission approve the financial incentive mechanism proposed by the Company in this proceeding based on the assumption of no revenue decoupling. If the Commission ultimately approved a revenue decoupling mechanism for Public Service, then as part of that Order the Commission could require simultaneous changes to the DSM financial incentive mechanism.

III. DVO COST RECOVERY AND FINANCIAL INCENTIVES

Q. TO WHICH WITNESSES WILL YOU RESPOND REGARDING DVO COST RECOVERY AND FINANCIAL INCENTIVES?

A. I will respond to the Answer Testimony of CEC witness Mr. Higgins; OCC witness Mr. Neil; SWEEP witness Mr. Geller; Staff witness Mr. Paul C.
Caldera; Colorado Energy Office (“CEO”) witness Mr. Christopher Worley; and City of Boulder witness Ms. Kelly B. Crandall.

Q. HOW WILL YOU ORGANIZE YOUR REBUTTAL TESTIMONY ON THIS TOPIC?

A. Since multiple witnesses raise identical or similar objections to the Company’s proposal regarding DVO cost recovery and financial incentives, I will focus on these common objections. I will also offer limited responses to specific witnesses.

A. DVO COST RECOVERY

Q. PLEASE REITERATE THE COMPANY’S PROPOSAL FOR DVO COST RECOVERY.

A. In my Direct Testimony I proposed that the Company be allowed current recovery of its DVO costs through a combination of base rates and the Demand Side Management Cost Adjustment (“DSMCA”) rider. Specifically, the Company would recover through the DSMCA any operating and maintenance (“O&M”) expenses and capital costs of the DVO project not approved for recovery through base rates.

Q. WHY DO INTERVENORS OBJECT TO THIS PROPOSAL?

A. OCC, Staff, CEC, SWEEP, and CEO conclude that the DVO project is basically an investment in utility infrastructure. (The OCC recommends rejection of the DVO project, so I construe their other recommendations regarding the project as applying only if the Commission decides to authorize it in some fashion). The intervenors then draw different conclusions from this
premise -- in that some believe the project belongs in the Company’s DSM portfolio, while others do not. Nonetheless, they appear to be united in their opposition to recovering any portion of such infrastructure costs through the DSMCA. Their fundamental position is that investments in utility infrastructure are traditionally recovered through base rates, and that there is no compelling reason to depart from that precedent for the DVO project.

Q. WHAT IS THE COMPANY’S RESPONSE TO THE INTERVENORS’ POSITION ON DVO COST RECOVERY?

A. Other Company witnesses will address the technical aspects of the DVO project and defend its inclusion in the DSM portfolio. I wish to focus on issues directly related to cost recovery.

It is important to remember that the Company’s proposal for DVO cost recovery would accomplish two goals:

- It would ensure that all DVO costs are ultimately recovered through base rates, as is the case for most utility investments; and
- It would ensure that the Company can recover its costs on a current basis.

Without some mechanism for rider recovery, the Company would be at risk for under-recovery due to both higher-than-anticipated costs and whatever regulatory lag results from the base-rate recovery approved by the Commission.
Q. IF THE DVO PROJECT IS SIMILAR TO OTHER UTILITY INFRASTRUCTURE PROJECTS, WHY SHOULD ANY RIDER RECOVERY BE ALLOWED?

A. I acknowledge that the DVO project is similar to utility infrastructure projects, in that DVO comprises distribution system improvements on the utility side of the meter. But there are also several important differences.

First, if the DVO project is part of the DSM portfolio, then the DVO cost recovery should mirror the cost recovery of other energy efficiency projects. The Company is afforded current recovery of the costs of its other energy efficiency measures through a combination of base rates and the DSMCA. The Company’s proposal for DVO cost recovery is consistent with this approach.

Second, the level and timing of costs is more uncertain for the DVO project than for other utility infrastructure projects, which mean that the Company’s risk of cost recovery is greater. The corollary to this shareholder risk is that our customers bear the other side of this risk; the representative level of DVO costs included in a test year may significantly exceed costs in future years, before base rates are reset. The recovery of actual DVO costs through the DSMCA better matches the ultimate recovery of such costs with their actual levels. In other words, the ability to secure timely and complete cost recovery through the DSMCA is a reasonable remedy to the inherent uncertainty of the DVO project.
Third, the DVO project, similarly to other DSM measures, ultimately reduces the Company’s revenues. Admittedly, this issue is better addressed through the financial incentive mechanism than through cost recovery. I highlight this difference here only to demonstrate the limitations of equating the DVO project with other utility infrastructure investments that do not reduce the Company’s revenues.

Ms. Debra Sundin discusses the DVO project’s place within the Company’s DSM portfolio in her Rebuttal Testimony. Company witness Ms. Kelly Bloch discusses the technical merits of DVO technology in her Rebuttal Testimony.

B. DVO FINANCIAL INCENTIVE

Q. PLEASE REITERATE THE COMPANY’S PROPOSAL REGARDING DVO FINANCIAL INCENTIVES.

A. In my Direct Testimony I proposed a two-part financial incentive: the direct recovery of the financial disincentive resulting from DVO implementation, and a Performance Incentive of 2 percent of net economic benefits to reward the Company for effective deployment.

Q. PLEASE SUMMARIZE THE INTERVENORS’ RESPONSE TO THIS PROPOSAL.

A. Mr. Higgins suggests that the recovery of financial disincentives “would establish an ill-advised precedent.” He suggests substituting a straight Performance Incentive of 5 percent of net economic benefits, which is the same incentive he would apply to other energy efficiency measures.
OCC and Staff oppose the inclusion of the DVO project within the Company's DSM portfolio, so the issue of financial incentives is moot. Mr. Neil does, however, state that if the Commission approves the inclusion of DVO with the Company's DSM portfolio, then the same financial incentive mechanism should be applied to both DVO and non-DVO measures.

Mr. Geller (SWEEP) endorses the inclusion of the DVO project within the Company's DSM portfolio. However, he recommends that the DVO project be treated similar to other system investments—recovery through base rates with no financial incentive.

Mr. Worley (CEO) echoes Staff's position, in that he believes the DVO project is similar to other investments on the utility side of the meter and should be excluded from the DSM portfolio. He acknowledges that the project may not be financially beneficial to the Company without incentives, but states that the evaluation of any such incentives is beyond the scope of a DSM proceeding.

Ms. Crandall (City of Boulder) is concerned that the Company could “double recover” by earning both a Performance Incentive based on the net economic benefits of the DVO project and a return on DVO assets included in rate base.

Q. WHAT IS YOUR RESPONSE TO THE INTERVENORS WHO OPPOSE ANY FINANCIAL INCENTIVE FOR THE DVO PROJECT?

A. Company witness Ms. Sundin will defend the inclusion of the DVO project within the DSM portfolio in more depth. At a high level I am unclear how
OCC, Staff, and CEO conclude that a project that reduces energy use should be excluded from the DSM portfolio. Similarly, I do not understand why SWEEP believes that the DVO project belongs in the DSM portfolio, but does not merit any financial incentives.

Regardless, the DSM designation or lack thereof is not a compelling factor when evaluating whether the Company deserves a financial incentive. If a utility initiative reduces billing determinants and earnings, then it presents the same financial challenges as traditional DSM measures. Despite their semantic disagreements with the Company, none of the four intervenors challenges the key financial basis for a DVO financial incentive; each intervenor appears to acknowledge that the DVO project would reduce customer use and the utility’s base revenues.

Q. **DO YOU WISH TO OFFER ANY ADDITIONAL RESPONSE TO CEC?**

A. Yes. Mr. Higgins supports the same financial incentive for the DVO project that is applied to the other energy efficiency measures. I explained why the DVO project merits a different incentive mechanism in my Direct Testimony. I saw nothing in Mr. Higgins’ Answer Testimony that would prompt me to change this recommendation.

I also disagree with Mr. Higgins’ assertion that the Commission would set a bad precedent by authorizing the direct recovery of the financial disincentive. In fact, I cannot imagine a better precedent in this proceeding than one that directly addresses the fundamental financial challenge facing
the utility in the provision of energy efficiency programs. That recognition would represent a significant step forward.

Q. PLEASE ADDRESS MS. CRANDALL’S CONCERNS ABOUT DOUBLE RECOVERY.

A. To address this concern it may be helpful to review the specific components of the cost recovery and financial incentive mechanisms that the Company proposes for the DVO mechanism.

The first component is the cost recovery. The Company proposes recovery of the costs of the DVO project through a combination of base rates and the DSMCA, including the cost of equity attributable to the DVO net investment. This return on equity does not constitute a special financial incentive to the Company to deploy the DVO project. Instead, this return component recognizes the cost of raising capital and is consistent with how traditional cost-of-service regulation has been applied to other utility assets.

The second component is the direct recovery of the financial disincentive attributable to the DVO project. This component eliminates the financial disincentive resulting from the DVO project, which is not an issue for traditional utility investments.

The third component is the (modest) performance incentive pegged to the net economic benefits attributable to the project. This third component provides the Company with an incentive to deploy the project effectively.

These three components accomplish three different objectives: the first ensures complete cost recovery of the project; the second eliminates the
undeniable financial disincentive to deploying the project; and the third provides a small financial reward to the Company for good performance. The combination of all three components yields the appropriate aggregate financial results; and the three components do not in any sense duplicate each other or result in double recovery.

IV. DYNAMIC PRICING PROGRAMS

Q. DO YOU WISH TO RESPOND TO ANY OF THE INTERVENOR ANSWER TESTIMONY REGARDING PRICING PROGRAMS?

A. Yes. On page 50, lines 5-6, of his Answer Testimony, OCC witness Mr. Neil urges the Company “to continue to move dynamic pricing programs along in its DSM programs.” He recommends that pilot pricing programs, mostly in conjunction with smart appliances and electric vehicles, be instituted in the 2015/2016 Biennial DSM Plan. If successful, these programs would be fully rolled out in the 2017/2018 Biennial DSM Plan (presuming that the Commission agrees with the Company’s effort to maintain a biennial DSM Plan schedule). I will respond to this recommendation.

Q. DO YOU HAVE ANY CONCERNS ABOUT MR. NEIL’S TESTIMONY?

A. Yes. I do not believe that the Commission should adopt his specific procedural recommendations. As I stated in my Direct Testimony, dynamic pricing programs are different in several respects from other demand response and energy efficiency measures. Customer rates are not simply “DSM programs”; they are developed to accomplish other ratemaking objectives as well – such as affording the utility the ability to recover its test-
year cost of service, sending the appropriate economic price signals to customers, and avoiding large bill impacts. Moreover, the benefit-cost ratios and impacts of dynamic pricing programs are more difficult to predict and verify, and their financial impacts on the utility may be better addressed through Phase II rate proceedings. Consequently, while it is certainly reasonable to explore dynamic pricing tariffs and smart appliances in various venues, a Phase II proceeding may be a better implementation vehicle than a DSM Plan. Moreover, there is insufficient information in the record to justify the specific timing of any pilot and permanent dynamic pricing options.

V. COMPANY’S MODIFIED FINANCIAL INCENTIVE MECHANISM

Q. WHY IS THE COMPANY MODIFYING THE FINANCIAL INCENTIVE MECHANISM THAT YOU PROPOSED IN YOUR DIRECT TESTIMONY?

A. As explained in the Rebuttal Testimony of other Company witnesses, the Company is modifying its estimates of avoided costs. Since net economic benefits depend in large part on the levels of assumed avoided costs, the outcomes of any incentive mechanism pegged primarily to net economic benefits are obviously very sensitive to changes in avoided costs. Consequently, the Company has recalibrated our proposed non-DVO incentive mechanism to achieve the goals articulated in my Direct Testimony in light of these input changes.
Q. WHY ARE YOU NOT RECOMMENDING CHANGES TO THE DVO FINANCIAL INCENTIVE MECHANISM?
A. The proposed direct recovery of the DVO project is self-correcting in terms of changes to the level of financial disincentives; to the extent these disincentives increase or decrease, the Company’s compensation increases or decreases accordingly. Moreover, this direct recovery of the financial disincentive is coupled with a flat, modest Performance Incentive that can still be effective over a wide range of estimated net economic benefits. Consequently, the Company is not proposing any changes to the DVO incentive mechanism.

Q. ARE YOU SPONSORING AN EXHIBIT THAT SUMMARIZES THE MODIFIED FINANCIAL INCENTIVE MECHANISM?
A. Yes. Exhibit No. SBB-7 provides this information. I summarize the incentive mechanism on page 1. On pages 2 and 3 I derive the estimated net financial results of this mechanism at various energy savings levels in 2015 and 2016, respectively.

Q. ARE THERE ANY IMPORTANT FEATURES OF THE REVISED PROPOSAL THAT YOU WISH TO HIGHLIGHT?
A. Yes. The most noticeable difference between the incentive mechanisms proposed in the Company’s Direct Testimony and Rebuttal Testimony is that the Company’s share of the net economic benefits is significantly higher at most levels of performance. This higher level of sharing is necessitated by
the decline in the estimated avoided costs and resulting net economic
benefits mentioned above.

Also, both the Company and intervenors have expressed concerns
about rate impacts due to the fact that many measures that are cost-effective
from a Modified Total Resource Cost ("MTRC") perspective do not pass a
Ratepayer Impact Measure ("RIM") Test. This situation is exacerbated by the
decline in forecasted avoided costs. To address this concern I have muted
the incremental incentive the Company can earn from performance well
above the established goals. In fact, the Company proposes to cap our
percentage share of net economic benefits at 21 percent. The Company
would begin to earn this level of incentive at 120 percent of goal achievement,
and would continue to earn this same incentive at increasing levels of
achievement. The cap on the non-DVO Performance Incentive would be $30
million in and $35 million in 2016, which would give the Company an incentive
to achieve at least 145 percent of the savings goals in those two years. But
the net financial incentives at high levels of achievement would be less than
under the Company’s initial proposal. In fact, the Company’s estimated net
financial gain would be capped at less than $9 million in 2015 and at about
$14 million in 2016 — assuming a two-year persistence of the financial
disincentive.

Finally, capping the percentage sharing at 120 percent would also
partially addresses Mr. Higgins’ concern regarding precipitous increases in
the Company’s net financial incentive at higher levels of achievement.
Q. IS THIS MODIFIED INCENTIVE MECHANISM EXPLAINED ABOVE BASED ON THE SAME POLICY GOALS YOU ARTICULATED IN YOUR DIRECT TESTIMONY?

A. Yes. These modified incentive mechanisms would still allow the Company to profit from the successful implementation of electric energy efficiency programs. Moreover, the extent to which we profit would be directly tied to the level of net economic benefits. By the same token, the Company would suffer a financial loss if we performed poorly.

Q. HAS THE COMPANY PROVIDED ALTERNATIVE SAVINGS GOALS IN ITS REBUTTAL TESTIMONY?

A. Yes. As Ms. Sundin explains in her Rebuttal Testimony, the Company has identified an alternative plan for the Commissions consideration. This alternative plan includes lower energy savings goals to recognize concerns about rate impacts.

Q. IF THE COMMISSION APPROVED THESE ALTERNATIVE SAVINGS GOALS, WOULD THE COMPANY STILL RECOMMEND THE SAME FINANCIAL INCENTIVE MECHANISM?

A. The Company would recommend the same incentive mechanism explained above with one exception: the proposed 2016 cap on the non-DVO Performance Incentive would be $32 million instead of $35 million. This lower cap is calibrated to ensure the Company still has a financial incentive to achieve additional energy savings up to approximately 145 percent of the approved energy savings goal.
Q. HAVE YOU PREPARED AN EXHIBIT THAT DERIVES THE ESTIMATED FINANCIAL IMPACT OF THE INCENTIVE MECHANISM YOU WOULD APPLY TO THE COMPANY’S ALTERNATIVE ENERGY SAVINGS GOALS?

A. Yes. Exhibit No. SBB-8 provides these impacts for 2015 and 2016. The Company’s maximum financial gain would be capped at less than $9 million in 2015 and at about $14 million in 2016 – assuming a two-year persistence of the financial disincentive.

VI. PROPOSED FINANCIAL INCENTIVE MECHANISMS BASED ON PROPOSED SAVINGS GOALS OF INTERVENORS

Q. IS THE COMPANY PROPOSING A CONTINGENT FINANCIAL INCENTIVE MECHANISM IF THE COMMISSION APPROVES THE ENERGY SAVINGS GOALS PROPOSED BY ONE OF THE INTERVENORS?

A. Yes. I have developed a unique incentive mechanism tailored to the energy savings goals proposed by the following intervenors: OCC, Staff, CEC, SWEEP, and the Sierra Club. The specifics of these financial incentive mechanisms and their estimated net financial impacts on the Company in 2015 and 2016 are provided in Exhibit Nos. 9 through 12. The magnitudes of the Performance Incentive sharing amounts, Disincentive Offsets and non-DVO Performance Incentive caps vary among the five contingent incentive mechanisms. Nonetheless, each maintains the same basic structure that the Company proposed in Direct Testimony.
Q. ARE THESE CONTINGENT INCENTIVE MECHANISMS CALIBRATED TO ACHIEVE THE SAME GOALS YOU ARTICULATED IN YOUR DIRECT TESTIMONY?

A. Yes. These modified incentive mechanisms are calibrated to allow the Company to profit from the successful implementation of electric energy-efficiency programs. Moreover, the extent to which we profit would be directly tied to the level of net economic benefits. By the same token, the Company would suffer a financial loss if we performed poorly.

Q. IF THE COMMISSION APPROVES ANOTHER PLAN THAT ENTAILS DIFFERENT FINANCIAL DISINCENTIVES AND NET ECONOMIC BENEFITS, HOW SHOULD A FINANCIAL INCENTIVE MECHANISM TAILORED TO THAT PLAN BE DEVELOPED?

A. If the Commission approves a plan not addressed in my Rebuttal Testimony, then the Commission should convene an expedited proceeding in which the Company and stakeholders can propose incentive mechanisms tailored to the Commission's approved plan. The Commission can then adopt a financial incentive mechanism based on this record.

VII. SUMMARY AND CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. With the exception of the Sierra Club, the intervenors in this proceeding ignore the true financial impacts of energy efficiency programs on the utility's profitability. Because the intervenors fail to specify the problem correctly, their recommended financial incentive mechanisms are ill-conceived and fail
to meet the statutory directive for the utility to be afforded the opportunity to
profit from the provision of DSM programs.

Sierra Club properly recognizes the financial disincentives to the utility,
and proposes comprehensive revenue decoupling as a remedy. The
Company is amenable to exploring revenue decoupling in a future
proceeding, but does not believe the next Phase I proceeding would be a
good venue.

The DVO project is in some ways similar to other utility infrastructure
investments, but also has unique characteristics and poses unique financial
challenges in terms of both revenue impacts and cost recovery. The
Company continues to believe that our proposed cost-recovery and financial-
incentive mechanisms are reasonable in light of these challenges.

In our Rebuttal case the Company is reducing its estimates of avoided
costs and net economic benefits attributable to our proposed energy
efficiency programs. In my Rebuttal Testimony I sponsor a revised financial
incentive mechanism that captures these changes. The Company is also
sponsoring an alternative DSM plan with reduced energy savings goals.
Accordingly, I sponsor an alternative incentive mechanism calibrated to the
net economic benefits and financial disincentives resulting from this
alternative plan.

I also sponsor contingent incentive mechanisms that the Company
would recommend if the Commission adopted the energy savings goals of the
OCC, Staff, CEC, SWEEP or the Sierra Club.
Finally, if the Commission approves a plan not addressed in my Rebuttal Testimony, then the Commission should convene an expedited proceeding in which the Company and stakeholders can propose incentive mechanisms tailored to the Commission’s approved plan. The Commission can then adopt a financial incentive mechanism based on this record.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.