Pace Energy and Climate Center

State Experiences with Performance-Based Regulation

OREGON STATE LEGISLATURE

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RMI

ENERGY. TRANSFORMED.

About your presenter

Janine Migden-Ostrander

Janine L. Migden-Ostrander is a fellow at Pace University. Prior to that, Ms. Migden-Ostrander was a Principal at the Regulatory Assistance Project where she advised regulators and advocates on energy efficiency, renewable energy, demand response, distributed generation, and integrated resource planning. Recent projects include working closely with the Puerto Rico Commission, Arkansas Public Service Commission on energy efficiency as part of the Clean Energy Ministerial for the U.S. Department of Energy (DOE), facilitating the Mid-Atlantic Distributed Resources Initiative (MADRI), and providing workshops on power sector transformation for Commissioners.

Ms. Migden-Ostrander has worked in public utility law for approximately 40 years, most recently as the Ohio Consumers' Counsel, where she oversaw the state agency that represents the interests of Ohio's 4.5 million residential households with their investor-owned electric, natural gas, telephone, and water companies.

About your presenter

Cara Goldenberg

Cara Goldenberg is a Principal on RMI's Carbon-Free Electricity Program where she leads RMI's work with utilities, regulators, and advocates to evolve utility business models and regulations to affordably and reliably decarbonize the power sector. In this capacity, Cara has managed engagements with the Hawaii Public Utilities Commission, Connecticut Office of Consumer Counsel, Illinois Commerce Commission, the North Carolina Department of Environmental Quality, and other stakeholders on regulatory reforms needed to support the equitable integration of clean energy resources. Cara is an experienced facilitator, leading stakeholder processes across the US to make progress on complex issues related to the energy transition. She is the co-author of various RMI reports focused on performance-based regulation, cost control, regulatory process design, market structures, and DER utilization.

Prior to joining RMI, Cara pursued a Master's in Public Affairs at Princeton University's Woodrow Wilson School, where she received a certificate in Science, Technology, and Environmental Policy. Prior to Princeton, Cara worked at Dian Grueneich Consulting in San Francisco. Her work focused on analyzing state and regional clean energy policies and regulations.

Two Concepts to Keep in the Forefront

1. Utilities have a fiduciary duty to their shareholders.

- Their primary driver is to earn a return for their investors/shareholders.
- Customers take a second place.

2. All regulation is incentive regulation.

- The ratemaking formula is critical because it defines how the utility can make money to reach its goal of increasing earnings and keeping Wall Street happy.
- Utilities will execute on what can give them the highest returns.

The Ratemaking Formula (Traditional Rate of Return Regulation)

$$RR = (RB \times ROR) + OE + DE + T$$

- RR =Revenue Requirement, the total amount the utility needs to operate.
- RB = Rate Base which consists of Utility Plant and assets, plus working capital.
- ROR = the Rate of Return that the Regulator gives the utility the opportunity to earn. It is calculated as a percentage of the rate base.
- OE = Operating Expenses such as transportation, postage, labor, etc.
- DE = Depreciation Expense – the amount by which an asset is amortized over a period of years.
- T = All taxes the utility pays which are passed through to its customers.

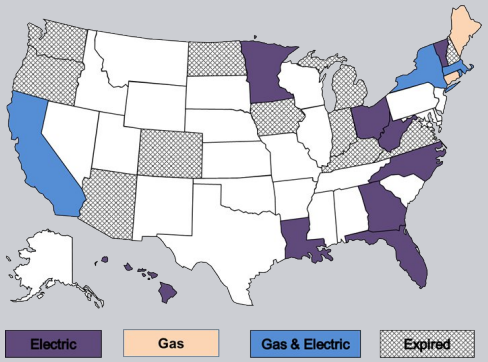
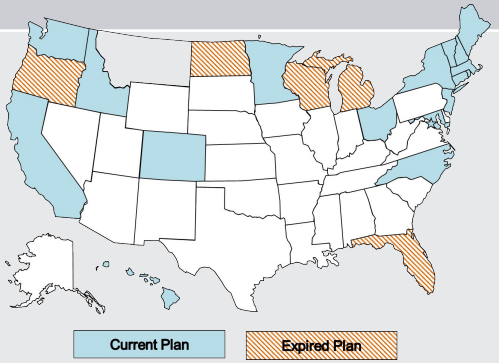
The Adverse Consequences of Traditional Rate of Return Regulation

- **Under Rate of Return Regulation, utilities earn money for shareholders by building more assets and increasing sales. This is not always in the customer's interests.**
  - The more a utility builds, the more it earns a return for its customers and the more rates go up for customers.
  - Increased sales means increased pollution.
- **Rate of Return Regulation creates an adverse tension between the utility and its customers, since what's good for the utility's shareholders is not necessarily good for its customers and vice-versa.**

Performance-Based Regulation – Aligning Utility Interests with Customers' Interests

- The goal of Performance-Based Regulation (PBR) is to align the utility's interest with the public interest to achieve the best policy outcomes which include affordable rates, clean and reliable energy and maintaining healthy utilities.
- This is a logical, but significant departure from traditional ratemaking.
- The result of a successful PBR framework is one in which the utility earns a reasonable return for its shareholders by changing business practices that more clearly benefit its customers and the general public.
- PBR attempts to minimize the tension between utility interests and customer interests to create win-win solutions.

PBR is not a single regulatory mechanism, but is a collection of tools that can advance a range of priorities

PBR tool	What it does	How it can support SB 688 Objectives	State examples
Revenue decoupling	Delinks utility revenue from sales, so that actual revenue is "trued up" to match the allowed revenue.	• Ensures that any excess utility revenues are returned to customers • Removes the utility disincentive to invest in demand-side resources (e.g., energy efficiency)	
Multi-year rate plan	Sets the utility's revenue requirement and base rates for more than one year. Typically includes a mechanism that caps revenues and adjusts them over time to reflect changing costs (either according to forecasts and/or external cost drivers).	• If designed right, encourages cost efficiency (since utilities can typically retain a portion of any cost savings)	

Source: Mark Lowry, Performance-Based Regulation for Energy Utilities (October 2023), NARUC Regulatory Training Initiative

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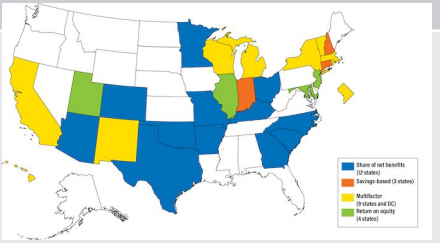
PBR tool	What it does	How it can support SB 688 Objectives	Examples
Capex-opex equalization	A range of strategies to incentivize utilities to pursue cost-effective solutions, no matter if they are capex or opex.	• Levels the playing field between capex- and opex-based solutions, which can encourage increased use of energy efficiency, distributed energy resources, and third-party owned generation	
Performance incentive mechanisms (PIMs)	Provide an incentive to the utility for meeting specified performance targets.	• Can be targeted on a range of priority regulatory outcomes, such as improving reliability and service quality, reducing disconnections, and utilizing distributed energy resources.	 Source: ACEEE, 2018
Reporting metrics & scorecards	A metric is a specific, quantifiable measure used to assess a utility's performance in achieving a desired outcome, whereas a	• Increase visibility into utility performance, such as on emissions from anthropogenic gases and atmospheric pollutants, utility operations, and resilience.	 Source: Hawaiian Electric

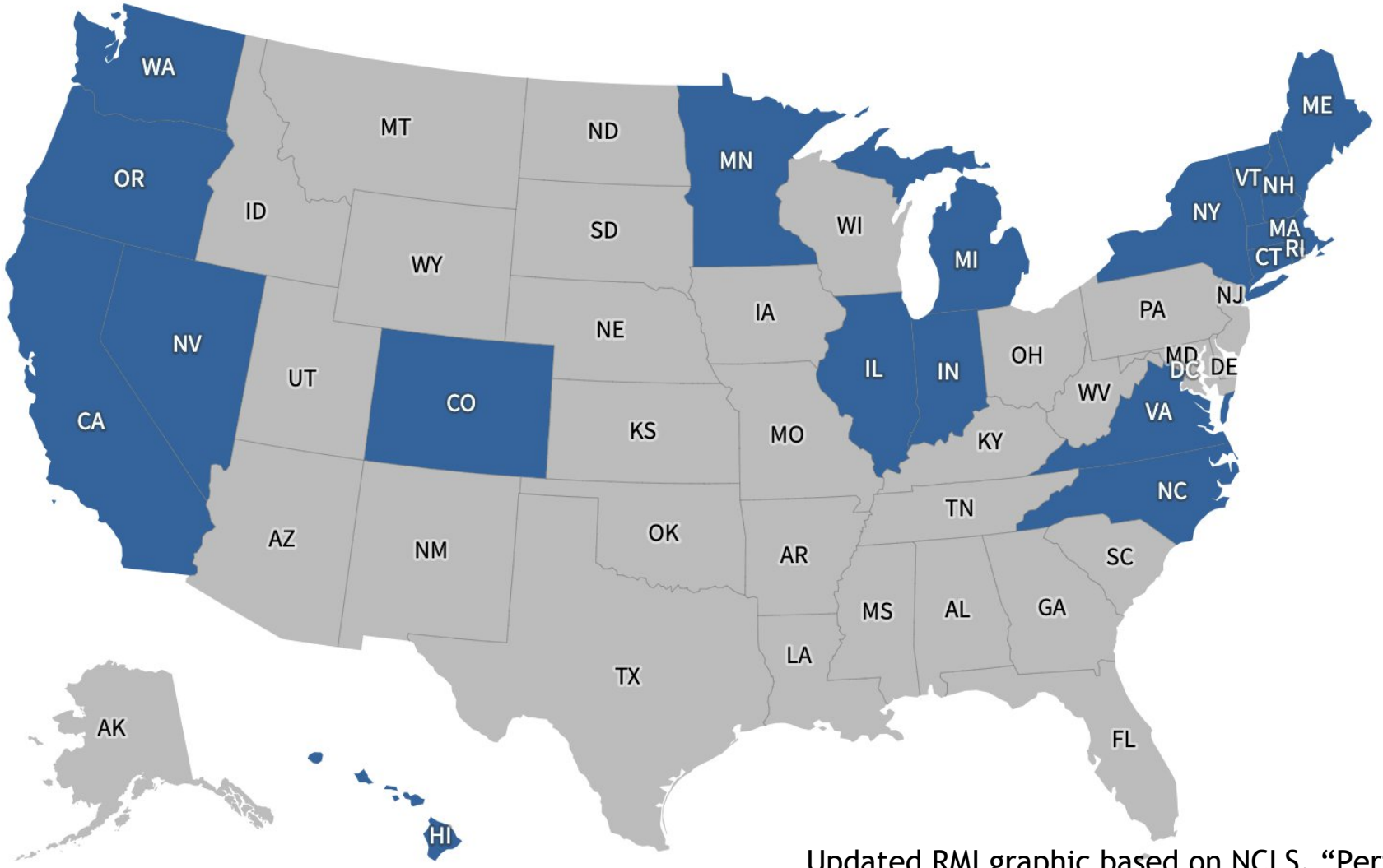
Why PBR Legislation is Needed

- Legislation enables the legislature to enumerate some of its policy priorities that can then be transformed into performance incentive metrics.
- Provides more accountability and transparency for ratepayers
- Reduces unnecessary utility investments and gold-plating to boost shareholder earnings
- Directs utility expenditures and efforts towards what is in the public interest
- Better aligns utility's fiduciary duty to shareholders with duty to its customers
- Enhances the efficiency of utility operations and improves services to

The Role of Good Legislation

- Articulates a clear vision
- Defines public interest and objectives What PBR should accomplish by explicitly stating the goals
- Provides guidance to regulators with sufficient direction and authority to carry out the legislative intent
- Provides broad statutory language to enable commission to implement public policies
- The details should be left to regulators
- Oregon's proposed legislation is a solid first step in this direction

Many states have passed legislation related to PBR over the years



Updated RMI graphic based on NCLS, “Performance-Based Regulation Harmonizing Electric Utility Priorities and State

Hawaii has an expansive portfolio of performance mechanisms

Goals	Outcomes	Examples of Metrics, Scorecards, and PIMs
Enhance Customer Service	Affordability	- Payment Arrangement metric - Disconnections metric
	Reliability	- Transmission & Distribution (T&D) System Average Interruption Duration Index (SAIDI) PIM - Generation System Average Interruption Frequency Index (SAIFI) PIM
	Interconnection Experience	- Interconnection Approval PIM - Independent Power Producer (IPP) Interconnection scorecard
	Customer Engagement	- Advanced Metering Infrastructure (AMI) Utilization PIM - Program Participation scorecard
Improve Utility Performance	Cost Control	- Collective SSM - Rate Base per Customer metric
	DER Asset Effectiveness	- Grid Service PIM - DER Grid Service Utilization metric
	Grid Investment Efficiency	- Avoided T&D Investment metric - Non-Wires Alternatives Total Cost metric
Advance Societal Outcomes	Capital Formation	- Credit Ratings metric - Third-Party Generation metric
	Customer Equity	- LMI Energy Efficiency PIM - LMI Program Participation metric
	GHG Reduction	- RPS-A PIM - GHG Emissions scorecard
	Electrification of Transportation	- Fleet Electrification scorecard - Measured Electric Vehicles (EV) Load scorecard
	Resilience	- Critical Load metric - Emergency Response Training metric

Examples of Performance Incentive Metrics from Puerto Rico

- The Energy Bureau issued an Order in Case No. NEPR-MI-2019-0007, requiring quarterly reports tracking Key Performance Indicators (KPI) which are reporting metrics, commencing September 15, 2019.
- Well over 100 KPI are required covering every aspect of PREPA's operations.
- On December 13, 2019, the Energy Bureau issued its regulations on Performance Incentive Mechanisms, Regulation 9137 in Case CEPR-IN-2016-0002.
- The regulations set forth an annual process for the Energy Bureau to issue for comment, proposed metrics and targets, along with which ones will be subject to a financial incentive. To date, PREPA (through Luma and Genera) continue to file Quarterly Reports with the Energy Bureau expressly reserving the right to levy penalties for lack of improvement.

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