Performance-Based Regulation: Purpose + Process

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NCSL Energy Supply Task Force | May 19, 2022

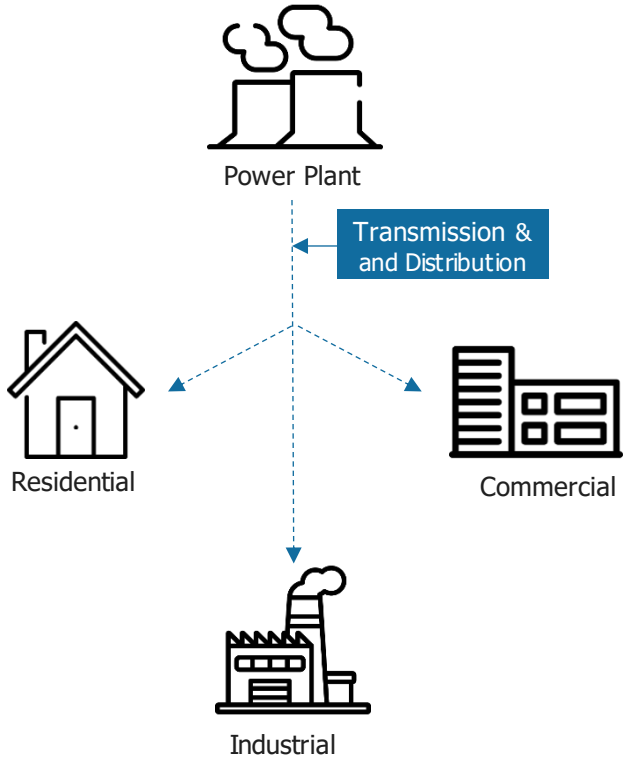
01

Performance-Based Regulation

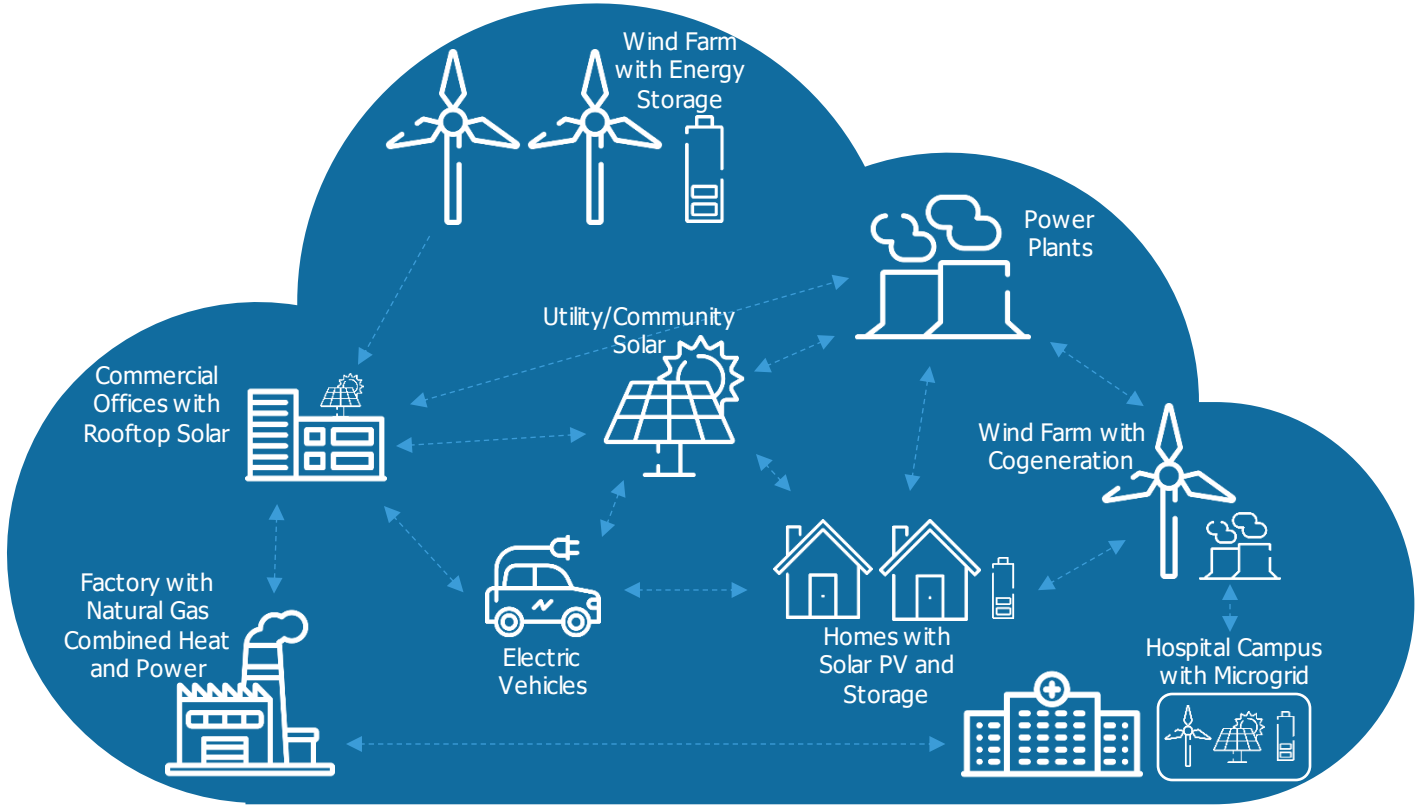
Overview + Context

The Energy Transition: Toward a Clean, Decentralized, & Intelligent Grid

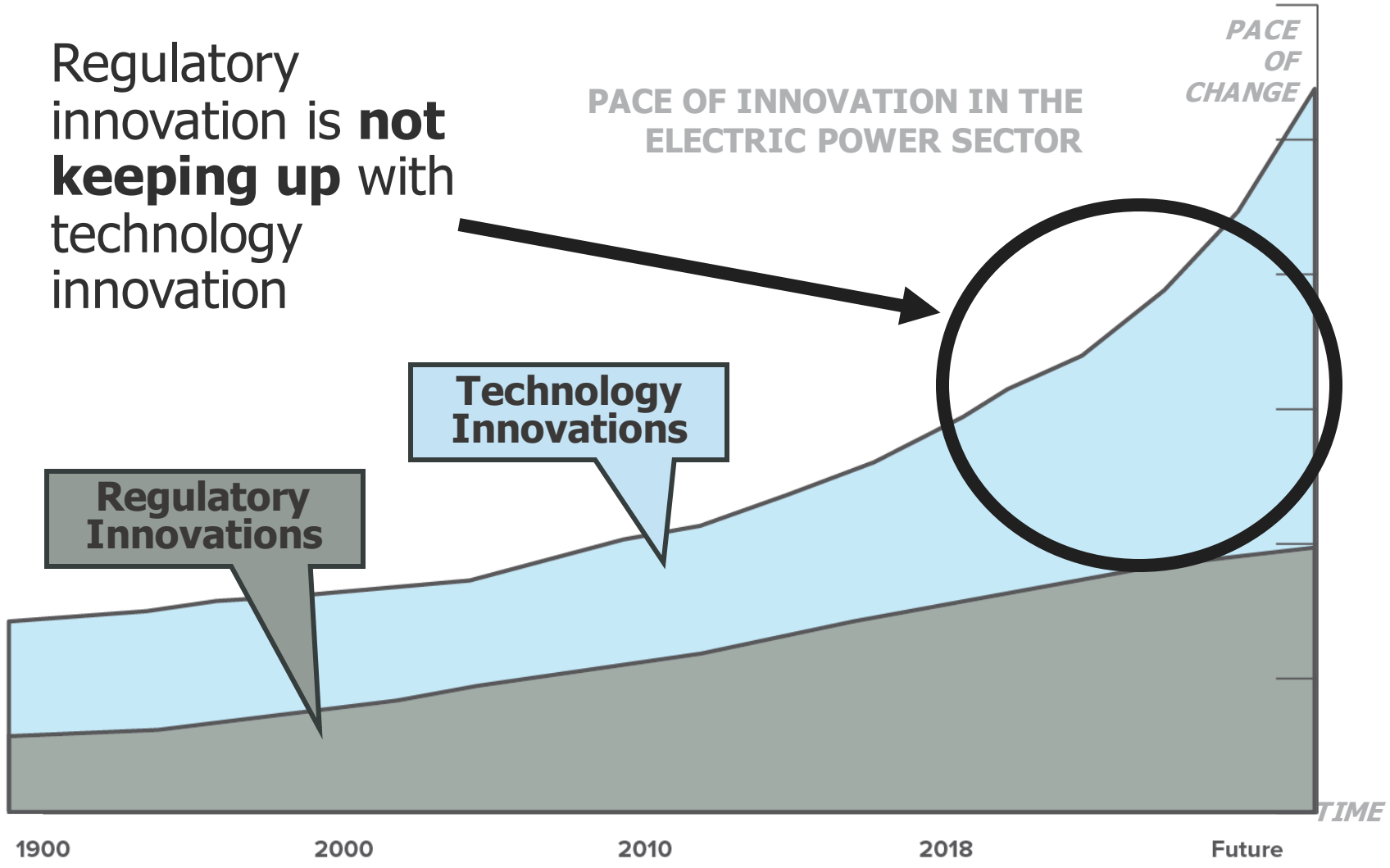
PAST: Traditional Power Grid
Central, One-Way Power System



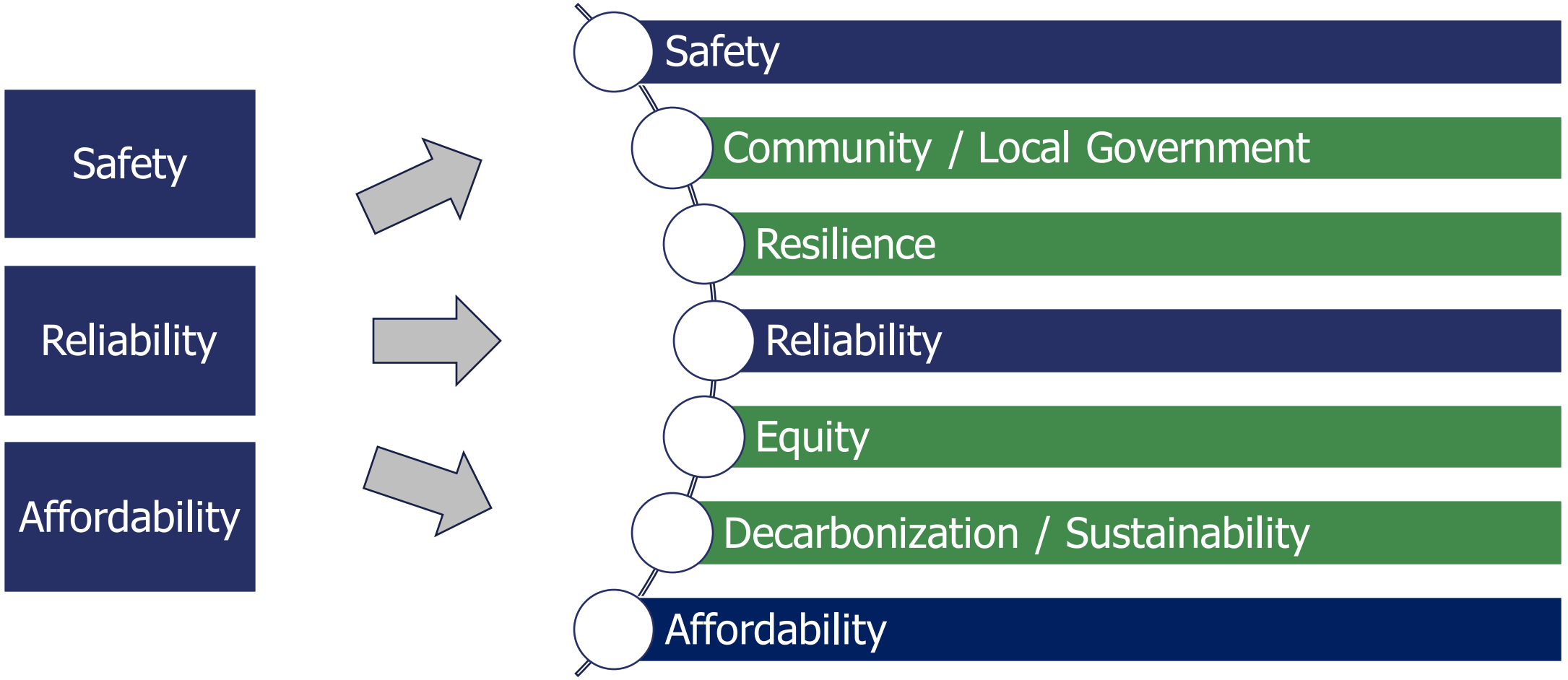
TODAY: The Energy Transition
Distributed, Cleaner, Two-Way Power Flows



Regulatory Innovation is the Key



Evolving Public Policy Objectives and Criteria

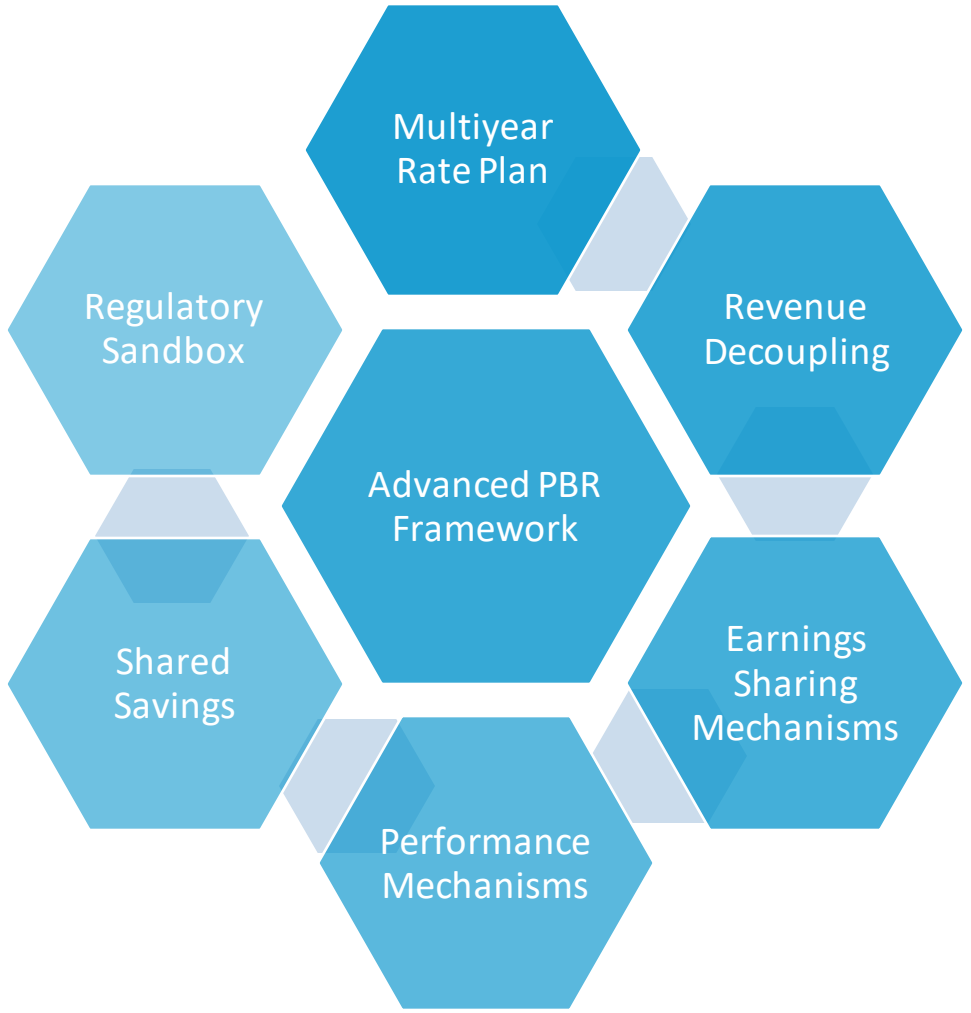


PERFORMANCE-BASED REGULATION

Core Elements of an Advanced PBR Framework

+ To create sufficient space for innovation, enhance customer satisfaction, lower overall costs, and facilitate the transition to a platform utility model, an advanced PBR framework includes an interrelated set of critical, core elements.

The power system of the future will not be affordable or optimized so long as utility financial returns are driven primarily by capital investment



Key Takeaways

1. New regulatory frameworks and performance-based mechanisms protect consumers through energy transition and ensure utility focus on critical system outcomes
2. Process design is needed to ground approach in key outcomes and to facilitate meaningful stakeholder engagement – ensuring incentives are aligned with public interest
3. PBR enabling legislation is critical to catalyze action but must be structured in a manner that empowers the PUC does not ‘stack the deck’ for the utility

02

PBR Regulatory Process Design

Design of Regulatory Proceeding Critical to Success

“Change is not an event, it’s a process”

Cheryl James

PROCESS DESIGN – PHASED APPROACH

Building the Foundation: Five Discrete Steps

Goals

Identify and articulate regulatory policy goals that the State wishes to achieve

Regulatory policy goals should be broadly defined while still providing sufficient certainty and flexibility

Outcomes

Determine the desired outcomes of utility service

Outcomes describe how utility services affect ratepayers and society

Regulatory Assessment

Evaluate current regulatory framework to examine which regulatory mechanisms may not be functioning as intended or are no longer aligned with the public interest

Identify specific areas of utility performance that should be targeted for improvement

Regulatory Mechanisms

Assess which regulatory mechanisms can best address the specific areas of interest

This assessment should result in the grouping of regulatory outcomes into: PIMs, RAMs, and/or other regulatory reforms

Metrics

Identify specific performance metrics, where appropriate

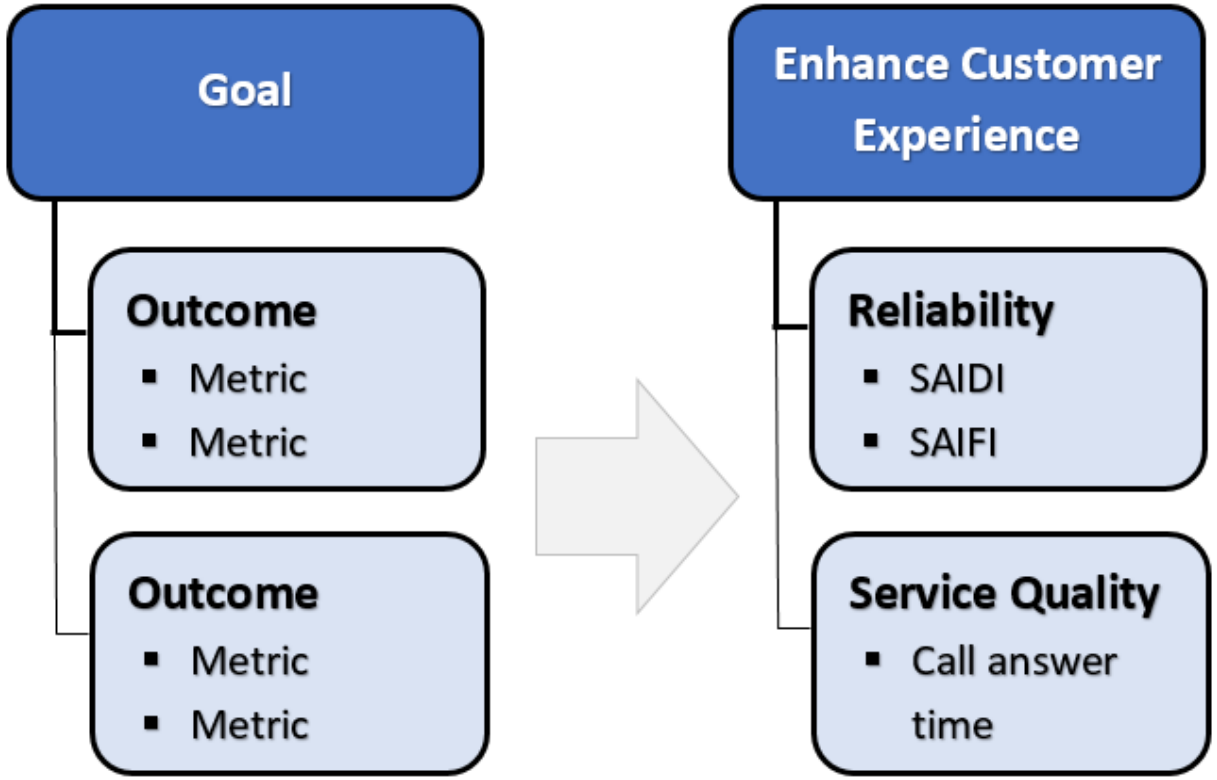
A metric is a standard of measurement that can allow regulators to determine how well utility is performing in achieving a particular outcome

Each workshop will be followed by an opportunity to comment from stakeholders

The first steps of a PBR proceeding should inform a Goals-Outcomes Hierarchy

Goals provide the highest-level orientation for what utility regulations and ratemaking seek to achieve

Outcomes are a more specific set of factors that derive, in whole or in part, from utilities' operations and business decisions



The proposed goals on the following slide are simply a starting point for discussion and are expected to be refined through stakeholder feedback in this process

03

Enabling Legislation for Successful PBR

Legislative Structure Can ‘Make or Break’ a PBR Process

ENABLING LEGISLATION FOR SUCCESSFUL PBR

Facilitating Meaningful Progress: Interface between Legislature and PUC

Current Legislative Shortcomings	Legislation continues to drive adoption of PBR in many states In several cases, PBR legislation to date has undelivered against the need for reform Utilities are advancing their own, narrow version of PBR via policy that lacks ambition or teeth
Why Model Legislation?	Provide strong policy signal and unambiguous legal authority to PUC Help with prioritization and resource allocation Implementation flexibility is critical Statutory deadlines can expedite progress – but to a point

Guiding Principles for Successful PBR Legislation

'First Mover'	Legislation that provides for utility to initiate PBR proceeding via a utility-developed plan cedes critical policy decisions to utility that can be difficult to course correct
Sufficient Time?	Commission and parties need sufficient space and time to ground proceeding in goals-outcomes and align on key policy decision points
Opt Out?	Utility should not be permitted to pick and choose whether it wants to be governed by traditional cost-of-service or a performance-based regulation framework
Holistic	Commission needs to be given adequate deference and discretion, but PBR structure should include a comprehensive collection of advanced PBR elements

State	Legislation	Passage
Hawaii	SB 2939	April 2018
Nevada	SB 300	May 2019
Connecticut	HB 7006	October 2020
Illinois	SB 2896	September 2021
North Carolina	HB 951	October 2021

STATE LEGISLATION FOR PBR: A COMPARATIVE VIEW

State	Statutory Timeline	Utility Opt Out?	Commission Discretion	MYRP	PIMs	Metrics
Hawaii	18 months to est. PIMs	No	High	N*	Y	Y
Nevada	210 days to review utility application	Yes	Low	Y	N	N
Connecticut	No statutory deadline	No	High	N*	Y	Y
Illinois	Utility to file initial metrics in 12 months	No*	Medium	N*	Y	Y
North Carolina	120-day rulemaking	Yes	Low	Y	Y	Y

Thank You! Get in Touch:

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Appendix

Matthew McDonnell
Managing Director

Matthew McDonnell

Matthew McDonnell is the Managing Director, US Consulting at Strategen. Matthew supports private-and public-sector clients across numerous domains, including energy storage, power system planning, rate design, grid modernization, distributed energy resources, and the development of new utility business models. Matthew leverages his prior experience as a state regulator to deliver valuable insights to clients.

An expert in electric utility regulation and energy policy, Matthew has led a variety of projects ranging from regulatory strategy for an energy storage manufacturer and tariff programs related to the integration of distributed energy resources, to the development of advanced performance-based regulatory frameworks. Matthew has deep regulatory experience in leading-edge markets and appreciates the broad perspectives of the industry's diverse stakeholders.

Matthew earned his Juris Doctor from the University of Arizona and a B.A. in Finance from Michigan State University. He is licensed to practice in both Arizona and Hawaii.

STRATEGEN CONSULTING

PERFORMANCE-BASED REGULATION

The Purpose and Elements of PBR

PBR Overview + Introduction

+ PBR can be broadly defined as a comprehensive approach to better aligning the utility regulatory structure with performance-based outcomes, using instruments to align financial incentives and encourage utility business model adaptation

+ Performance-based or incentive-based frameworks and regulatory mechanisms can result in:
  - Greater cost control and reduced rate volatility
  - Efficient investment and allocation of resources regardless of classification as capital or operating expense
  - Fair distribution of risks between utilities and customers
  - Fulfillment of policy goals
  - Supporting electric grid innovation and drive emissions reductions

+ PBR generally includes two critical components: (1) revenue adjustment mechanisms and (2) performance mechanisms, though other elements may not fall cleanly within these categories

The ongoing energy transition will not be optimized or affordable if financial returns continue to be driven primarily by utility capital investment

PERFORMANCE-BASED REGULATION

Revenue Adjustment Mechanisms provide alternative approaches to utility cost recovery and earnings

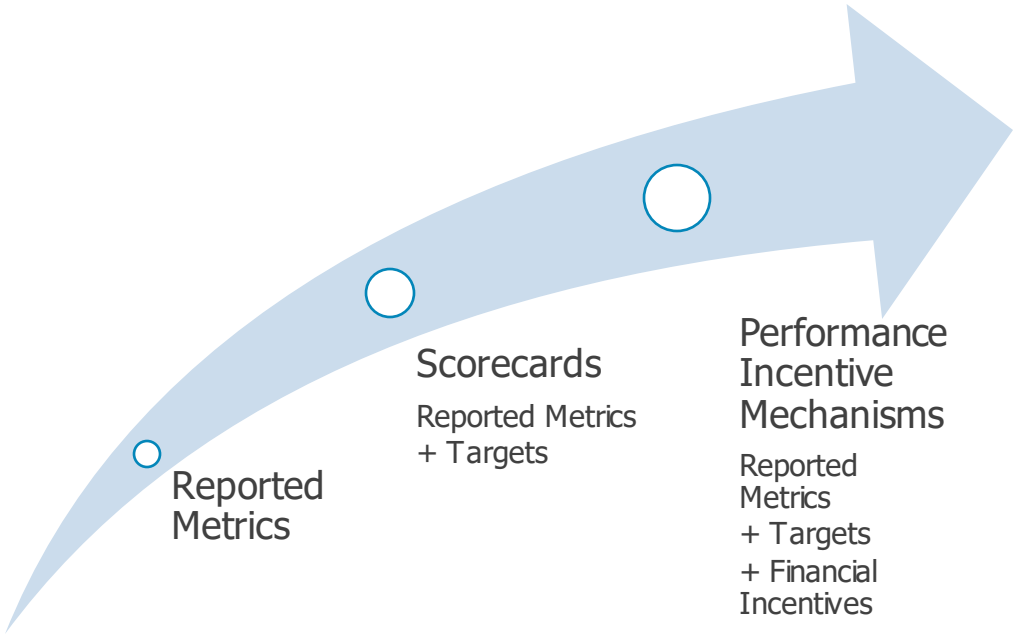
Revenue Adjustment Mechanisms	
Multiyear Rate Plan (MRP) and Indexed Revenue Cap	3-5-Year Control Period with Externally Indexed Revenue Cap allowing interim adjustments to both CAPEX and OPEX pursuant to a revenue cap to an externally indexed formula (e.g., inflation less productivity). A 3-5-year plan period will help to incentivize cost containment over the duration and will free up resources previously spent on annual rate reviews to focus on grid modernization and adding customer value.
Revenue Decoupling	A revenue decoupling mechanism to true-up revenues to an annual revenue target, which ensures the electric company receives the target revenue, regardless of increases or decreases in energy sales. Revenue decoupling smooths out volatility that otherwise would occur over a 5-year MRP period and removes an incentive barrier to energy efficiency and DER adoption.
Earnings Sharing Mechanism (ESM)	A symmetrical ESM that provides both upside and downside sharing of earnings between the electric company and customers when earnings fall outside an Authority-approved range. A symmetrical ESM can act as a "safety valve" around earnings, allowing for a meaningful percentage of overall earnings to be tied to performance-based incentives while protecting the electric company's financial integrity and the customers' interests.

PURA Staff Concept Paper #1

PERFORMANCE-BASED REGULATION

Performance Mechanisms provide a method to align utility operations, services, and products with public policy goals

Performance mechanisms can be used to assess diverse areas of the utility's performance, such as safety and reliability, customer satisfaction, and adoption of energy efficiency programs. The reported metrics and scorecards can also be used as building blocks for a utility, helping it to build metric tracking capabilities and gather historic and peer-compared performance trends to ultimately pursue a PIM.



Beyond traditional PBR mechanisms, other more comprehensive regulatory reforms may be needed

Other Regulatory Mechanisms	
CAPEX/OPEX Parity	Shared savings mechanisms to incentivize the cost-effective pursuit of non-wires alternatives and revise regulatory ratemaking treatment so electric companies can earn a rate of return on third-party service solutions.
Innovation	A regulatory sandbox to create space for the development of innovative products and services and experiment with subscription pricing to facilitate enhanced customer access to new products and services.
Value-Added Services	Examine how value-added services can be incorporated into the regulatory framework to diversify electric company revenues in the near-term and facilitate a customer-centric model in the longer term.

PURA Staff Concept Paper #1