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

Regulatory innovation is **not keeping up** with technology innovation.

**PACE OF INNOVATION IN THE ELECTRIC POWER SECTOR**

- **Technology Innovations**
- **Regulatory Innovations**

**EVIDENCE OF A CHANGING ELECTRIC INDUSTRY**
EVIDENCE OF A CHANGING ELECTRIC INDUSTRY

Evolving Public Policy Objectives and Criteria
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.
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
PBR Regulatory Process Design

Design of Regulatory Proceeding Critical to Success
“Change is not an event, it’s a process”
Cheryl James
# 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.

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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.
Enabling Legislation for Successful PBR

Legislative Structure Can ‘Make or Break’ a PBR Process
# 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
<table>
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<tr>
<th><strong>Guiding Principles for Successful PBR Legislation</strong></th>
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<td><strong>‘First Mover’</strong></td>
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<td><strong>Sufficient Time?</strong></td>
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<td><strong>Opt Out?</strong></td>
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Thank You! Get in Touch:

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

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<td>Multiyear Rate Plan (MRP) and Indexed Revenue Cap</td>
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<td>Revenue Decoupling</td>
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<td>Earnings Sharing Mechanism (ESM)</td>
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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

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<td><strong>CAPEX/OPEX Parity</strong></td>
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<td>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.</td>
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<td><strong>Innovation</strong></td>
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<td>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.</td>
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<td><strong>Value-Added Services</strong></td>
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<td>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.</td>
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