

From: Jerry Beck
Sent: Friday, August 23, 2024 8:13 AM
To: PUC: Clerks Office <clerksoffice@puc.nh.gov>
Subject: Performance based regulation

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I suspect that the PUC Commissioners are familiar with the Rocky Mountain Institute (RMI) and their work. I recently came across a report published by RMI that I thought was worthy of review by the PUC. I took the liberty of copying the report's Executive Summary in hopes that it would inspire the Commissioners to download the report as it could be useful in transitioning our energy systems to meet future needs. I did not include a link to the report as I suspect security concerns preclude following links from unknown sources.

I hope you find this helpful.
Respectfully,
Gerald Beck
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Executive Summary Performance-based regulation (PBR) is an alternative to traditional cost-of-service regulation (COSR) that aims to improve the alignment between the incentives utilities face and the interests of customers and society. PBR is most often used to regulate for-profit, investor-owned companies, though some aspects of it are also relevant to other types of utilities (e.g., government-owned enterprises). Though PBR is not new, it has been attracting more attention in recent years due to the growing mismatch between traditional COSR and modern policy goals. For example, the structure of traditional COSR creates a strong financial incentive for utilities to spend more money than needed on infrastructure — but affordability is a growing concern as the need to manage new load growth, modernize the grid, replace aging infrastructure, and ensure system resilience in the face of a changing climate grows. Traditional COSR also encourages utilities to prefer investing their own capital over utilizing third-party services and customer-owned solutions. However, in the modern era the best solution to a problem may not be a big utility-owned asset, but a virtual power plant, a demand-flexibility program, or behind-the-meter distributed resources. The features of traditional COSR that encourage utilities to take undesirable actions (e.g., to spend more money than necessary) are referred to as “perverse incentives.” However, the traditional regulatory model also falls short in what it fails to prioritize. Over the past century the focus of utility regulators has expanded to encompass a variety of outcomes, such as reduced carbon emissions, enhanced customer choice, and greater social equity, yet the traditional utility business model is not directly linked to how well the utility performs in these areas. Regulators can address these challenges by updating the existing regulatory model to create better incentives for utilities. Yet although this concept may seem simple, the actual process of implementing PBR reforms can be complicated and challenging. One reason for this is that

PBR is not just one tool, but a whole toolkit — and one that can be implemented in a wide variety of ways. This means it can be challenging for both regulators and other parties to figure out what PBR options could be helpful and how to get started with the reform process. Though every PBR framework is unique, a useful distinction can be drawn between incremental and comprehensive forms of PBR: Incremental PBR involves layering select PBR tools onto a traditional COSR-based framework. This creates new incentives that can help counteract the impact of the perverse incentives created by the traditional regulatory model, but it does not fundamentally change them. Comprehensive PBR addresses the root causes of the perverse incentives, so the utility has a new, inherent motivation to act in ways aligned with the public interest. Comprehensive PBR also creates new incentives to encourage utilities to focus on outcomes of interest that they lacked sufficient reason to pay attention to under traditional COSR. In essence, incremental PBR involves adopting piecemeal reforms to the traditional COSR framework, whereas comprehensive PBR fundamentally restructures the incentives facing regulated utilities. Yet this [How to Restructure Utility Incentives: The Four Pillars of Comprehensive Performance-Based Regulation rmi.org / 6](#) raises new questions. What does it mean to fundamentally restructure utility incentives, and how extensive must these reforms be to be considered comprehensive? In response, we suggest that comprehensive PBR rests on four pillars, as shown in Exhibit ES1. These consist of incentivizing cost efficiency, removing the throughput incentive, equalizing the incentives between capital expenditures (capex) and operating expenses (opex), and incentivizing targeted outcomes. Together, the pillars address the key shortcomings of traditional COSR: gold plating, capex bias, the throughput incentive, risk aversion, resistance to third-party and customer-owned solutions, and insufficient attention to key outcomes. Each of the pillars can be supported by specific PBR mechanisms. Comprehensive Performance-Based Regulation Incentivize Cost Efficiency Remove the Throughput Incentive Equalize Capex & Opex Incentives Incentivize Targeted Outcomes Exhibits ES1 & 9 Exhibit ES1 The Four Pillars of Comprehensive PBR RMI Graphic Applying the Four Pillars Model requires a working knowledge of the PBR options available. To help regulators and stakeholders get the lay of the land, we provide an overview of multiyear rate plans, revenue decoupling, and several different capex-opex equalization strategies, as well as metrics, scorecards, performance incentive mechanisms (PIMs), and data dashboards. We also offer a breakdown of the many ways a PIM's financial incentive can be structured. We also identify specific PBR reforms that are well suited to addressing each of the four pillars. Pillar 1 can be supported by an array of reforms, including multiyear rate plans, shared savings mechanisms, fuel-cost sharing mechanisms, and metrics and scorecards focused on spending trends. Pillar 2 is best addressed through revenue decoupling and Pillar 3 through capex-opex equalization strategies. The PBR reforms that are likely to best support Pillar 4 are metrics, scorecards, and PIMs. The Four Pillars Model can be employed in different ways to support the PBR design process. These include using it to assess the current regulatory regime, to target particular areas for PBR reforms, to advocate for a portfolio approach, and to evaluate proposed reforms for comprehensiveness. We encourage regulators [How to Restructure Utility Incentives: The Four Pillars of Comprehensive Performance-Based Regulation rmi.org / 7](#) and stakeholders to use the model to consider not only whether

each pillar is represented in a given regulatory framework, but also how firm a foundation that pillar rests on. In other words, while all pillars should be present for a PBR framework to be considered comprehensive, it is important to go beyond just checking off all four boxes. Although PBR can be powerful, it is not a silver bullet for every regulatory problem. Even a well-designed comprehensive PBR framework will achieve the best results when it is part of a larger basket of synergistic reforms, such as widening opportunities for stakeholder input, adopting innovation policies, updating planning and procurement processes, and expanding regulatory commission authority and responsibilities. We therefore encourage regulators and stakeholders to think about PBR, whether incremental or comprehensive, within the larger regulatory context. Designing a comprehensive PBR framework can be challenging, but the process can be broken down in ways that make it more manageable. For instance, a regulator could organize the work by first identifying the desired outcomes, and then assessing the existing regulatory framework, considering options that could address the identified needs, and taking a portfolio approach to PBR design. To reduce the risk of unintended consequences, it is also advisable to evaluate the likely joint impacts of potential reforms before making a final decision. Hawaii has implemented one of the most thorough overhauls to traditional COSR in the United States. Over the past several years, the state has adopted a portfolio of PBR mechanisms, which we consider through the lens of the Four Pillars Model. This case study provides a real-world example of how different PBR tools can be combined into a comprehensive framework, and how a jurisdiction has made improvements to its framework over time. PBR offers solutions to many of the undesirable outcomes of traditional COSR, and it will be most effective when complementary PBR mechanisms are combined into a well-designed comprehensive framework. We hope the addition of the Four Pillars Model to the regulatory toolbox will help public utility commissions chart a course toward improved regulatory frameworks in their jurisdictions.