BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the matter of the Proceeding to Develop a Policy Statement Addressing Alternatives to Traditional Cost of Service Rate Making	Docket U-210590

SECOND COMMENTS OF THE ENERGY PROJECT ON PERFORMANCE-BASED REGULATION IN WASHINGTON

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Brad Cebulko
STRATEGEN
(510) 296-8481
bcebulko@strategen.com

Consultant to The Energy Project

Yochanan Zakai
SHUTE, MIHALY & WEINBERGER LLP
(415) 552-7272
yzakai@smwlaw.com

Attorneys for The Energy Project

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I. Introduction

On December 30, 2021, the Commission issued a work plan (Work Plan) to develop a policy statement addressing alternatives to traditional cost of service rate making. The Work Plan establishes five phases and runs three years. In the first phase, which covers 15 months, the Commission aims to articulate regulatory goals, desired outcomes, and performance metrics. On April 7, 2022, the Commission noticed a virtual workshop to be held on April 19, 2022, and invited comments by April 27, 2022, on five questions identified in the notice. The Energy Project (TEP) submitted timely comments to the docket, articulating four regulatory goals for the Commission, each with recommended outcomes. On May 2, 2022, the Commission issued a notice (Notice) seeking additional comments on regulatory goals, desired outcomes, and metric design principles, as well comments on the shortcomings of the status quo regulatory regime. These comments respond to the Commission's May 2 Notice.

TEP strongly supports the path described in the workshop, where the Commission identifies specific regulatory goals, provides desired outcomes associated with those goals, and then establishes metrics to assess utilities' performance towards achieving these goals and outcomes. This path will establish a robust foundation for performance-based regulation (PBR) in Washington.

The ultimate purpose of regulation is to protect customers and promote the public interest. TEP's recommended goals for regulation address customers' needs, including affordability, and the public interest. The Legislature recently expanded the definition of public interest to encompass societal outcomes, including "environmental health and greenhouse gas emissions reductions, health and safety concerns, economic development, and equity."[1] Below TEP provides a table describing specific regulatory goals and outcomes rooted in the Commission's statutory authority, as well as our rationale supporting these goals and outcomes.

Neither the traditional regulatory model nor tools, such as revenue adjustment mechanisms, employed today by the Utilities and Transportation Commission (UTC) sufficiently incent utilities to provide affordable service, equitable service, or advance societal outcomes. For this reason, the Commission should continue to its work to develop a new performance-based regulation model that aligns utility incentives with customers' interest in affordable rates, equitable service, and societal outcomes.

Finally, TEP largely agrees with the four metrics design principles identified in the Commission's Notice, however, the Commission should also ensure that metrics are quantified using available data and easily interpreted.

II. Please provide a list of your priority regulatory goals, desired outcomes, and a rationale for including those, using the table format illustrated below. Your suggested regulatory goals should align to the Commission's statutory authority with respect to utility regulation in Washington. For each Regulatory Goal, there should be one or more desired outcomes that reflect what is desired from utility performance to achieve that goal. Please include a rationale for the goals and the outcomes, as applicable.

[1] RCW 80.28.425(1).

Regulatory Goal	Desired Outcome	Rationale
Provide Affordable Service	1. Reasonable bills for all customers 2. Reasonable energy burdens for all customers 3. Provision of service does not result in economic harm to customers 4. Efficient use of grid investments and distributed energy resources	• A key pillar of regulation is the provision of affordable service. • Regulation should result in reasonable bills. Unreasonable bills disproportionately impact low-income customers. • Affordability metrics (e.g., average bill per customer, percentage of customers with high energy burden) are widely known and already used in regulation. • Under-performance has strong negative outcomes for society. • All IOUs should be held to the same standard. • Accessing utility service should not cause economic harm to customers, particularly vulnerable customers who would be acutely impaired by any additional impacts. • In addition to the overall impact of a high energy burden, a low-income customers could experience economic harm from fees, a deposit requirement, or a negative mark on their credit report. • To the extent possible, regulation should prevent these harms, which perpetuate inequality. • Regulation should ensure that utilities efficiently use all available assets (including DERs) to provide customers' service.
Provide equitable service	1. No disparity in the quality of service provided to named communities 2. Distributed energy resources serve hard-to-reach customers, including named communities, as well as customers who are low-income, are renters, or have	• The Commission should establish that equity is a central goal for regulation in Washington. • RCW 80.28.425 establishes that societal outcomes, including equity, are part of the public interest that the Commission is charged with protecting and promoting.[2] • Named communities, which include vulnerable populations and highly impacted communities,[3] should receive the same quality of service as other customers. Preventing or reducing this disparity could require providing customers in

[2] RCW 80.28.425(1).

[3] See RCW 19.405.020(23); RCW 19.405.020(40).

	limited access to telecommunications 3. Universal access to affordable clean energy 4. Utility operations and investments promote equity	named communities a different or more expensive form of service. • RCW 19.405.040(8) requires electric utilities to ensure that all customers are benefiting from the transition to clean energy: Through the equitable distribution of energy and nonenergy benefits and reduction of burdens to vulnerable populations and highly impacted communities; long-term and short-term public health and environmental benefits and reduction of costs and risks; and energy security and resiliency. • SB 5141, the HEAL Act, found that the state has a compelling interest in preventing and addressing such environmental health disparities in the administration of ongoing and new environmental programs including allocation of funds, and in administering these programs so as to remedy the effects of past disparate treatment of overburdened communities and vulnerable populations. • As evidenced in the Washington Department of Health's Health Disparities Map, certain communities, particularly people of color and low-income population, experience disproportionately higher levels of pollution and toxic exposures. • Frontline community organizations are saying that equitable access to affordable and renewable power is a priority. • Regulation should ensure that hard-to-reach customers and named communities have access to, and are served by, DERs in the same way as other customers. • A key pillar of regulation is universal access.[4] • In providing service to customers, utilities make investments, manage human resources, hire contractors, and interact with their community. Through these activities, utilities can promote equity. • All IOUs should be held to the same standard.

[4] For example, regulated monopolies have an obligation to serve. RCW 80.28.110.

Advance societal outcomes	1. Utility plant and facilities do not adversely impact residents' health 2. Reduced pollution burden and pollution exposure 3. Reduction of greenhouse gas emissions	• RCW 80.28.425 establishes that societal outcomes, including "environmental health and greenhouse gas emissions reductions, health and safety concerns, [and] economic development" are part of the public interest that the Commission is charged with protecting and promoting.[5] • Utility operations should not harm Washingtonians or our neighbors. • In addition to eliminating pollution exposure directly attributable to utility operations where possible, regulation in Washington should track pollution burdens in our communities and promote the reduction of those burdens. Although the utilities are not responsible for certain segments of pollution, such as emissions associated with diesel and gasoline-based transportation, the utilities can have a substantial role reducing those burdens through their electrification programs. • The Legislature set reducing greenhouse gas emissions as a goal of state regulatory policy and established various programs to effectuate that goal.[6] • All IOUs should be held to the same standard.

[5] RCW 80.28.425(1).

[6] See, *e.g.*, RCW 80.28.425(1); RCW 19.405.040(1) ("It is the policy of the state that all retail sales of electricity to Washington retail electric customers be greenhouse gas neutral by January 1, 2030."); Senate Bill 5092 (2021), Sec. 143(4) (funding the commission to examine pathways for investor-owned utilities to reduce greenhouse gas emissions, including "How natural gas utilities can decarbonize"); RCW 70A.45.020; RCW 7A.65 (Climate Commitment Act).

Satisfy customer needs	1. Provide reliable service 2. Positive customer service interactions	• Regulation in Washington should aim to satisfy customers' needs, which builds upon the Legislature's requirement that utilities provide service in a "safe, adequate and efficient, and in all respects just and reasonable" manner.[7] • RCW 80.28.010 requires that every methane gas company and electrical company must provide service that safe, adequate and efficient, and in all respects just and reasonable.[8] • Utilities must provide customers positive experiences when interacting with utilities; for example, customer service metrics are often used to grade utility service.[9]

III. How well do current regulatory mechanisms accomplish goals and outcomes you listed above? Please share specific reasons for your answer.

A. The traditional regulatory model incents utilities to deploy capital-intensive solutions and does not incent utilities to provide affordable service, equitable service, or advance societal outcomes.

The traditional cost-of-service regulatory paradigm has an infrastructure bias.[10] Utilities are financially rewarded for investing capital and not for reducing electricity sales, procuring energy efficiency, or initiating services in lieu of capital expenditures.[11] At the time that the traditional model was developed more than 100 years ago, customer and utility incentives were generally aligned. Customer demand was increasing and utilities were trying to keep pace with

[7] RCW 80.28.010(2).

[8] RCW 80.28.010.

[9] See, *e.g.*, Dkt. UE-072300, Puget Sound Energy 2021 Service Quality and Electric Service Reliability Report, at 19-42 (March 29, 2022) (discussing customer satisfaction metrics).

[10] *See* Harvey Averch and Leland L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, THE AM. ECON. REV. 1052-1069 (1962).

[11] Hawaii Pub. Util. Comm., Dkt. No. 2018-0088, Proceeding to Investigate Performance-Based Regulation, Staff Proposal for Updating Performance-Based Regulations (Feb. 7, 2019), https://puc.hawaii.gov/wp-content/uploads/2019/02/2018-0088-PBR-Staff-Proposal.pdf.

that demand by building out the general, transmission, and distribution systems.[12] The traditional cost-of-service model built a safe and reliable system. Then, over time, the way Washingtonians live changed. Customer demand flattened, new cost saving technologies emerged, and the imperative of climate change entered the public consciousness. In certain areas of the value chain, such as generation, the utility no longer has a natural monopoly.[13] As a result of these changes the traditional cost-of-service model no longer aligns the interests of customers and utilities in the same way.

In response to these changes, some regulators developed performance-based regulation. The goal of PBR is to identify today's regulatory goals and then align the interests of utilities around these goals. Implementing PBR typically includes a wholesale evaluation of today's regulatory goals and outcomes, followed by measurement of utilities' progress towards those goals and outcomes.[14] There are variety of tools within the PBR framework that can help achieve these outcomes.

Indeed, the Washington Utilities and Transportation Commission (Commission) has been using a number of PBR tools for years. In recent memory, the Commission has been particularly focused on revenue adjustment mechanisms, widely employing revenue decoupling, fuel cost

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[12] Whited, M., Woolf, T., Napoleon, A., *Utility Performance Incentive Mechanisms, A Handbook for Regulators*, Synapse Energy Economics (March 9, 2015), https://www.synapse-energy.com/sites/default/files/Utility%20Performance%20Incentive%20Mechanisms%2014-098_0.pdf.

[13] Independent power producers compete against utilities at macro-level, and customers are siting renewable resources (sometimes paired with storage) on their own premises.

[14] Connecticut Pub. Util. Reg. Authority, Dkt. No. 21-05-15, Investigation into a Performance-Based Regulation Framework for the Electric Distribution Companies, Staff Concept Paper #1: Performance-Based Regulation: Introduction, Goals, and Outcomes, at 10 (March 17, 2022), http://www.dpuc.state.ct.us/DOCKCURR.NSF/8e6fc37a54110e3e852576190052b64d/38fad47344b7e2e4852588080078f8a4/$FILE/21-05-15%20%20Staff%20Concept%20Paper.pdf.

adjustment mechanisms, and earnings sharing mechanisms. However, revenue adjustment mechanisms do not break the utility's infrastructure bias—the utility still earns its return on equity only when it adds new capital expenditures to its rate base. The traditional regulatory model, even when paired with revenue adjustment mechanisms, is not designed to achieve all the Legislature's regulatory goals, including the need to provide affordable service, provide equitable service, advance societal outcomes, and satisfy customer needs.

Because of the traditional regulatory model's infrastructure bias, the utility's financial incentive is at odds with customers' interest in maintaining affordable service. This bias is compounded by a regulatory process that relies on the utility to make certain decisions based on information it holds. For example, the utility chooses when to ask for additional revenue from the Commission in a general rate case, has an asymmetric control over the information that is used to determine new rates, and generally has more resources than intervenors to deploy during a general rate case.

Next, the traditional regulatory model does not incent equitable service or advance societal outcomes. Under the traditional model utilities often select the "least cost, least risk" capital expenditures without consideration of impacts to highly impacted communities or vulnerable populations. Until the passage of the Clean Energy Transformation Act (CETA), the Commission generally only focused on a subset of vulnerable populations: low income customers. With the passage of CETA in 2019, and subsequently the HEAL Act,[15] the Legislature articulated the equitable distribution of benefits and burdens as a state regulatory goal. However, simply passing legislation does not alter a regulated utility's financial incentives. Instead, this requires a regulatory process that adjusts how the utility recovers its costs and earns

[15] 2021 Wash. Laws Ch. 314 (SB 5141).

profits. To monitor utilities' progress towards meeting the Legislature's new equity requirement, the Commission needs set of performance metrics for determining utilities' success.

Similarly, the electric and methane gas utilities' financial incentives are generally not aligned with advancing societal outcomes, namely transitioning to a decarbonized economy. As explained above, utility's current financial incentives are to build additional plant, and that bias is indifferent to the source of energy or its carbon content.

B. PBR mechanisms currently employed by the Commission do not break utilities' infrastructure bias, address affordability, promote equitable service, or advance societal outcomes.

The Commission has experience with revenue adjustment mechanisms and, to a lesser extent, performance mechanisms, such as scorecards and reported metrics. This Commission has less experience with other PBR tools, such as allowing a return on investment in service-based solutions or contracts (capex/opex equalization). Deploying some PBR tools does not in-and-of-itself result in a regulatory structure that aligns utility and customer interests. The Commission is rightly taking a holistic view of its entire regulatory structure, examining its objectives and goals, and determining if its current portfolio of regulatory mechanisms is aligned with the expanded definition of public interest recently established by the Legislature.

The Commission's Notice asked how well current regulatory mechanisms accomplish the goals and outcomes that we listed above. To respond to this question, below we examine several of the more prominent regulatory mechanisms and review if they accomplish the goals and outcomes TEP identified above. As a part of its transition to performance-based ratemaking, the Commission should also consider whether the current design of revenue adjustment mechanisms align with its regulatory goals or if they need to be modified.

1. Service Quality and Reliability Index Report Cards

The Commission has ample experience with one of the building blocks of a PBR regulatory framework: metrics with associated benchmarks and penalties. Avista and Puget Sound Energy produce annual service quality and reliability (SQI) report cards that report the utility's achievement with certain customer service and reliability performance measures.[16] The report cards include approximately a dozen measurements, or metrics, with an associated benchmark. The SQI report cards are the product of litigation. For Puget Sound Energy, it was first implemented when the Commission approved the merger of Washington Natural Gas Company and Puget Sound Power & Light in 1997. The stated purpose of the program was to "provide a specific mechanism to assure customers that they will not experience deterioration in quality of service" and to "protect customers of PSE from poorly-targeted cost cutting."[17]

Each of the SQI programs have evolved over the years, some of the metrics have, or have had, penalties or customer guarantees associated with the metric. The SQI scorecards are a foundational tool that the Commission should build upon when developing its list of performance measures in this proceeding. Indeed, in each of their current general rate cases, Avista and PSE each have proposed performance metrics developed from these report cards. However, these report cards are focused on only one of the goals that we are articulated above: satisfying customer needs. The SQI report cards do not directly address affordability, equitable service, or advancing societal outcomes. The Commission's work in this docket will help build out complementary metrics for the other regulatory goals.

[16] PacifiCorp's SQI report card requirement expired.

[17] Dockets UE-951270 and UE-960195.

2. Revenue Decoupling

All but one of the investor-owned utilities in Washington has full revenue decoupling with annual adjustments. Revenue decoupling is necessary to break a utility's short-term throughput incentive and, as a consequence, some utility revenues are isolated from variances in annual energy sales. Revenue decoupling is often used in multi-year rate plans to smooth out some of the revenue volatility that otherwise would occur. Because the short-term throughput incentive is broken, the utility should be less inclined to oppose energy efficiency measures. Therefore, decoupling succeeds, to some degree, in supporting affordable service and advancing positive societal outcomes. However, revenue decoupling does not address the utility's bias towards capital expenditures nor break the utility's long-term incentive for additional energy and peak demand.

Decoupling can also have negative performance related outcomes. If the utility is indifferent to its annual throughput, then it lacks a financial incentive to immediately reconnect a customer after an outage or maintain a high level of reliability. The UTC has rightly identified this issue and established service quality and reliability metrics, with penalties, for certain electric utilities, as discussed above.

Revenue decoupling also reduces the utility's risk as it is not subject to the variances of annual throughput caused, in large part, by annual weather conditions. A reduction to the utility's risk can be beneficial for customers as well, as it reduces the cost for the Company to attract equity investment. Unfortunately, the Commission has never paired revenue decoupling with a corresponding reduction to the utility's ROE.

Revenue decoupling also does not incent or inhibit the utility from providing equitable service nor satisfying customer needs.

3. Power Cost Adjustment

A power cost adjustment is a regulatory mechanism that allows electric utilities to recover the difference between the actual cost of generating and purchasing electric energy and the authorized revenue from the sale of that energy.[18] The utility forecasts a baseline of costs for the year and then sets rates to recover that cost, annually trued-up and adjusted. The utility makes this adjustment outside of a general rate as a separate rider to the bill. Power cost adjustments primarily benefit the utility and, indirectly and to a smaller extent, customers. The primary benefit to the utility is that the PCA reduce regulatory lag of a sizable portion of a utility's costs. However, PCAs do not incent utilities to control costs. Under a simple PCA mechanism, the utility passes 100 percent of the costs onto customers. To ensure that utilities have an incentive to control costs, the UTC set dead and sharing bands around the utility's forecasted baseline, so that the utility and customers benefit when a utility's actual costs are below the baseline, and the two share costs when actual costs are above the baseline. This is an appropriate performance incentive mechanism that begins to align utility and customer interests. However, it is worth noting that the utility and customers do not share equally in the risk. The UTC sets the bands so that customers carry most of the high-side risk from extreme price excursions.

To date, the PCA baseline has generally been adjusted on an annual basis. Germane to this discussion, SB 5295, which initiated this proceeding, requires the utility to update its power costs as of the rate effective date of the third year, if the Commission approves a multi-year rate plan with a duration of three or four years.[19] The PCA is designed to be adjusted on a very frequent basis; it is not designed such that the utility and customers share in the risks and benefits

[18] Util. and Transportation Comm., *Puget Sound Energy electric rates going up Dec. 1* (Nov. 24, 2020), https://www.utc.wa.gov/news/2020/puget-sound-energy-electric-rates-going-dec-1.

[19] RCW 80.28.425(3)(e).

of long-term fuel cost movements. For example, imagine a hypothetical situation in which a utility is deciding between maintaining an existing methane gas plant or accelerating its retirement and replacing it with a new, clean renewable alternative. If the utility decides to retain the existing methane gas plant because it forecasts the fuel cost to remain low, the PCA largely insulates utility shareholders from the financial risk associated with increased methane gas prices. This means that no regulatory mechanism holds utility shareholders financially accountable for the long-term fuel cost variance.

Finally, the PCA does not address the utility's bias towards capital expenditures, nor does it incentivize the utility to provide equitable service, advance societal outcomes, nor satisfy customer needs.

4. Purchase Gas Adjustment

The Purchase Gas Adjustment (PGA) is structurally the same as the PCA but is used to pass through the commodity cost for the methane gas utilities. However, unlike the PCA, the Commission has not required the use of dead and sharing bands on the PGA. The general argument is that the utility does not have the same fuel optionality as electric utilities and is subject to the whims of the methane gas market. Consequently, the PGA does not have an incentive for the utility to control the costs of its methane gas purchases. In fact, the PGA incentivizes the utility to minimize its prudency risk at the expense of minimizing costs to customers. The utility's expectation is that it can pass 100 percent of methane gas costs onto customers unless its actions are imprudent. The utility can minimize its chances of a finding of imprudence by minimizing risk. In general, there is a tradeoff between risk and cost, and when an entity reduces its risk, its costs go up, and vice versa.

Finally, the PGA also does not address the utility's bias towards capital expenditures, does not provide affordable service, does not provide equitable service, does not advance societal outcomes, and does not satisfy customer needs.

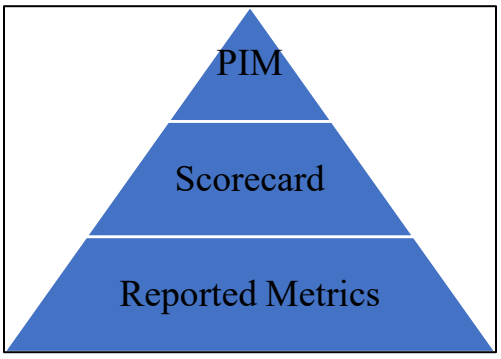
IV. Please provide any specific metric design principles you would like the Commission to use when it adopts metrics, and why. Please also comment on whether the Commission should use the metric design principles listed below:

a. **Outcomes-based: track outputs or outcomes, not inputs.**
b. **Non-duplicative: avoid any overlap of reward or penalty for legal or regulatory requirements**
c. **Clear, measurable, and verifiable: base metrics on easy-to-acquire data that can be verified — or even collected — by a third party.**
d. **Evaluated regularly: revisit the effectiveness of metrics and incentives on regular intervals with the expectation that adjustments may be made.**

There are three different ways to use metrics in PBR. The design of a metrics for use in each level is similar, but not identical. Below TEP first describes the differences between the three levels, then addresses generic metric design principles.

A. TEP conceptually categorizes metrics into three different levels: reported metrics, scorecards, and performance incentive mechanisms.

Figure 1: Levels of Reported Metrics



The three levels of metrics are best depicted as a pyramid. At the base, regulators establish a large number of metrics to track outcomes across all of the state's regulatory goals. Of those reported metrics, regulators select a subset to place on the Scorecard and assign targets

or benchmarks. Finally, regulators select a limited number of performance incentive mechanisms (PIMs) to associate with financial incentives or penalties.

1. Level 1: Reported Metrics

The base level, reported metrics, consist of a broad array of metrics that measure a utility's progress towards achieving each outcome.[20] Each outcome should have at least one metric, although some metrics can help determine the achievement of two or more outcomes. In general, the metrics should be outcome-based, although in certain circumstances it may be appropriate for a metric to identify an input.[21] The purpose of reported metrics is primarily to determine if the utility is making progress towards the outcome. The mere act of reporting and publishing the metrics can incent utility performance, although that incentive is not as a strong as metrics in Levels 2 or 3.

2. Level 2: Score Card

Level 2 adds a target or benchmark to a reported metric. The Hawaii Staff Report defines a target as the desired or expected level of performance, essentially providing the utility with regulatory guidance on how the utility should perform.[22] It defines a benchmark as a standard by which to assess utility performance and may include utilization of historic trends or comparison to the performance of other utilities. Put simply, a target is a performance expectation while a benchmark is most often a comparison to peer utilities. In either case, through the Score Card the Commission identifies a specific threshold for determining if the utility is meeting the outcome. As described earlier, this concept is not new to the Commission as two utilities currently provide

[20] Regulators often can identify multiple outcomes associated with each goal.

[21] We address this more thoroughly in a later section of these comments.

[22] Hawaii Pub. Util. Comm., Dkt. No. 2018-0088, Proceeding to Investigate Performance-Based Regulation, Staff Proposal for Updating Performance-Based Regulations at 33 (Feb. 7, 2019).

an annual score card, with targets and benchmarks, that is focused on customer service and reliability.[23] For a PBR framework, the number of metrics reported on the Score Card should be a subset of the entire base level of reported metrics. In some cases, the Commission may not want to assign a target or benchmark to a Level 1 metric if it is uncertain of the appropriate expected level of performance.

3. Level 3: Performance Incentive Mechanism

A performance incentive mechanism (PIM) is a metric with a benchmark or target to which the Commission attaches a financial incentive. The purpose of a PIM is to focus a utility's attention on achieving the most important outcomes by providing a financial incentive. The financial incentive can include penalties, rewards, or both. This Commission has a long history using PIMs as a part of its existing SQI report cards, which include financial penalties but not rewards.

The Commission does not need to determine the appropriate number of PIMs at this time, nor does it need to identify the specific structures of the PIMs (*e.g.*, is the PIM set as a percentage of ROE, as a fixed dollar amount, or individually determined). The Commission should anticipate only identifying a handful of PIMs, as well as carefully select which metrics to attach PIMs to. By limiting the number of metrics that have an associated financial incentive, the Commission can better ensure that the utility's financial incentives are clear and meaningful.

[23] TEP cautions that those scorecards were developed at a different time and for a different purpose and is not endorsing the specifics of each score card. TEP recommends that the Commission reconsider each metric and associated target/benchmark at the appropriate phase of this proceeding.

B. TEP largely agrees with the four metric design principles identified in the Commission's Notice, however, the Commission should also ensure that metrics are quantified using available data and easily interpreted.

TEP appreciates the Commission's thoughtful consideration of metric design principles; it is appropriate for the Commission to focus its energy on identifying the appropriate design for performance metrics at this early stage of the process. Metrics are particularly useful for providing targeted incentives in support of outcomes that may not be sufficiently addressed by revenue adjustment mechanisms alone.[24] Other PBR structures around the country, including in Hawaii, use a similar structure. TEP encourages the Commission to use Hawaii's metric design principles as a starting point for its work.[25]

1. Metrics should be quantified using available data and easily interpreted.

TEP largely agrees with the four metrics design principles identified in the Commission's Notice, and we describe each in more detail below. However, the Commission should also ensure that metrics are quantified using available data and easily interpreted. Although there is overlap between these and the design principles identified in the Commission's Notice, they are worthy of a brief explanation:

- Quantifiable: Performance metrics should be quantifiable using reasonably available data. The utility provides data and metrics in other dockets, reports, and proceedings to state and federal regulators, and the Commission and utility should take advantage of that information when crafting performance metrics.

- Easily interpreted: Performance metrics should be simple and easily interpreted by stakeholders. That means the metrics should be comparable across utilities and from year to year. The metric should also seek to minimize the number of factors that can influence the measurement.

[24] Hawaii Pub. Util. Comm., Dkt. No. 2018-0088, Proceeding to Investigate Performance-Based Regulation, Staff Proposal for Updating Performance-Based Regulations, at 31 (Feb. 7, 2019).

[25] Hawaii Pub. Util. Comm., Dkt. No. 2018-0088, Proceeding to Investigate Performance-Based Regulation, Staff Proposal for Updating Performance-Based Regulations (Feb. 7, 2019), https://puc.hawaii.gov/wp-content/uploads/2019/02/2018-0088-PBR-Staff-Proposal.pdf.

The Commission should also be thoughtful about what design principles it should not adopt. Some PBR literature argues that utilities should completely control the indicator, or that the metric is "largely free from exogenous influences."[26] We do not recommend adopting that design principle. It is certainly true that the Commission should consider the relative influence of outside factors when reviewing performance metrics, and the Commission should be diligent in its approach if it considers targets or incentives for metrics with significant outside influence. However, many of the most important metrics for evaluating utility performance are influenced by exogenous influences. It is nearly impossible to identify a metric that does not have some level of outside influence. For example, a utility does not have complete control over the costs it incurs (*e.g.*, inflation, weather, and market commodity costs to name a few outside factors), but the Company does have significant control over its capital and operational expenses, as well as the timing of those costs. TEP strongly encourages the Commission to adopt a portfolio of affordability metrics, including total customer bill. If the Commission were to adopt a broadly written principle that metrics should be free of exogenous influence, the Commission may hamper its effort to measure utility performance for meeting its regulatory goals.

The remainder of this section describes the design principles identified in the Commission's Notice.

2. Metrics should be outcomes-based

TEP generally agrees that metrics should be outcome based. This is a standard practice for any business or organization that is creating performance measures. Customers are entitled to rates that are fair, just, and reasonable – all outcomes. Furthermore, incentivizing inputs can have

[26] Whited, M., Woolf T., Napoleon, A., *Utility Performance Incentive Mechanisms, A Handbook for Regulators,* at 30.

unintended consequences, result in inefficient allocation of resources, or send perverse incentives. There are times when it may be appropriate to measure an input, for example if the focus area is new and less established, but the Commission should generally be reticent to attach a benchmark or target, much less a PIM, to an input measure.

3. Metrics should be non-duplicative

In general, the utilities should not be rewarded for meeting statutory or regulatory obligations. This includes, but is not limited to, meeting the requirement of the Energy Independence Act, the Clean Energy Transformation Act, reliability requirements, or other regulatory requirements. It may be appropriate to penalize a utility if it does not meet a legal or regulatory obligation that does not have an associated penalty, but the Commission should refrain from penalizing the utility twice.

4. Metrics should be clear, measurable, and verifiable

All metrics must be non-confidential, measurable, and verifiable. It is paramount that the utility's performance metrics are transparent and accessible to the public, and easily verifiable by any interested party.

5. Metrics should be evaluated regularly

At this time, TEP does not propose a specific cadence for evaluating the metrics, benchmarks/targets, and incentive mechanisms. However, we recognize that each must be evaluated at some interval to reassess if they are still relevant, meaningful, and having the desired impact of meeting the regulatory goals. We anticipate that the frequency of reviews may be more frequent in the years that follow the transition to a PBR framework.

V. Conclusion

TEP thanks the Commission for the opportunity to submit these comments. Together with stakeholders, the UTC should proceed to establish a performance-based regulatory structure

which prioritizes providing affordable service, providing equitable service, advancing societal outcomes, and satisfying customers needs.

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By: */s/ Yochanan Zakai*

Yochanan Zakai, Oregon State Bar No. 130369*
SHUTE, MIHALY & WEINBERGER LLP
396 Hayes Street
San Francisco, California 94102
(415) 552-7272
yzakai@smwlaw.com

Attorneys for The Energy Project

* Mr. Zakai is not a member of the State Bar of California.