U-210590
Received
Records Management
Jun 6, 2025

NW Energy Coalition

June 6, 2025

Via Electronic Filing

Attn: Jeff Killip, Executive Director and Secretary
Washington Utilities and Transportation Commission
621 Woodland Square Loop SE
P.O. Box 47250
Lacey, WA 98503

Re: NW Energy Coalition's Comments for Phase 2 of Performance-Based Ratemaking (PBR) **(Docket U-210590)**

Dear Director Killip:

The NW Energy Coalition (NWEC) appreciates the opportunity to submit these comments in response to the Notice of Workshop and Opportunity to Comment from May 5, 2025. NWEC has submitted nine sets of comments since the docket's inception in 2021 and we look forward to continuing to engage on the important work of shifting the system of traditional utility ratemaking towards one that better reflects the costs and benefits of utility services to customers and society.

We provide comments in two sections below, starting with feedback on the Updated Work plan and ending with resources and recommendations for the development of financial mechanisms, including performance incentive mechanisms (PIMs).

PART 1: Updated Work Plan

Question 1: What general feedback do you have on the Updated Work Plan?

We appreciate the Commission providing an updated work plan and committing to continue this PBR docket which opened in October 2021, as required by the passage of SB 5295. We are concerned that the pace of implementation of the PBR components of the legislation has lagged behind the swift adoption of the multi-year rate plan provisions. Phase 1 of this docket spanned nearly three years (October 2021 – August 2024), which raises some concern that, if this pace

continues, final guidance in this docket may not be issued until well into the 2030s. We understand that this is a new and complex policy area for Washington utilities and acknowledge the importance of getting it right; however, we hope future phases can proceed more efficiently.

Establishing a PBR framework ahead of CETA's 2030 carbon neutral electricity mandate is essential. PBR can reward utilities for achieving the outcomes of the four goals outlined in the Commission's April 12, 2024 Interim Policy Statement (i.e., reliability and resilience, affordability, equity, and environmental improvement), aligning utility profit incentives with CETA's public policy objectives. Because CETA requires systemic shifts to the utility system, PBR can also incentivize early, sustained investment in necessary tools like DERs, grid flexibility, and electrification instead of waiting until 2030 and 2045 approaches. Furthermore, transparency and accountability—which are necessary to implement CETA—are not only built into successful PBR frameworks; they are principles that the UTC has committed to for PBR.[1] Finally, NWEC believes that with a clear PBR framework in place, utilities will be given regulatory certainty as they navigate the complex energy transition.

In our responses to the Commission's specific questions in this section, we point out differences from the original work plan. We ask that the Commission discuss its reasoning for the revised work plan at the June 17, 2025 public workshop.

Question 2: Do you have thoughts, concerns, or suggestions on the proposed scope and order of Phases 3, 4, and 5?

Yes. We have concerns and suggestions surrounding two topics from the Updated Work Plan: 1) the order in which PIMs are discussed, and 2) when environmental metrics are established.

In the prior work plan[2], discussion of cost containment was in Phase 2B. In the Updated Work Plan, it is in Phase 3. Why does the new work plan switch the discussion of PIMs and cost containment? It seems to make more sense to discuss cost containment strategies sooner and before PIMs. The Updated Work Plan divides the discussion of PIMs by putting cost containment in Phase 3, whereas PIMs are discussed in Phases 2 and 4. **We are concerned that the conversation around PIMs, and thus the outcomes of that discussion, will be weakened.**

Additionally, it is possible that Phase 4 will occur multiple years after the conclusion of Phase 2. In that event, engaged parties may not recall with specificity what happened in Phase 2 or may have new staff assigned to this docket that need to spend additional time coming up to speed. It

[1] See Table 1 on pages 3-5 of the UTC's Interim Policy Statement. April 12, 2024. Docket U-210590.
[2] Shown on page 4 of Appendix A Work Plan. May 5, 2025. Docket U-210590.

appears more efficient to discuss the two phases of PIMs together after first discussing cost containment. **We recommend that the two phases of PIMs (Phases 2 and 4) be discussed together and, thus, cost containment strategies (Phase 3) be discussed first.**

NWEC is also concerned that, under the Updated Work Plan, environmental reporting metrics will not be established until Phase 4. Metrics for the three other goals established by the Commission have already been identified in Phase 1. It is not appropriate to wait so long to establish environmental metrics. We ask that the Commission discuss its reasoning for this at the June 17, 2025 public workshop.

Based on the Updated Work Plan, Phase 4 is not only when the Commission expects to "[e]stablish metrics for Outcomes and Goals with no current metrics"[3] (including metrics for Goal 4: Environmental Improvements), but also when the Commission expects to "identify performance baselines, performance targets, and PIMs if or where appropriate". **We recommend establishing environmental metrics under Goal 4 sooner than in Phase 4.** We must do this first to ensure environmental metrics are given the same level of importance and implemented on the same timeline as the metrics within the other three Goals.

Best practices (from resources provided in responses within Part 2 of these comments) suggest that metrics, baselines, and performance targets should be established *prior to* establishing PIMs. This includes environmental metrics. It is our understanding that under a PBR framework, financial mechanisms do not necessarily need to be assigned to every metric. Rather, they should be assigned after the Commission, utilities, and public are able to see what metric data shows, what the performance targets should be, and where there's an indicated need for an additional incentive and/or penalty. We cannot follow this process if we haven't first established metrics.

We also note that least one utility (PSE) has already implemented a PIM for demand response. We urge the Commission to continue to be open to PIMs being implemented while the PBR is still under development, and these instances can provide important lessons learned for future PIM design.

Question 3: Are there any additional topics the Commission should consider addressing in Phases 3, 4, and 5?

Highlighted in the original work plan below are topics missing from the Updated Work Plan. We reiterate our request that the Commission discuss its reasoning for the revised work plan at the June 17, 2025 public workshop.

[3] See Updated Work Plan on page 4 of Appendix A Work Plan. May 5, 2025. U-210590.

Phase 4 (Alternatives to Traditional Cost-of-Service Regulation) from the original work plan has been removed entirely. We note that the educational webinar originally planned could still serve a valuable purpose. Hosting a public webinar could help inform interested parties and the public about the docket's progress, provide context, and support more meaningful engagement and feedback.

Work Plan – Phases 1 – 5

Phase and Scope	Anticipated Date
Phase 1 – Performance Metrics A. Identify regulatory goals, desired outcomes, and principles for metric design B. Identify performance metrics	October 2021 – March 2023
Phase 2A – Reporting and Review A. Establish utility-specific performance metrics B. Establish reporting and review process	April 2023 – December 2023
Phase 2B – Multi-year Rate Plans (MYRP) Revenue Adjustment Mechanisms A. Identify approaches to utility cost containment B. Identify principles for designing revenue adjustments within multiyear rate plans C. Reexamine existing mechanisms (e.g., decoupling mechanisms, power cost adjustments, cost recovery mechanisms, etc.)	April 2023 – March 2024
Phase 3 – Performance Incentive Mechanisms (PIMs) A. Identify performance baselines, performance targets B. Identify guidelines for PIM development C. Establish incentive and penalty mechanisms D. Examine interplay between existing mechanisms, MYRPs, performance metrics, and PIMs	January 2024 – December 2024
Phase 4 – Alternatives to Traditional Cost-of-Service Regulation A. Educational and level-setting webinar alternatives to traditional cost-of-service regulation B. Identify alternatives to traditional cost-of-service regulation C. Consider the merits and prospects for alternative forms of regulation for regulated utilities in Washington State	January 2025 – December 2025
Phase 5 – Continuous Policy Process A. Establish a continuous process for re-evaluating and improving Commission policy on performance-based ratemaking and other alternative forms of regulation B. Continuously reevaluate regulatory objectives C. Continuously reevaluate metrics, targets, and incentive mechanisms	January 2025 – ongoing

*The work plan will be reexamined after each phase.

Question 4: Are there any additional phases the Commission should consider?

NWEC does not propose additional phases.

PART 2: Financial Mechanisms

Question 1: What general feedback do you have on guidelines and foundational principles for PIM design?

The remainder of our comments largely summarize and consolidate the guidelines, principles, and design recommendations from several key resources on this topic published within the last decade. Our comments do not cover every single recommendation and design feature from the resources, so **we encourage Staff and other interested parties to review the resources linked below**. Additionally, for the purposes of answering the specific questions, we have extrapolated information specifically pertaining to financial mechanisms, but these resources offer additional noteworthy principles and recommendations for other elements of PBR (e.g., setting performance targets, implementing PBR) that are worth reviewing as well.

- *Utility Performance Incentive Mechanisms: A Handbook for Regulators,* Synapse Energy Economics, Inc. (2015).
- *Staff Proposal for Updated Performance-Based Regulations*, Hawai'i Public Utilities Commission. (2019).
- *PIMs for Progress – Using Performance Incentive Mechanisms to Accelerate Progress on Energy Policy Goals*, Rocky Mountain Institute. (2020).
- *Performance Incentive Mechanisms for Strategic Demand Reduction*, American Council for an Energy Efficient Economy. (2020).

PBR is not new as a concept, having existed since the 1980s. However, it still feels new to implement because it can significantly alter utilities' long-standing business model, and that is relatively uncommon. While Washington is going through this process—which is admittedly going to be long and complex—we want to reaffirm to the Commission that this is a necessary process that will result in better outcomes for the utilities, its customers, and society. We are fortunate to have a path to follow. Other states, including Hawai'i, Illinois, Rhode Island, Massachusetts, Michigan, Minnesota, Vermont, New York, and Texas all have implemented or deeply explored PBR and PIMs. We encourage looking at these states for guidance and lessons learned.

Question 2: What design principles or general guidelines should inform PIM development?

The five principles below are from Chapter 5 ("Financial Rewards and Penalties") of Synapse's 2015 report, *Utility Performance Incentive Mechanisms: A Handbook for Regulators.*

1. **Consider the value of symmetrical versus asymmetrical incentives.**
   "Penalty-only incentives may be appropriate when the outcome is either an essential requirement for the utility, or when performance above target outcomes provides little additional benefit to ratepayers." (pg 41) For example: reliability is something utilities must achieve, and customers shouldn't have to pay the utility a reward if they achieve this responsibility. Additionally, "reward-only incentives tend to encourage utilities to be more innovative, and may result in more collaborative and less adversarial processes." (pg 42) For example: energy efficiency.

2. **Ensure that any incentive formula is consistent with the desired outcome.**
   "Incentive formulas can take numerous forms, including linear, quadratic, and step functions. It is important that the formula (and the shape and slope) of the incentive is consistent with the desired outcome and supports appropriate utility performance. The shape and slope of the formula determine how quickly the curves reach the maximum reward or penalty as performance deviates from the target (or the ends of the deadband)." (pg 42) See the report for a list of several incentive formulas, visualizations, and discussion of their benefits and drawbacks starting on page 42.

3. **Ensure a reasonable magnitude for the incentive.**
   "Financial rewards and penalties should be large enough to capture utility management's attention and provide sufficient motivation to reach the desired outcome." And at the same time "[t]he reward should not unduly reward or penalize the utility, and rewards should not offset the benefits to ratepayers." (pg 45) "Performance incentive mechanisms should include a cap on the maximum penalty or reward." (pg 45)

   "When establishing the magnitude of financial rewards and penalties, regulators may also need to consider the particular financial circumstances of the utility involved." (pg 45)

   "Presenting financial rewards and penalties in multiple units is useful during the process of setting the financial incentives. However, administration of the incentives is generally simplest when done as dollars[.]" (pg 46)

4. **Tie the incentive formula to actions within the control of utilities.**
   "First, if an action or outcome is beyond the control of the utility, then the performance incentive would have little to no effect on achieving the desired outcome, and therefore should not be applied at all. Second, it is unfair for customers to pay for utility rewards that are not a result of utility actions. Third, it is unfair to penalize utilities for outcomes that are beyond their control." (pg 47) See page 47 for three examples of when it may be appropriate to provide financial incentives for actions that are only partly within the utility's control.

5. **Allow incentives to evolve.**
   "Financial incentives are sometimes adjusted when the magnitude of the incentive is found to be unreasonably large or small, or the basis for the financial incentive (e.g., avoided fuel costs is found to be excessively volatile, resulting in excessive penalties or rewards. Excessive penalties and rewards can sometimes be addressed easily, such as with a cap on rewards or penalties. In other cases, a correction might require fundamental redesign of the incentive mechanism, including a full stakeholder process." (pg 47) "In order to avoid the possibility of overcompensation, it is advisable to begin with small financial incentives and adjust these gradually upward over time if needed." (pg 48)

In their 2020 report, *PIMs for Progress – Using Performance Incentive Mechanisms to Accelerate Progress on Energy Policy Goals*, Rocky Mountain Institute found that successful PIMs have the following **characteristics**:

1. They are aligned with public policy goals and desired regulatory outcomes.
2. They support new or improved services that utilities would not otherwise pursue.
3. They balance utility financial rewards with customer and societal benefits.
4. They do not disproportionately reward the utility for an action they are already incented to undertake.
5. They avoid gaming and unintended consequences.

The five **guidelines** below are from pages 11 and 12 ("Evaluating PIM Design") of ACEEE's 2020 report, *Performance Incentive Mechanisms for Strategic Demand Reduction.*

1. Link the metrics, or standards of measurements for performance tracking and reporting, to policy goals. This might include helping influence the utility to do what it might otherwise not be inclined to do under traditional regulation, recognizing that inherent utility preferences should guide whether (and what amount of) a performance incentive might be required.
2. Guide the utility's actions toward specific desired outcomes.
3. Encourage strong effort beyond the baseline toward desired outcomes, but also establish metrics that are within the utility's control.
4. Provide transparent tracking that can be easily interpreted and accountability regarding utility performance.
5. Be structured in a way that is fair and reasonable for ratepayers.

Question 3: What strategies, principles, or design elements should the Commission consider to ensure PIMs effectively support the PBR goals and outcomes established in this proceeding?

Principles

- **Identify performance targets before establishing PIMs**. This may be the Commission's plan, but it is unclear based on the tasks listed in Phase 4 of the current work plan. Please see our comments in response to Question 2 of Part 1.
- Please see Synapse's five principles listed in response to Question 2 of Part 2.

Design Elements

- **Publicly available scorecards and performance metrics** promote accountability and provide a reputational incentive. Hawaiian Electric's PBR Dashboard is an excellent example of this.
- **Timing of revenue recovery**. "If the recovery of equity costs is partially replaced by the recovery of performance incentives, then the timing should be properly aligned. Currently utilities are allowed to recover equity and debt costs over the full book life of a capital asset. If the financial incentives are recovered over a shorter time period, then there might be a misalignment of when customers experience the benefit and when they are charged for it. On the other hand, performance incentives typically work best when the rewards and penalties are applied relatively close in time to the performance outcomes themselves." (Synapse, pg 49)

Common Pitfalls & Strategies to Avoid Them

- **Disproportionate Rewards (or Penalties).** "One way to avoid this pitfall is for regulators to adopt an incremental approach: begin with small rewards and monitor and adjust over time. Another option is to establish caps on rewards (and penalties), to ensure that they stay within reasonable bounds. Another tool that can help prevent excessive compensation to utilities for some PIMs is shared savings." (Synapse, pg 53) "[I]t is advisable to begin with a shared-savings mechanism that passes most profits to ratepayers, and reduce this proportion over time if needed in order to provide the utility with greater incentives." (Synapse, pg 53-54)
- **Unintended Consequences.** "A common effect of establishing an incentive for one aspect of utility performance is to shift management's attention to the areas with incentives, to the detriment of areas that do not have incentives." "Strategies to minimize negative impacts include:
    - Implement a diverse, balanced set of incentives to avoid concentrating management attention on only one area.
    - Focus on performance areas that are relatively isolated from others, where possible. Energy efficiency is a good example of an area that may have relatively little impact on other aspects of utility performance.
    - Explicitly assess up front how performance standards might influence other performance areas that do not have standards. Solicit input from multiple stakeholders and learn from experiences in other states.

    - Allow for performance incentives to evolve over time to correct for unintended consequences." (Synapse, pg 54)
- **Regulatory Burden.** "[R]egulators should endeavor to streamline performance incentive mechanisms by using existing data and protocols where possible and relying on simple mechanism designs. If a specific PIM is becoming a distraction, it may be because too much money is at stake." (Synapse, pg 55)
- **Uncertainty.** "Metrics, targets, and financial consequences that are not clearly defined create uncertainty, introduce contention, and are less likely to achieve policy goals. In addition, significant and frequent changes to incentives create uncertainty for the utilities, thereby inhibiting efficient utility planning and encouraging utilities to focus on short-term solutions." "If historical data are available, it can be instructive to use such data to provide examples of how the performance data will be assessed and rewarded or penalized in the future." "Information regarding the achievement of targets and the magnitude of incentives should be provided as quickly as possible, to minimize uncertainty and allow for mid-course corrections as soon as possible." (Synapse, pg 55)
- **Gaming and Manipulation.** "This pitfall can be quickly remedied by ensuring that regulators carefully monitor how well performance incentive mechanisms are achieving their intended results, and step in quickly to make necessary adjustments". "[T]he potential for gaming makes it all the more important that financial rewards and penalties are set conservatively in the beginning, and only increased once regulators and utilities gain experience with the performance incentive mechanism." "To reduce the risk of manipulation, verification methods should be adopted and independent third parties used to collect, analyze, and verify data where practical." (Synapse, pg 56)

Broad Strategies

- "In thinking about new regulatory models, one key question that regulators should ask is: **Will the set of new performance incentives be sufficient to modify, or at least balance against, the financial incentives of the existing regulatory model?** Regulators should compare the magnitude of the proposed performance incentives with the magnitude of existing financial incentives. If new regulatory models are to result in a fundamental shift of incentives away from capital investments and toward performance outcomes, then the magnitude of the financial rewards and penalties will need to be significantly larger than the amounts used to date in the United States, and may need to be larger than under the RIIO model used in the UK". (Synapse, pg 48-49)
- "In addition, new regulatory models will need to **reduce the incentive that utilities currently have to increase their rate base**. This could be achieved by reducing, or eliminating, the amount of profit that a utility earns from rate base, and replacing that amount of profit with revenues from performance incentives." (Synapse, pg 49)

Question 4: What criteria or methodologies should the Commission consider to promote a fair balance between utilities' financial rewards and tangible customer benefits?

We offer a few methodologies (some of which have been raised in response to prior questions):

- Tie incentive formula to actions within the control of utilities
- Allow incentives to evolve over time (they won't be perfect at first, and that's okay).
- Set PIMs conservatively in the beginning and only increase them once regulators and utilities gain experience with the performance incentive mechanism.
- The reward should not unduly reward or penalize the utility, and rewards should not offset the benefits to ratepayers.

Question 5: What design approaches or mechanisms should the Commission consider when developing PIMs? For example, should tools such as savings sharing mechanisms, equity adders, fixed rewards or penalties, or structural variations (e.g., symmetrical vs. asymmetrical, upside-only vs. downside-only) be prioritized, and why?

On page 26 of its 2020 report, *PIMs for Progress – Using Performance Incentive Mechanisms to Accelerate Progress on Energy Policy Goals*, RMI details some advantages and disadvantages for many of the different mechanisms listed in this question. We believe the advantages and disadvantages should be considered by the Commission for the following mechanisms.

Shared-Savings Mechanism

"One way to avoid this pitfall [of disproportionate rewards or penalties] is for regulators to adopt an incremental approach: begin with small rewards and monitor and adjust over time. Another option is to establish caps on rewards (and penalties), to ensure that they stay within reasonable bounds. Another tool that can help prevent excessive compensation to utilities for some PIMs is shared savings." (Synapse, pg 53)

"[I]t is advisable to begin with a shared-savings mechanism that passes most profits to ratepayers, and reduce this proportion over time if needed in order to provide the utility with greater incentives." (Synapse, pg 53-54)

However, one disadvantage of a shared-savings mechanism is that it could create an incentive for utilities to inflate their avoided costs. (RMI, pg 26)

Percentage Adders

Because percentage adders offer utilities a rate of return on certain desired investments (e.g., distributed generation), this tool may be seen as similar to the current utility business model and,

thus, easy to understand and not very burdensome. However, NWEC is wary that this tool may wrongly incentivize utilities to overspend, as earnings are based on program costs. (RMI, pg 26)

Fixed Rewards or Penalties

Based on our knowledge of fixed incentives in other states' PBR frameworks, fixed incentives seem commonly tied to energy efficiency and demand response with generally positive results.

Fixed incentives tend to work well when the metrics are measurable and clearly tied to policy goals, large enough to influence utility decisions, and (perhaps most importantly) when regulators regularly revisit and adapt the metrics as needed.

Here is a summary of where and how fixed incentives are used in the U.S., the policy area, and how effective it has been.

State	PIM Type	Focus Areas	Effective?	Notes
HI	Fixed rewards and penalties	Reliability, customer service, DER integration, energy efficiency	Promising but still early	Nation's most comprehensive PBR. Includes "shared savings" and "scorecards."
NY	Fixed earnings adjustment mechanisms (EAMs)	Energy efficiency, DERs, peak demand reduction	Moderate	Growing attention on how to make EAMs more impactful.
MA	Fixed incentive % of program costs or savings	Energy efficiency, demand reduction	Very effective	High national EE rankings; utility goals strongly aligned with state policy.
RI	Fixed dollar rewards based on % savings	Energy efficiency, demand reduction	Historically effective	Program evolution under debate; previously very strong performer.
MN	Fixed dollar incentives for % savings	Energy efficiency	Effective	Xcel Energy has consistently met or exceeded its targets.

CT	Fixed and variable incentives for demand-side programs	Energy efficiency, demand response	Mixed	Regulatory instability has affected consistency.
VT	Bonus/penalty for Efficiency Vermont performance	Energy efficiency, GHG savings, customer service, demand reduction	Effective	Long history of strong outcomes tied to clear incentives.

Asymmetry and Symmetry

Symmetrical incentives are intended to balance risk by making the reward and penalty equal. Balancing risk is generally good policy, though we re-emphasize a principle and recommendation from Synapse that makes a good case for penalty-only incentives: Consider the value of symmetrical versus asymmetrical incentives. "Penalty-only incentives may be appropriate when the outcome is either an essential requirement for the utility, or when performance above target outcomes provides little additional benefit to ratepayers." (Synapse, pg 41) Additionally, "reward-only incentives tend to encourage utilities to be more innovative and may result in more collaborative and less adversarial processes." (pg 42)

Question 6: Which goals and metrics established in the Policy Statement Addressing Initial Reported Performance Metrics issued on August 2, 2024, should be prioritized when developing PIMs?

We reiterate that environmental metrics have not been established. **NWEC recommends that the Commission prioritize identifying metrics for its Goal 4: Environmental Impacts** before moving forward with determining which goals and metrics should be prioritized.

At that point, we believe it is appropriate to focus on areas of utility performance that are relatively isolated and, thus, have little direct impact on other areas of utility performance (such as energy efficiency).

While Hawai'i PUC Staff recommended that some outcomes be tied to PIMs, they recommend that other outcomes be tied to alternative performance mechanisms such as scorecards and reported metrics. See a summary table below from page 23 of the Hawai'i PUC's 2019 *Staff Proposal for Updated Performance-Based Regulations.*

Performance Mechanisms	
Performance Incentive Mechanisms (PIMs)	Implement a set of **PIMs** designed to help drive achievement of the following priority outcomes: *Reliability; Interconnection Experience*; *Customer Engagement*; and *DER Asset Effectiveness*
Scorecards	Design and publish **Scorecards** with targeted performance levels to track progress against the following priority outcomes: *Interconnection Experience*; *Customer Engagement*; *Cost Control*; and *GHG Reduction*
Reported Metrics	Develop a portfolio of **Reported Metrics** to highlight activities under the following priority outcomes: *Affordability*; *Customer Equity*; *Electrification of Transportation*; *Capital Formation*; and *Resilience*

Thank you for the opportunity to comment.

Respectfully,

/s/ Charlee Thompson
Policy Associate, NW Energy Coalition
charlee@nwenergy.org