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

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

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I. Introduction and Summary

On May 5, 2025, the Commission issued a Notice of Workshop and Opportunity to Comment (Notice) with an updated work plan and questions concerning the development of performance incentive mechanisms (PIMs). TEP has participated in every workshop in this proceeding and previously submitted nine written comments on performance-based regulation (PBR). In earlier comments on PBR, TEP supported the original Work Plan because it allowed the Commission to first identify goals, outcomes, and metrics to assess utilities' performance towards achieving these goals and outcomes. The original Work Plan also contemplated identifying cost containment strategies before developing PIMs. TEP supported that path, as it aligns with best practices for establishing a robust foundation for PBR.

TEP is concerned that the Commission intends to engage in a robust discussion of PIM design before completing its foundational work establishing metrics for all its regulatory goals, developing a scorecard with targets and benchmarks, or identifying cost containment strategies. As the Commission aptly observed:

> We also find it important to avoid conflating PBR solely with the use of Performance Incentive Mechanisms (PIMs) . . . It may be that PIMs are not always the best incentive for utility action as there may be other motivators such as legal liability or reputational risk that provide adequate intrinsic motivation not advanced by an additional financial reward or penalty. It is imperative that a shift

in regulatory paradigm promote efficiency and avoid overburdening the regulator, utilities, customers, or other impacted groups.[1]

PBR is not all about PIMs. TEP would prefer that the Commission first finish building the foundation of the PBR pyramid by adopting measures of environmental progress, addressing cost containment strategies, and then developing a scorecard with targets and benchmarks.

A. Best Practices for Performance-Based Ratemaking

A well-designed PBR framework should result in a risk-sharing structure that encourages utility performance to meet the Commission's identified regulatory goals, outcomes, and objectives. A PBR framework should provide a utility with the opportunity to earn a fair return in relation to its risk, based on a business model that is aligned with achieving public priorities. It is imperative that the Commission set the PBR framework correctly to avoid poor outcomes for customers. Poorly thought-out MYRPs and PIMs can lead to worse outcomes for customers than traditional cost-of-service regulation.

PBR mechanisms can typically be grouped into three categories:[2]

1. **Revenue adjustment mechanisms** focus on how an electric company's target revenues are determined, collected, and/or adjusted over time, and include policy tools that shift regulation away from a backward-looking focus on costs and sales to a more forward-looking approach that promotes cost control and improved performance. This Commission has extensive experience with revenue adjustment mechanisms.

2. **Performance mechanisms** provide focused incentives for an electric company to reach performance targets aligned with policy and identified customer priorities through the public display of metrics or Scorecards, or more overtly through financial reward for achieving certain levels of exemplary performance. This Commission has extensive experience with performance mechanisms, including bands for power cost adjustments and service quality and reliability metrics and Scorecards.

[1] Interim Policy Statement Addressing Performance Measures and Goals, Targets, Performance Incentives, and Penalty Mechanisms, ¶ 19 (April 12, 2024).

[2] Hawaii Pub. Util. Comm., Dkt. No. 2018-0088, Proceeding to Investigate Performance-Based Regulation, Staff Proposal for Updating Performance-Based Regulations, at 12 (Feb. 7, 2019) (Hawaii Staff Proposal), https://puc.hawaii.gov/wp-content/uploads/2019/02/2018-0088-PBR-Staff-Proposal.pdf

3. **Other regulatory mechanisms** include those that provide electric companies an opportunity to earn revenues from the procurement of cost-effective, third-party solutions, such as aggregated DERs.

A comprehensive and balanced PBR framework is key to achieving public policy goals. Aligning the utility's interests with its customers interests necessitates building a customer-centric regulatory framework. Balance is somewhat subjective but at a high-level it is about the appropriate level of risk-sharing between shareholders and ratepayers. To ensure that the framework is designed to achieve multiple regulatory goals and outcomes, the framework cannot be constructed in an ad-hoc manner. Rather, the best practice is to select the right combination of alternative regulatory mechanisms to achieve a balanced approach that is in the public interest. An appropriately structured PBR framework provides clear regulatory boundaries, highlights areas of focus, aligns financial incentives with customer interests and public policy goals, and creates fair, transparent risk sharing.

Three guiding principles should help inform development of PBR frameworks:[3]

1. Customer-centric approach,
2. Administrative efficiency, and
3. Utility financial integrity.

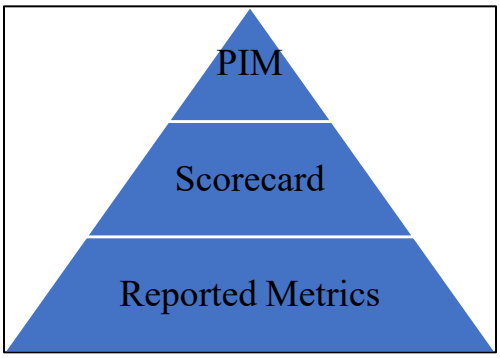
A customer-centric approach means expanding opportunities for customer choice and participation in all appropriate aspects of utility system functions. Administrative efficiency means that the implementation of PBR is an opportunity to simplify the regulatory framework and enhance the overall efficiency of the regulatory process. Finally, PBR should support the utility's financial health.

[3] Hawaii Staff Proposal at 11.

A. The Commission has not completed the base of Washington's performance-based regulation pyramid.

TEP conceptually categorizes metrics into three different levels: reported metrics, Scorecards, and PIMs. The three levels of metrics are best depicted in a pyramid, as shown in Figure 1 below.[4]

Figure 1: Levels of Reported Metrics



At the base, regulators establish a broad set 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 PIMs to associate with financial incentives or penalties. PIMs should only be used for the smallest subset of metrics that are the most important to furthering the public interest; this ensures that utility management focuses on the most important outcomes and avoids imposing significant financial impacts (on both customers and the utility) for relatively less important outcomes.

As of today, the Commission and stakeholders have not yet completed building the base of Washington's PBR pyramid. The Policy Statement Addressing Initial Reported Performance Metrics (Policy Statement) adopted metrics associated with three of the four regulatory goals

[4] For more detail on TEP's approach, *see* Second Comments of The Energy Project on Performance-Based Regulation in Washington, at 14 (June 13, 2022); *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dkts. UE-220066 & UG-220067, Post-Hearing Brief of The Energy Project, at 14-16 (Oct. 31, 2022).

identified. The Policy Statement did not identify any metrics to measure outcomes for environmental improvements.

With the benefit of several years of reported data for the base measures, the Commission in the future can build the middle layer of the pyramid by identifying a select number of metrics to attach a benchmark or target and place in a Scorecard.

B. The Commission has not started work on a Scorecard.

A Scorecard is a set of metrics, each including a target or benchmark. A target is a desired or expected level of performance, while a benchmark is most often a comparison to peer utilities. In either case, through the Scorecard the Commission identifies a specific threshold for determining if the utility is meeting the outcome. This concept is not new to the Commission, as both Avista and Puget Sound Energy provide annual score cards with service quality indicators—focused on customer service and reliability—that include targets and benchmarks. A Scorecard should use a clear visual so the public can easily understand how the utility is performing relative to its targets. Scorecards can incent utilities to meet goals, even in the absence of a financial incentive. Ideally, a Scorecard includes a limited number of metrics, anywhere from 12-24 metrics.

After the middle layer of the pyramid is solidified, the Commission will have a foundation upon which it can design a limited number of PIMs to promote the public interest. Working from the scorecard, the Commission should select a handful of those targets from which to design PIMs.

II. The base of the Evergreen State's PBR pyramid lacks metrics to track utilities' progress towards meeting environmental goals.

TEP suggests that the Commission should finish building the base of its PBR pyramid by first adopting reported metrics that measure the outcomes identified for the Commission's

"environmental improvements goal." The Policy Statement notably omitted any environmental metrics. The UTC previously identified the outcomes associated with this goal as:

1. Reduce pollution burden and pollution exposure with a focus on communities with elevated exposures to health hazards, including Highly Impacted Communities, Vulnerable Populations, and low-income customers;
2. Cost-effective alignment of load with clean energy generation and storage through load management, energy efficiency measures, and demand response; and
3. Accelerate the cost-effective achievement of Commission or state public policy goals and statutes, including the reduction of greenhouse gas emissions.[5]

It is premature to move forward with the design of PIMs that go at the top of the metrics pyramid when the Commission has not finishing building the foundation of reported metrics. The Commission's original Work Plan in this proceeding contemplated identifying performance metrics for all goals in the first phase.[6] Because it is a best practice to have a reasonable set of baseline data and a Scorecard before establishing a PIM, delaying the adoption of environmental metrics could also mean delaying the adoption of targets, benchmarks, and eventually PIMs that promote such outcomes. The Commission should avoid such delay by establishing metrics for the environmental improvements goal as its next step in this proceeding.

III. The Commission can review revenue adjustment mechanisms and identify cost-containment strategies before developing design principles for PIMs.

The Commission's original Work Plan in this proceeding contemplated reviewing revenue adjustment mechanisms and identifying cost-containment strategies[7] before identifying guidelines for PIM development.[8] TEP believes that the original Work Plan represents a better approach to this proceeding because the Commission has yet to collect sufficient data on its

[5] Interim Policy Statement Addressing Performance Measures and Goals, Targets, Performance Incentives, and Penalty Mechanisms, ¶ 13 (April 12, 2024).

[6] Original Work Plan, Phase 1.

[7] Original Work Plan, Phase 2B.

[8] Original Work Plan, Phase 3.

reported metrics to create a scorecard with targets and baselines. Creating a Scorecard is a best practice before designing a PIMs around the scorecard's targets. Accordingly, TEP does not see a need to prioritize development principles for PIMs over other work that can be completed without waiting to develop baseline data that will be used to design PIMs.

IV. Performance incentive mechanism design should follow best practices outlined in the relevant literature.

PIMs should incentivize utilities to meet stretch goals in new and difficult territory. Conversely, PIMs should not incentivize utilities to meet the Company's core obligations, such as delivering safe and reliable service, nor statutory obligations, such as the requirements of the Clean Energy Transformation Act or the Climate Commitment Act. Further, PIMs should be associated with metrics that measure outcomes tied to the Commission's regulatory goals, not inputs. Finally, a PIM should only be established if the Commission has confidence in its ability to set an optimal target using suitable data.

Data sources used in PIMs should be reputable, complete, verifiable, and available for anyone to view. Incomplete or insufficient sets of historical data may distort the Commission's analysis when developing a target. The Commission should also refrain from using confidential data as transparency is a necessary for setting targets and imperative for setting an incentive or penalty. Finally, if the Commission is setting a benchmark comparison to peer utilities, the data should be reputable, complete, verifiable, and available to the public. Synapse's Handbook for Regulators on Utility Performance Incentive Mechanism includes a useful appendix of available data sources.[9]

[9] Whited, M., Woolf, T., Napoleon, A., *Utility Performance Incentive Mechanisms, A Handbook for Regulators*, Synapse Energy Economics, at 96 (March 9, 2015) (Synapse PIM Handbook), https://www.synapse-energy.com/sites/default/files/Utility%20Performance%20Incentive%20Mechanisms%2014-098_0.pdf.

Once the Commission is comfortable with the breadth and depth of the underlying data, the Commission then needs to be confident that it can identify the optimal target for a PIM. Targets should be tied to achieving regulatory and policy goals[10] and should be a stretch for the utility, but not unobtainable. Setting a target will likely involve some mix of quantitative and qualitative analysis to support the Commission's judgment and may require periodic adjustments.

Where financial incentives are provided for extremely good performance, it may also be appropriate to also provide penalties for extremely poor performance. The Commission should also consider when it is appropriate for the PIM to include both a reward and penalty, or whether the PIM should be reward- or penalty-only. The RMI report, PIMs for Progress, suggests that a "penalty-only incentive might be useful to address areas that are considered basic service obligations or other more traditional outcomes that have been ingrained in utility regulations for many years, such as maintaining reliable service."[11] The report also suggests that rewards may be used to encourage growth into new or emergent outcome areas.

A. Resources describing best practices for the design of performance incentive mechanisms.

For additional information on best practices for the design of PIMs, TEP suggests reviewing:

1. Cara Goldenberg, Dan Cross-Call, Sherri Billimoria, and Oliver Tully, *PIMs for Progress: Using Performance Incentive Mechanisms to Accelerate Progress on Energy Policy Goals*, Rocky Mountain Institute (2020), https://rmi.org/insight/pims-for-progress/.

In 2020, RMI released a report titled "PIMs for Progress," which reviewed a selection of

[10] Synapse PIM Handbook at 34.
[11] Cara Goldenberg, Dan Cross-Call, Sherri Billimoria, and Oliver Tully, PIMs for Progress: Using Performance Incentive Mechanisms to Accelerate Progress on Energy Policy Goals, Rocky Mountain Institute, at 14 (2020), https://rmi.org/insight/pims-for-progress/.

historical PIM examples and provides a system classifying or organizing the results to identify important lessons for future PIM development. The report found that successful PIMs have the following characteristics:

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

The report also provides eight recommendations for regulators who are considering using PIMs, such as "strive for outcome-based PIMs where possible" and "prioritize flexibility and learning."

2. RMI PIMs Database

RMI maintains a database of PIMs that have been adopted across the United States. The database is comprehensive and searchable by state, utility, incentive type, and incentive structure. The PIMs database can be found at: https://pims.rmi.org/.

3. Whited, M., T. Woolf, A. Napoleon, *Utility Performance Incentive Mechanisms: A Handbook for Regulators*, Synapse Energy Economics for the Western Interstate Energy Board (2015).

This 2015 Synapse Report provides guidance for regulators on using performance PIMs to improve utility performance. The report highlights the benefits of PIMs—including making regulatory goals explicit, correcting misaligned financial incentives, and encouraging innovation—while also cautioning against potential pitfalls, like disproportionate rewards, regulatory burden, and unintended consequences. The report offers recommendations on designing metrics, setting targets, and implementing penalties or rewards, and it outlines a step-by-step approach for implementation.

4. Hawaii Public Utilities Commission (Docket No. 2018-0088): Performance-Based Regulation (PBR) for the Hawaiian Electric Companies, https://puc.hawaii.gov/energy/pbr/

Hawaii is widely recognized as the state that has most extensively implemented PBR concepts and principles through its PBR Framework for the Hawaiian Electric Companies. The Hawaii PUC's 2018 docket uses four types of regulatory tools: revenue adjustment mechanisms, performance mechanisms, an innovative pilot process, and safeguards. The PUC identifies PIMs as "additional revenue opportunities if the utility meets certain performance outcomes, which are supplemented by a portfolio of scorecards and reported metrics to monitor the utility's progress." While the entire docket has several relevant discussions, TEP encourages the Commission to focus on the Hawaii Staff Concept Paper from November 18, 2018,[12] and the Hawaii Staff Proposal from February 7, 2019.[13]

V. It is premature to identify priority goals and metrics for performance incentive mechanism development.

TEP believes that it is premature for the Commission to identify goals and metrics that should be prioritized for PIMs at this time. As noted above, TEP believes that it is prudent to first establish metrics for environmental outcomes, and then targets and benchmarks for performance selected metrics on a Scorecard before deciding on how to implement PIMs.

Nonetheless, the UTC may find the Hawaii Staff Proposal helpful in shaping its response to this question. Specifically, Table 2, Mapping Outcomes to Specific Regulatory Mechanisms,

[12] Hawaii Pub. Util. Comm., Dkt. No. 2018-0088, Proceeding to Investigate Performance-Based Regulation, Prioritized Outcomes, Regulatory Options, and Metric Development for Performance-Based Regulation in Hawaii, Concept Paper to Support Docket Activities (Nov. 14, 2018), https://shareus11.springcm.com/DownloadDocuments.ashx?aid=25256&oUid=ba1e3a5f-700d-ee11-b83b-48df377ef808&pslUid=05a37047-650e-ee11-b83b-48df377ef808.

[13] Hawaii Staff Proposal, https://puc.hawaii.gov/wp-content/uploads/2019/02/2018-0088-PBR-Staff-Proposal.pdf

described what regulatory mechanism are appropriate to meet certain goals.[14] Table 2 suggests that some outcomes are not as well served by metrics or PIMs, but rather should be addressed through other ratemaking tools, *e.g.*, revenue adjustment mechanisms. For example, TEP notes that for affordability, cost control, and grid investment efficiency, the Hawaii Staff Proposal recommends using an indexed revenue cap. TEP again encourages the Commission to explore cost-containment strategies such as an indexed revenue cap before designing and implementing PIMs.

VI. Conclusion

TEP thanks the Commission for the opportunity to submit these comments. Please do not hesitate to contact me with any questions.

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[14] Hawaii Staff Proposal at 17-20.

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