Overview of Phase 1 Staff Proposal For an Improved PBR Framework

New Utility Regulations to Create Customer Savings and Integrate Clean Energy

On February 7, 2019, Hawaii Public Utilities Commission (PUC) staff issued a proposal to adopt updated utility regulations to encourage the HECO Companies[1] to cost-effectively achieve state energy goals and deliver cost savings to customers.

Staff's proposal would adopt a combination of *performance-based regulation* (PBR) tools to better align the HECO Companies' business interests with Hawaii's energy needs and customer preferences. Instead of the current utility ratemaking approach that ties utilities' profits to the amount of capital investment, the proposed *performance-based* structure would set a *target revenue* amount that encourages immediate cost savings for HECO customers. The utility would have the opportunity to earn additional *performance revenue* if it achieves identified objectives. Profit would be shared with utility customers in a manner that maintains the utility's financial health as well as ensure motivation to achieve cost savings—while passing savings to customers.

The proposed update to utility ratemaking is described by the following illustrative formula:

Utility Revenue = (Target Revenues + Performance Revenues) +/- Earnings Sharing

Each part of this formula includes sub-components to support appropriate capital and operational expenses, as well as cost trackers and automatic adjustments to encourage prudent utility business practices while investing in a clean energy future. Details of this approach are provided in the comprehensive proposal issued by PUC staff.

12 Priority Outcomes to Guide PBR Design

The staff proposal suggests anchoring Hawaii's regulatory reforms to 12 prioritized outcomes, organized according to three overarching goals for regulations: to enhance the customer experience, to improve utility performance, and to advance societal outcomes. The following 12 outcomes were determined in consultation with Hawaii electricity stakeholders and industry experts, and include a combination of "traditional" outcomes that remain longstanding priorities for utility regulation and "emergent" outcomes that require attention in light of changing grid economics, technology advancement, and state energy goals.

Goal	Regulatory Outcome	
Enhance Customer Experience	Traditional	Affordability
		Reliability
	Emergent	Interconnection Experience
		Customer Engagement
Improve Utility Performance	Traditional	Cost Control
	Emergent	DER Asset Effectiveness
		Grid Investment Efficiency
Advance Societal Outcomes	Traditional	Capital Formation
		Customer Equity
	Emergent	GHG Reduction
		Electrification of Transportation
		Resilience

[1] The HECO Companies include three utility operating companies: Hawaiian Electric on Oahu; Maui Electric on Lanai, Maui, and Molokai; and Hawaii Electric Light on Hawaii Island.

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Updated Performance-Based Regulation to Achieve Hawaii's Energy Goals

Staff proposes three guiding principles to inform the PBR framework:

1. **A customer-centric approach,** including immediate "day 1" savings when the new regulations takes effect;
2. **Administrative efficiency** to reduce regulatory burdens to the utility and stakeholders; and
3. **Utility financial integrity** to maintain the utility's financial health.

To achieve these, the proposal suggests a comprehensive portfolio of PBR elements to consider for the HECO Companies. These include:

A **five-year multi-year rate plan (MRP),** during which annual **utility revenues are capped at target levels** (indexed for inflation). The MRP would encourage utility cost savings, as well as reduce the administrative burden from frequent rate case review. Target revenues would consider both capital and operating expenditures to level the playing field between these types of expenses and promote selection of least-cost solutions.

Performance revenues would derive from a combination of regulatory mechanisms designed to align utility strategy with customer interests and the State's clean energy goals. Staff suggests tailoring these to a subset of prioritized outcomes, including use of **performance incentive mechanisms (PIMs)** to give the HECO Companies a financial interest in promoting key outcomes. PIMs should be considered for interconnection experience, customer engagement, and distributed energy resource (DER) asset effectiveness, while existing PIMs for reliability be maintained or updated.

Staff proposes that utilities also be eligible for performance revenues for **innovation and new partnerships** with third-party service providers. These mechanisms will encourage the HECO Companies to deliver exemplary service, adapt to changing business conditions, and accelerate the achievement of State energy goals.

An **earnings sharing mechanism (ESM)** would ensure continued financial health of the utilities, while protecting ratepayers from the potential for disproportionate utility profits. The ESM would create both upside and downside sharing between utilities and ratepayers around a target earnings level.

The Staff Proposal Is Built Upon Stakeholder Input and Expert Guidance

The staff proposal responds to utilities' and stakeholder input, as well as legislative direction to introduce greater performance incentives for the HECO Companies.

The PUC launched the *Proceeding to Investigate Performance-Based Regulation* in April 2018. Phase 1 of the proceeding included three technical workshops, attended by the HECO Companies, the State's consumer advocate, state and county government representatives, clean energy companies, and other stakeholders. The workshops included presentations from regulatory experts and investor representatives, robust dialogue among participants, and party presentations to give input on PBR options.

Phase 1 also included three concept papers issued by PUC staff to frame options and describe current regulations, as well as successive rounds of party briefs submitted by parties to offer input on options under consideration.

The PUC partnered with Rocky Mountain Institute, a Colorado-based clean energy think tank, to design and facilitate the stakeholder workshops.

Next Steps

The PUC invites comments from parties to the proceeding by March 8, following which there will be a period for reply comments then, informed by input received, the Commission intends to issue a Phase 1 decision to adopt or refine staff's proposal. Details of the suggested PBR framework will then be determined in Phase 2 of the proceeding (to take place through the remainder of 2019).

For questions or inquiries, please contact: Matthew McDonnell, Commission Counsel to the Hawaii PUC (matthew.t.mcdonnell@hawaii.gov).

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The following table provides additional details of the proposed PBR structure for the HECO Companies. Full discussion is included in the *Staff Proposal for Updated Performance-Based Regulation* (Docket 2018-0088).

Revenue Adjustment Mechanisms	
Multi-Year Rate Plan (MRP) and Indexed Revenue Cap	**5-Year Control Period** with **Externally-indexed Revenue Cap** allowing interim adjustments pursuant to a revenue cap index formula: **RevCapIndex** = (**Inflation**) - (**X-Factor**) + (**Z-Factor**) - **Consumer Dividend**[2]
Revenue Decoupling	Continue to utilize **revenue decoupling** (i.e., the Revenue Balancing Account ["RBA"]), to true up revenues to an annual revenue target, which ensures the utility receives the target revenue, regardless of increases or decreases in energy sales
Earnings Sharing Mechanism (ESM)	Apply a modified **ESM** that provides both "upside" and "downside" sharing of earnings between the utility and customers when earnings fall outside a Commission-approved range
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
Other Regulatory Mechanisms	
Capex/Opex Equalization	Offer one or more **shared savings mechanisms** and explore development of other approaches to equalize treatment of capex/opex, such as a **return on service-based solutions** and the **capitalization of prepaid contracts**
Innovation	Develop one or more of the following mechanisms to support utility and third-party innovation: expedited **innovation pilot process**; a web-based **innovation platform**; **innovation fund**
Platform Service Revenues	Examine how **platform service revenues** can be incorporated into the regulatory framework, leveraging the experience of other jurisdictions where appropriate

[2] Where: Revenue Cap Index: Percent change allowed in total annual revenues; Inflation: Percent change in a published inflation index; X-Factor: Predetermined annual productivity factor; Z-Factor: Factor applied (ex post) to account for exceptional circumstances not in utilities direct control (e.g., tax law changes); and, Consumer Dividend Factor: A "stretch factor" or reduction (e.g., 0.5%) in allowed revenues.