PUBLIC UTILITIES COMMISSION
STATE OF HAWAII

SUMMARY OF PHASE 1 DECISION & ORDER ESTABLISHING A PBR FRAMEWORK

On May 23, 2019, the Hawaii Public Utilities Commission (PUC or Commission) issued a Decision and Order concluding the first phase (Phase 1) of the *Proceeding to Investigate Performance-Based Regulation*. The Commission's decision advances a comprehensive framework of utility regulations to align the Hawaiian Electric Companies' business interests with Hawaii's clean energy goals and customer preferences.

The PUC identified a portfolio of performance-based regulation (PBR) tools intended to update traditional cost of service regulation with a new framework that will deliver immediate, "day one" savings to customers, while rewarding the HECO Companies for exemplary performance in achieving specific outcomes, including increased renewable energy adoption and improved customer service.

The PUC decision establishes three guiding principles, three regulatory goals, and twelve priority outcomes to guide the development of the PBR mechanisms in the second phase of the proceeding (Phase 2).

Decision & Order Builds on Stakeholder Input Received During Phase 1

The PUC decision incorporates feedback and input provided by stakeholders throughout Phase 1 of the proceeding. The HECO Companies, the State Consumer Advocate and other government representatives, clean energy companies, environmental groups, as well as other stakeholders participated in three technical workshops facilitated by Rocky Mountain Institute, and prepared written briefs summarizing their positions. PUC staff developed reports on the current regulatory framework and options for developing new PBR tools, and in February 2019 offered a comprehensive proposal for updated PBR mechanisms for comment by stakeholders.

Guiding Principles, Regulatory Goals, and Priority Outcomes

The following guiding principles will inform the development of the commission's 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, including access to low-cost capital.

The twelve priority outcomes are organized around three overarching regulatory goals, and are grouped as either "traditional" outcomes, or "emergent" outcomes, where emergent outcomes reflect new opportunities or changing expectations.

Goal	Priority 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

Updated Performance-Based Regulations

Unlike traditional cost of service regulatory models, where the utility's cost recovery is largely based on the amount of capital investments, the PBR framework will establish a new regulatory paradigm for the HECO Companies. Instead of incentivizing capital investment, utility revenue will be based on a combination of *target revenues,* designed to encourage cost control, resulting in savings for customers, with the opportunity to earn additional *performance revenues* for achieving highly valued objectives. There will also be an *earnings sharing mechanism* to maintain utility financial integrity and ensure that profits are shared with customers.

Revenue Adjustment Mechanisms For Cost Control

Under the new framework, **updated revenue adjustment mechanisms** will establish target revenues which will be applied over a five-year **multiyear rate plan (MRP)** during which there will be no general rate cases. The target revenues will be adjusted annually according to an **annual revenue adjustment (ARA)**, which will be determined according to a formula that accounts for inflation, utility productivity, and customer benefits. The extension from a three year rate case cycle to a five-year MRP should encourage utility cost savings, and reduce the administrative burden of frequent rate cases. Establishing target revenues without distinguishing between capital and operating expenditures will level the playing field between these different types of expenses and promote selection of least-cost solutions.

During the MRP, the **major projects interim recovery (MPIR)** adjustment mechanism will continue, providing the potential for interim recovery for exceptional investments.

Performance Revenues for Key Outcomes

The HECO Companies will have the opportunity to earn performance revenues from a set of three to six new **Performance Incentive Mechanisms (PIMs)** designed to give the HECO Companies a financial interest in promoting key outcomes aligned with customer interests and achievement of Hawaii's clean energy goals. For Phase 2, the commission has prioritized development of new PIMs addressing improvements in the areas of *Interconnection Experience, Customer Engagement,* and *DER Asset Effectiveness*.

Additional Elements of Updated Framework

An **earnings sharing mechanism (ESM)** will ensure the continued financial health of the utilities, while protecting ratepayers from the potential for disproportionate utility profits. The ESM will feature both upside and downside sharing between the Companies and customers around a target earnings level, such that customers will share in excess utility earnings, while the Companies will be insulated from extreme financial hardship.

In order to "true up" appropriately adjusted recorded revenues to an approved revenue target, **decoupling and the Revenue Balancing Account (RBA)** will be maintained to ensure that the utilities recover their approved target revenue, regardless of energy sales. Similarly, **existing cost tracking and pass through mechanisms** will continue to operate to ensure recovery of costs that are not recovered through existing base rates, and which may not be appropriate for recovery through target revenues at this time.

Next Steps

Phase 2 will prioritize development of the specific details of the Regulatory Adjustment Mechanisms and Performance Mechanisms, as described in the PUC's decision. The Commission will issue a convening order describing the procedural schedule and plans for Phase 2 in June 2019.

The comprehensive PBR framework to be further developed in Phase 2 is summarized in the table below:

Revenue Adjustment Mechanisms	
Multiyear Rate Plan (MRP) with Indexed Revenue Adjustment	**5-Year Control Period** with **Externally-indexed Revenue Adjustment** allowing interim revenue changes pursuant to an indexed formula: **Annual Revenue Adjustment** = (**Inflation**) - (**X-Factor**) + (**Z-Factor**) **- Customer Dividend**
Earnings Sharing Mechanism (ESM)	Apply an **ESM** that provides both "upside" and "downside" sharing of earnings between the utility and customers when earnings fall outside a Commission-approved range
Major Project Interim Recovery (MPIR)	Examine the **MPIR adjustment mechanism** to determine how it can continue to provide relief for appropriate major projects during the MRP consistent with other approved PBR objectives and mechanisms
Revenue Decoupling and Existing Cost Trackers	Continue to utilize **revenue decoupling** (i.e., the Revenue Balancing Account) to true up revenues to an annual revenue target, and existing **cost tracking mechanisms** (e.g. PPAC, ECRC, etc.) to track and recover certain approved costs
Off-Ramps	Develop **off-ramp** mechanisms to provide for review of approved PBR mechanisms, pursuant to specified circumstances or conditions
Performance Mechanisms	
Performance Incentive Mechanisms (PIMs)	Implement a set of **PIMs** designed to help drive achievement of the following priority outcomes: *Interconnection Experience*; *Customer Engagement*; and *DER Asset Effectiveness*
Shared Savings Mechanisms	Develop **shared savings mechanisms** to address priority outcomes including *Grid Investment Efficiency* and *Cost Control*, mitigate capex bias, and reward pursuit of cost effective solutions to meet customer needs
Scorecards and Reported Metrics	Publish **Scorecards** with targeted performance levels to track progress against the priority outcomes of *Interconnection Experience, Customer Engagement, Cost Control,* and *GHG Reduction* and utilize **Reported Metrics** to highlight performance on the priority outcomes of *Affordability, Customer Equity, Electrification of Transportation, Capital Formation,* and *Resilience*

Media Contact:
Jodi Endo Chai, Executive Officer
Public Utilities Commission
Direct: (808) 586-2276
Mobile: (808) 741-4542
puc@hawaii.gov
https://puc.hawaii.gov