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May 13, 2019

Chairperson Margaret Curran
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: Docket 4943: Acadia Center's Comments on Principles to Guide the Development and Review of Performance Incentive Mechanisms

Chairperson Curran and Members of the Public Utilities Commission,

Acadia Center is a non-profit research and advocacy organization committed to advancing the clean energy future by providing reliable information, comprehensive advocacy and problem-solving through innovation and collaboration. Acadia Center appreciates the opportunity to submit written comments on Commissioner Anthony's March 5, 2019, memorandum outlining Principles for Performance Incentive Mechanisms (PIMs). Acadia Center strongly supports and advocates for Rhode Island's use of PIMs to reform the utility business model by rewarding improved performance. By increasing the portion of revenue requirements recovered through PIMs, while reducing the portion of revenue linked to the rate base, PIMs help shift the utility financial incentive towards achieving performance goals that benefit ratepayers and the environment.

Acadia Center specifically supports the Commission's desire to provide guidance in a single, separate docket to establish clear, complete and consolidated guidance on the appropriate use and design of PIMs. Separating the concepts and principles of utility business model transformation from the heightened sensitivity and time-pressure of a specific utility rate case and allowing appropriate time for iterative, evolving proposals and stakeholder input will be a benefit to all involved.

Acadia Center is generally supportive of the Principles memorandum, and provides in these comments an overview of our support, specific feedback on individual principles, and our perspective on three related concepts that may inform further development of the Commission's guidance surrounding PIMs: 1) the need to first set policy goals; 2) how PIMs must integrate with other business model reforms; and 3) whether penalties must accompany incentives.

Comments on "Principles for Performance Incentive Mechanisms"

Principle 1

A performance incentive mechanism can be considered when the utility lacks an incentive (or has a disincentive) to better align utility performance with the public interest and there is evidence of underperformance or evidence that improved performance will deliver incremental benefits.

Acadia Center supports use of this principle but cautions that it may be too narrowly worded. PIMs may be appropriate for use in multiple conditions: to address an existing disincentive, to create an incentive when there is no signal, and to increase an incentive that is too small to spur appropriate action. Application of this principle must not confine use of PIMs to only novel undertakings for the utility. Innovative, forward-looking utilities sometimes take actions in line with public interest goals, even if their own business incentives are not perfectly aligned – for instance, taking efforts to reduce the wait time for interconnection of distributed energy resources. The Commission must not penalize such early action by denying a PIM based on viewing the early innovation as evidence of apparent alignment of incentives. Nor is it appropriate for this principle to bar creation of a PIM to reward improved performance and incremental benefits in areas where the utility has always operated, such as the delivery of safe and reliable service. In this regard, this principle is a significant improvement on old standard #2 requiring the incentive to focus only on "behavior the utility would otherwise not take."

PIMs can useful in a variety of situations: to expand the utility's business into new, beneficial areas (such as EV infrastructure, peak demand reductions, data distribution); to fill in where traditional incentives create a disincentive (such as application of non-wires alternatives); and to shift the risk of innovation between customers and the utility. Application of this principle and a specific focus on "evidence that improved performance will deliver incremental benefits" will allow use of PIMs across the categories where they may be useful.

Principle 2

Incentives should be designed to enable a comparison of the cost of achieving the target to the potential quantifiable and cash benefits.

Acadia Center supports use of this principle. However, application of this principle will require significant improvement in utilities' ability to quantify both the costs and benefits of their potential actions. Given that part of the role of PIMs is to provide a "carrot" to focus the utility to innovate and try different tactics to solve an identified problem, the exact path to the solution, and thus both the costs and benefits, will likely be unknowable when the financial level of the PIM is set. Acadia Center encourages the Commission to provide room in the comparison for qualitative and directional analysis when precise quantification is not possible.

The Commission's guidance in Docket 4600 may be instructive here, particularly as it regards non-quantifiable aspects that are still relevant to determining cost-benefit ratios. Benefits that have historically been viewed as "externalities" for regulated utilities will become important in application of PIMs. Acadia Center supports vigorous analysis and verification of various categories of costs and benefits, including a full and accurate accounting of the social cost of carbon. It is essential to provide the greatest degree of certainty possible that ratepayers are not bearing unknown amounts of risk in any carbon-reduction-related PIMs (or any PIMs, for that matter). Quantifying the value of distributed energy resources, energy security, market transformation, and even less tangible concepts like avoiding species loss, and supporting public health may prove difficult for utilities. Although Docket 4600 has provided a robust framework for analyzing costs and benefits, it may be necessary for the Commission to issue additional guidance to aid in the rigorous quantification contemplated by principles 4 and 5.

Principle 3

Incentives should be designed to maximize customers' share of total quantifiable, verifiable net benefits. Consideration will be given to the inherent risks and fairness of allocation of both cash and non-cash system, customer, and societal benefits.

Acadia Center supports application of this principle but cautions that it assumes more advanced abilities to quantify and verify system, customer, and societal benefits than has been demonstrated in recent dockets. Acadia Center again calls for the full complement of benefits identified in Docket 4600 to be considered, and notes that this will likely require further guidance from the Commission.

One of the most important concepts contained within this principle is the idea that "[t]he PIM should align the utility's motivation with maximizing total net benefits" rather than creating unintended consequences like gaming opportunities or budget inflation. A PIM that achieves the nuanced balance needed to maximize both customers' share and the utility's motivation to increase total net benefits would be ideal – but likely very difficult to hit precisely. It may be a more fruitful tactic to begin with allocating a higher share of benefits to the utility than optimal, to maximize its incentives to focus on increasing total net benefits, followed by adjustments in the proportions to favor customers over the course of the performance period.

Principle 4

An incentive should offer the utility no more than necessary to align utility performance with the public interest.

Acadia Center strongly supports the concept embodied in this principle that PIMs should not create a windfall for a utility, particularly at the expense of the consumer. However, application of this principle requires more clarity on the Commission's view of what constitutes "the public interest" and a sense of how it would weigh the significance of competing interests. As an example, if a stakeholder suggests a PIM related to carbon emissions (addressing the unmet yet critically important public interest to sustain human life and livability by rapidly decreasing the amount of carbon), how would the Commission balance that public interest against other public interests such as the incremental costs to ratepayers, privacy concerns, or degree of certainty in grid reliability?

The phrase "no more than necessary" also would benefit from further clarification. In theory, this means not a penny more – to maximize consumer benefits by minimizing what must be paid in incentives to achieve those benefits. However, the Commission may want to consider adding a degree of flexibility in what it considers "necessary." As highlighted in our comments on Principle #3, the competing goals of maximizing total benefits and minimizing a utility's share of those benefits relative to consumers may be aided by a shifting proportional balance. The Commission should also consider how time may affect what is "necessary." How would it would factor in a utility's ability to develop new sources of revenue from areas supported by the PIMs, and at what point might a utility's accomplishment of the PIM goals make it too successful?

Principle 5

The utility should be offered the same incentive for the same benefit. No action should be rewarded more than an alternative action that produces the same benefit.

Acadia Center supports application of this PIM, particularly as it relates to consistency in incentive levels across programs and activities. Acadia Center agrees that mature PIMs should focus on outcomes, rather than prescribe specific actions, and allow the utility to find the lowest cost and most cost-effective methods to earn the incentive. However, application of this principle should not foreclose a utility from layering incentives, if it can undertake one activity to accomplish multiple goals, as that will likely result in cost-savings for consumers as well.

Three Additional Concepts

Identify and Articulate Policy Goals Which Utilities Can Help Achieve

Utilities can be significant players in helping to shape the next phase of our economy and Rhode Island's response to the climate crisis. However, a utility is not the appropriate vehicle to address all consumer and environmental concerns, even if they could have a net positive public impact. Other factors, such as existing competitive markets, the occasional failures within those markets, intent to facilitate market transformation, and a utility's core competencies must also play a role in determining what areas are appropriate.

As such, Acadia Center believes that an important first step, before application of the Principles, is to identify and articulate the policy goals towards which the regulator wishes to move and match these preferred policy goals with areas in which there is known potential for the utility to play a significant role in creating benefits. Only at that stage, with specific policy goals that are relevant to utility performance already in mind, should one begin to design PIMs to shift utility behavior. To provide an example, the difference between the Hawaii PUC's overarching goal of "advance societal outcomes" and its specification of the regulatory outcome of "electrification of transportation" prevents, as a wild idea outside of a utility's core competencies, proposal of a utility PIM related to expanding internet access via advanced metering functionality.[1]

How PIMs Integrate with Other Utility Business Model Reforms

As Acadia Center stated in UtilityVision[2], PIMs can be used to ensure that utility management is promoting goals aligned with state policy and providing clear benefits to ratepayers. But PIMs must be used in conjunction with other reforms, and not merely to inflate utility profits. To achieve transformation of the utility business model and progress

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[1] See https://puc.hawaii.gov/wp-content/uploads/2019/02/PBR-Staff-Proposal-3-page-Summary-Sheet_20190207.pdf.
[2] Available at: https://acadiacenter.org/document/utilityvision/

in addressing improper incentives, PIMs must replace other utility revenue. By increasing the portion of utility revenue requirements that is recovered through PIMs while reducing the portion recovered from the rate base, PIMs can help shift the financial incentive away from capital investments and towards achieving consumer-friendly outcomes. As utilities, state agencies, and stakeholders get more comfortable with increasing the emphasis on value of benefits to customers, such as savings and carbon reductions, it will create a positive feedback loop. Of course, even when fully effectuated, the incentive payment must not exceed the value of the resulting benefits.

Incentives and Penalties

The Principles document seems to regard PIMs as an entirely upside mechanism – allowing a utility to earn additional rewards as it improves its performance along specific targeted goals. This may be appropriate for this early stage of utilizing PIMs primarily to motivate utility activity in new areas where it can generate customer, societal and environmental benefits. Additionally, given the Principles' emphasis on not over-rewarding the utility for its generation of benefits, application of a penalty for failing to hit the target may place an unnecessary burden on the utility. However, as the business model changes to accommodate a higher portion of utility compensation tied to long-range PIMs, the Commission should contemplate the application of symmetrical penalties for underperformance, particularly in areas that are well-integrated into the utility's normal course of business.

Thank you again for the opportunity to comment. Acadia Center looks forward to working with the Commission, and all stakeholders, on the development of appropriate PIMs and, more broadly, reform of the utility business model.

Sincerely,

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