

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

IN RE: GUIDANCE DOCUMENT REGARDING
PRINCIPLES TO GUIDE THE DEVELOPMENT
AND REVIEW OF PERFORMANCE INCENTIVE
MECHANISMS

DOCKET NO. 4943

COMMENTS OF THE R STREET INSTITUTE

Introduction

The memorandum distributed in this proceeding¹ reflects an impressive and careful level of consideration about the topic of performance incentive mechanisms (PIMs). PIMs are an additional feature that may be layered atop either the traditional cycle of rate cases or preferably, a multi-year rate plan or “stay-out” provision that causes utilities to attend to efficiencies in their cost structure.

Performance-based regulation (PBR) may be understood essentially to have two parts. The first is rates that do not attempt to minutely “track” costs, instead allowing the company to share in the benefits of cost reductions as they occur—before they are re-captured to the benefit of consumers in the next rate-setting. The second is PIMs, which positively reward a company when certain objectives are achieved.

In the coming decade, PBR will probably become the most important topic in utility regulation. This is because the traditional cost-of-service regulatory model and its implicit capital bias are poorly fitted to the modern challenges of the utility industry.² Utilities are a mature sector and they should therefore be more open to innovations, including and perhaps especially those that are non-capital intensive or not related to traditional channels of utility capital investment. To get utilities comfortable with this new reality, they must be incentivized away from a model that inures toward capital bias. This situation necessitates some form of PBR.

Incentivizing Outcomes, Not Actions

As the Commission’s memorandum and its recent actions relative to PIMs imply, PBR is hard to do well and it will not—and indeed should not—survive unless its benefits are tailored to create outcomes at an appropriate level of award. The Rhode Island Commission has clearly done a great deal of thinking on this subject, for which it is to be applauded.

We respectfully suggest that the principle that requires the most development in this proceeding is Principle #5, as it embodies the important concept that “the utility should be offered the same incentive

¹ Commissioner Abigail Anthony, “Re: Principles for Performance Incentive Mechanisms,” March 5, 2019.

² For a lengthier discussion of R Street’s views on the incentives facing the U.S. regulated-utility industry, see: Travis Kavulla, “Monopoly and Regulation in Context,” keynote address to the *34th Annual Western Energy Conference*. <https://www.rstreet.org/2019/05/06/monopoly-and-regulation-in-context>.

for the same benefit.” However, the question remains as to what specifically should be considered a “benefit.”

For example, let us consider that the electrification of transportation may align with social welfare generally, and the goals of utility regulation specifically. Is the installation of electric-vehicle charging stations the benefit we have in mind—or is it the overall number of electric vehicles (EVs) adopted? If the latter, applying Principle #5 would mean that it would be inappropriate to simply count the number of charging stations installed and create a PIM on that basis, as opposed to the EV adoption they had likely induced. Defining the benefit in an outcome-driven way would suggest that the utility might consider an alternative means of achieving EV adoption, such as credits or rebates to customers who use their own capital to buy an EV or install a home- or office-based charging station. In short, if one were to choose dichotomously between “charging stations” versus “EVs,” it would be reasonable to pick the latter because it better conforms to the principle of allowing multiple pathways to achieve the presumptive ultimate goal. Put another way, one does not install charging stations for their own sake; one installs them to accommodate EVs, and that is why the latter and not the former should be measured.

Of course, even counting the number of EVs is not really the correct measurement. Like charging stations, EVs are not an end unto themselves. One may presume that they offer a pathway to “beneficial electrification,” bywords that imply economy efficiency gains associated with direct consumer savings and the environmental benefits of displacing internal-combustion-engine vehicles. But can one measure more generic economic efficiency outcomes, rather than a PIM that is squarely focused on EVs?

Unfortunately, as one directs PIMs toward the benefits at the heart of the matter, they become more difficult to measure. For example, it is harder to measure the number of EVs adopted as a consequence of utility-installed charging stations than it is to measure the number of charging stations installed. And it is harder to measure the efficiency gains of EV adoption (or another policy) than it is to measure either EVs adopted or charging stations installed.

Nonetheless, we believe that the Commission should condition any PIM on one of two things to fulfill the intentions of Principle #5. Either PIMs should: 1) amplify the rate-case cycle’s emphasis on cost reductions (perhaps including costs imposed by one or two truly significant externalities) or 2) they should increase access to energy and the reliability of that access. These two things can be in tension with one another, but properly designed rates and PIMs should drive a service that is both affordable and abundant.

As such, we believe that Principle #5 should consciously focus on a “back-to-basics” approach that magnifies the essential public-service outcomes of a utility, while minimizing the capital bias present in modern trends in cost-of-service regulation. We suggest that Principle #5 therefore incorporate guidance that any PIM must incorporate a metric associated with at least one of two things. Specifically, a PIM’s underlying metric should measure cost reductions (by volume of energy distributed and by capacity), which would increase a utility’s incentive to obtain savings over a multi-year period.³ Or,

³ A more ambitious PIM could go outside the fence-line of the utility’s property and relate to the wider energy economy, where consumers trade off energy sources. For example, the Commission could set a PIM that measures the delivered cost of energy consumed at the utility’s EV charging stations, comparing it to the cost to a comparable consumer of an internal-combustion engine. Clearly, the Commission would want to proceed with caution on this, but it coheres to the framework we describe here.

alternatively or in addition, a metric should measure and reward for increased system utilization, (possibly measured by average load factor), which is accomplishable either by a system-peak reduction or by increasing throughput at certain times.

Returning to the EV example, charging stations will result in additional capital costs, but if they are able to make up these costs by spreading them over the system such that costs-per-unit decline, or if overall capital utilization is improved, then such a PIM would bind. We believe this is a more technology-neutral, outcome-based approach that aligns with social welfare generally.

The Commission will always be handicapped by information asymmetry. This could lead it to take a managerial focus (e.g., calling out the “right” number of charging stations and then counting them as part of a PIM). But it would be better if the Commission instead specified broad outcomes, rewarding or penalizing the utility for them, even if it cannot be clearly established whether the results are directly tied to the utility’s behavior. This is superior to an approach that tries to closely inspect utility results, which simply guides one back to the very “Mother May I?” game that a well-designed PBR intends to avoid.

Respectfully submitted,

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