blue planet FOUNDATION



SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION, & HEALTH
Mar. 1, 2017, 9:30 A.M.
Room 229
(Testimony is 3 pages long)

TESTIMONY IN SUPPORT OF SB 366

LATE

Aloha Chair Baker, Vice Chair Nishihara, and Committee Members:

The Blue Planet Foundation **supports** SB 366. This bill would:
(1) Establish a **deadline** to implement a performance-based mechanism for utility compensation;
(2) Establish a **framework** for reviewing performance-based utility incentives and penalties;
(3) Maintain a non-prescriptive **deference** to the PUC on the details of the performance-based mechanism.

As detailed below, implementing a performance-based revenue mechanism is needed to improve **alignment between ratepayer and shareholder interests**. Note that the Hawaiian Electric Companies have asked for a new investigatory docket to examine performance-based mechanisms. Also, in the recent Hawaiian Electric rate cases, the Companies have proposed a limited set of performance incentives (but no penalties).

This testimony explains why performance-based ratemaking is **necessary** and **urgent**. We suggest two amendments. Performance-based ratemaking is most applicable to investor-owned utilities. Also, utility performance is equally important for both electric and gas utilities. Thus, we propose altering the bill's language to clarify that performance-based ratemaking should apply to both electric and gas utilities, and that the PUC may determine whether to exempt cooperative or municipal utilities.

"Cost-Plus" Ratemaking

Many Hawai'i residents and businesspeople are surprised to learn that utility rates across the country were traditionally set using a "cost-plus" system. Under this system, utility profits are generally set as a percentage of utility expenditures. As noted in the preamble of the bill, the Wall Street Journal has explained that under cost-plus ratemaking, "the more [utilities] spend, the more profits they earn." The report called this "a regulatory system that turns corporate accounting on its head."

During a recent informational briefing, utility expert Jim Lazar from the nonprofit Regulatory Assistance Project agreed with the Wall Street Journal's assessment. He summarized that in a cost-plus regime, "building stuff" leads to utility earnings. And "building more stuff" leads to

info@blueplanetfoundation.org
55 Merchant Street 17th Floor • Honolulu, Hawai'i 96813 • 808-954-6142 • blueplanetfoundation.org

more earnings. He further explained that this can create a disincentive for energy options that aren't owned by a utility. This might include energy efficiency, customer-owned energy projects, or third-party-owned energy projects.

This unbalanced incentive system is bad for everyone. Customers lose if it spurs sub-optimal investments in capital projects by utilities. Utility shareholders lose if the utility chooses third-party options.

"Cost Plus" Should Be Replaced with a Performance-Based System

In contrast to a cost-plus system, performance-based ratemaking would tie utility revenues to the achievement of PUC-approved performance benchmarks, while also ensuring that utilities remain viable by recouping approved expenditures. This would more firmly align the financial interests of utility shareholders with the interests of consumers.

The bill identifies several types of performance benchmarks to be considered by the PUC. The bill is **not prescriptive**. It also allows other categories of performance benchmarks to considered; **different benchmarks could be suggested by the PUC, Consumer Advocate, utilities, or other stakeholders.**

Potential Performance Benchmarks

- Rate affordability
- Reducing ratepayer risk
- Service reliability
- Customer satisfaction
- Quickly interconnecting customer projects
- Timely competitive procurement processes
- Exceeding renewable targets or otherwise progressing on renewables

Long-Awaited Reform

The 2014 PUC "Inclinations" were focused on aligning customer interests with the electric utility business model. Subsequent years have seen this re-alignment examined in several ways. For example, the PUC has directed utility power supply improvement plans to evaluate the utility business model. In a docket open since 2013, the PUC has also investigated the "decoupling" process, which was intended to remove an incentive to sell more energy (and thus removing a disincentive for energy efficiency).

Recently, the Hawaiian Electric Companies have filed several "rate cases" with the PUC. Those rate cases propose a limited set of performance benchmarks. **Hawaiian Electric has also requested that the PUC "initiate a separate investigatory docket based on HRS § 269-6(d) . . . to fully develop a comprehensive PBR [performance-based ratemaking] Framework for all three Hawaiian Electric Companies."**[1] This prior and ongoing work provides a foundation for implementing a comprehensive performance-based ratemaking process. With SB 366, the legislature would ensure that this long-awaited and consumer-friendly update to the regulatory compact will be accomplished within the next three years.

---

[1] *See* Hawaiian Electric Company, Inc. 2017 Test Year Application, filed Dec. 16, 2016 in Docket No. 2016-0328, at page 20.

Suggested Amendment

To ensure that the PUC maintains discretion to fashion appropriate ratemaking mechanisms for the various utility ownership models that are, or may be, under its regulatory control, we suggest amendments to clarify that the PUC may exempt cooperative and municipal utilities. In addition, we suggest applying performance-based revenue models for both electric and gas utilities. (*New/revised text indicated in red underlining. For readability, deleted text is not shown. We are happy to provide a full markup if the Committee so desires*).

SECTION 1.

. . .

The purpose of this Act is to protect consumers by urgently and proactively ensuring that the existing utility and regulatory business model will be updated for the twenty-first century by requiring that electric <u>and gas</u> utility revenues be directly tied to performance incentive and penalty mechanisms established by the public utilities commission.

SECTION 3. Chapter 269, Hawaii Revised Statutes, is amended by adding a new section to part I to be appropriately designated and to read as follows:

"§269- Performance incentive and penalty mechanisms. On or before January 1, 2020, the public utilities commission shall establish performance incentive and penalty mechanisms that directly tie <u>investor-owned</u> electric <u>and gas</u> utility revenues to a utility's achievement on performance metrics. Once established, such performance incentives and penalties, as may be amended by the public utilities commission from time to time, shall apply to all regulation of utility rates under section 269-16. <u>The commission shall have discretion to determine whether performance incentive and penalty mechanisms shall apply to utilities owned by a cooperative or municipality</u>.

In developing performance incentive and penalty mechanisms, the public utilities commission's review of electric <u>and gas</u> utility performance shall consider, but not be limited to, the following:

(1) The economic incentives and cost-recovery described in section 269-6(d);

(2) Exceeding the State's renewable portfolio standards as described in section 269-92, <u>or otherwise advancing the state's transition to renewable energy</u>;

(3) <u>Rate</u> affordability and ratepayer volatility risk;

(4) <u>Service</u> reliability;

(5) Customer satisfaction, including customer options for managing electricity costs;

(6) Rapid integration of renewable energy sources, including customer-sited resources; and

(7) Timely execution of competitive procurement and other business processes.

Thank you for this opportunity to testify.

CPH Testimony

From:	mailinglist@capitol.hawaii.gov
Sent:	Tuesday, February 28, 2017 10:16 PM
To:	CPH Testimony
Cc:	jameea@hawaii.edu
Subject:	Submitted testimony for SB366 on Mar 1, 2017 09:30AM

LATE

SB366
Submitted on: 2/28/2017
Testimony for CPH on Mar 1, 2017 09:30AM in Conference Room 229

Submitted By	Organization	Testifier Position	Present at Hearing
Jamee Allen	Young Progressive Demanding Action	Support	No

Comments: IN SUPPORT: HB366 RELATING TO THE HAWAII RATEPAYER PROTECTION ACT Aloha Chair, Vice Chair, and committee members, On behalf of the Young Progressives Demanding Action of Hawaii, I strongly support Senate Bill 366, a bill that will require the Public Utilities Commission (PUC) to establish a performance-based ratemaking incentive for our electric utility, Hawaiian Electric Company (HECO). Cost-plus ratemaking, otherwise known as rate-of-return (ROR) regulation, is a method established by the PUC to regulate HECO, which, by definition, is a natural monopoly. ROR regulation, however, is inefficient not only for consumer pricing, but for the further implementation of renewable energy. ROR regulation generally causes a "gold-plating" culture within the utility due to the fact that they are rewarded for spending more money. The money spent can be in the form of labor, but most commonly, in the form of capital expenditures. Since prices are set equal to their cost of production, the utility will increase consumer pricing due to their high in-house costs. Hawaii pays twice the national average for electricity, currently paying roughly $0.29 per kWh. Performance-based ratemaking will lower the costs for consumers. Performance-based ratemaking is an alternative to ROR regulation that will benefit consumers and the renewable energy market. It gives incentive benchmarks for the utility to reach; some examples of these benchmarks include reducing ratepayer risk, electric service reliability, customer satisfaction, and timely competitive procurement processes. It will also address concerns about decreasing revenues from solar PV. It is critical that we shift to a more incentive-based ratemaking structure in Hawaii in response to our comparatively high electricity rates. This regulation will benefit consumers, the renewable energy market, and the utility. Jamee Allen Environmental Chair | Young Progressives Demanding Action Hawaii

LATE

Rachel Schutz
1504 Uluhao St.
Kailua, HI 96734

Feb. 28th, 2017

Aloha Commerce, Consumer Protection, and Health Committee Members,

My name is Rachel Schutz and I am writing in support of Senate Bill 366 which directs the utility to set up a performance-based rate incentive rather than a profit-based one.

Last year my husband and I decided to make the switch to solar energy. We had been contemplating it for some time, but were forced into a decision due to HECO's decision to disincentive household solar through the elimination of the NEM rate program. While we had the option of quickly submitting our application before the NEM program was closed, others did not. We felt at the time that the choice to close down this program was not done in the interests of customers, but in the interest of HECO's profit and network capacity alone.

I am proud that our state has become the first to pledge 100% sustainable energy production by 2045, and I know most of my fellow residents feel the same way. I'm sure many more would like to make the switch to solar, but HECO's current model of setting rates through cost-plus methods means that they are not being incentivized to respond to their customers needs and desires. A performance-based ratemaking system would ensure that HECO responds to its *customers* not only its bottom line. This in turn would encourage a more timely switch to renewables, which would eventually lead to a reduction in the cost of energy to Hawai'i residents.

This bill would renew our dedication to renewable energy and protect electricity consumers. I urge you to support the bill to protect our 'aina and our bottom lines.

Mahalo for your time.

Rachel Schutz