Natural Resources Council of Maine

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Testimony in Support of LD 2172,
An Act to Enhance Electric Utility Performance-based Ratemaking

By Rebecca Schultz,
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Senator Lawrence, Representative Zeigler, and members of the Joint Committee on Energy, Utilities and Technology, my name is Rebecca Schultz. I am a Senior Advocate for Climate and Clean Energy at the Natural Resources Council of Maine (NRCM). NRCM is Maine's leading environmental advocacy organization with more than 30,000 members and supporters, on whose behalf I am testifying today in support of LD 2172, with suggested changes to clarify and strengthen the legislation.

Performance-based regulation, or PBR for short, has been around since at least the 1980s, implemented in various shapes and sizes by dozens of jurisdictions around the world, with a common goal of correcting misaligned incentives in the regulated utility sector. More recently, at least 17 states and Washington D.C. have adopted PBR reforms.[1]

Behind this renewed surge of interest is the widespread recognition that conventional approaches to utility regulation fail to motivate the investment, planning, and operational decisions that we need to ensure an affordable and equitable clean energy transition.

Electrifying heating and transportation and adding new renewable energy to substitute dirty and expensive fossil-fuel generation will require an enormous expansion of Maine's transmission & distribution (T&D) system. Traditional "cost of service" regulation provides utilities an opportunity to earn a return on capital investment. To be clear, this is the primary profit motivation of our regulated utilities—and it is very poorly matched to the unprecedented grid build-out we face today.

Instead of incentivizing costly infrastructure investments, we need to **align utility incentives with innovative ways to save ratepayers money**. In addition to more straightforward categories of performance pertaining to reliability, customer service, outage response, etc., performance-based regulatory reform is being used in jurisdictions around the country to help guide utility behavior for:

1. **Improved load flexibility to make the most out of the grid infrastructure we have** (e.g., by shifting and shaping demand for electricity to low-use times through time-of-use rates, electric vehicle smart charging, etc., thereby delaying expensive infrastructure upgrades).
2. **Utilizing customer-driven investments in new energy technologies** (to provide services to the grid, thereby shifting costs away from ratepayers).
3. **Increasing innovation through expert vetting and market competition** to challenge utility proposals.

Performance incentive mechanisms being used in U.S. jurisdictions today indeed target these emerging areas of power sector regulation. Standards and metrics have been developed in the following categories, for example: peak demand reduction, interconnection approval time for distributed energy

[1] https://www.ncsl.org/energy/performance-based-regulation-harmonizing-electric-utility-priorities-and-state-policy

resources (DERs), grid services acquired from DERs, utilization of Advanced Metering Infrastructure (AMI), emission reductions from electric vehicles, emission reductions from energy storage, etc. See Exhibit A, Figure 1 below for common policy goals in recent PBR legislation.

Attached to these comments is a draft **redline to the sponsor's amendment (Exhibit B)** in which we suggest revisions that address the following recommendations:

- **Use the term performance-based regulation, not rate design.** "Rate design" refers to retail rate structures, and, as used in the sponsors' amendment, is technically inaccurate. A correct term would be ratemaking or regulation. We recommend using the standard industry parlance "performance-based regulation" so as not to limit the regulatory tools available to Public Utilities Commission (PUC). See Exhibit A, Figure 2 below.

- **Strengthen the Commission's authorities in rate cases.** In Section 1, we recommend adding additional language to clear the way for the Commission to forcefully apply performance evaluation in ratemaking, specifically in determining an appropriate rate of return in a rate case.[2]

- **Reorient Section 3 around incentive regulation**. "All regulation is incentive regulation" so goes the saying. Understanding what exactly is being incentivized is part of the challenge for regulators in designing effective reforms. Recent analysis of PBR in practice suggests that rewards and penalties must be set to provide sufficient financial motivation to affect a change in behavior. To this end, performance incentives should substitute the current earnings on capital expenditure and take into account a market-based cost of equity.[3] See Exhibit A, Figure 3 below. In the redline, we proposed changes to Section 3 that clarify and expand the purpose to incentive regulation and make several clarifying edits to empower the PUC to more holistically reform underlying incentives.

- **Create a Competitive Innovation Program**. Sheltered from market competition, monopoly utilities infamously lack pressure to innovate. To help address this, we recommend creating a program to solicit innovative proposals from utilities, third-parties, and other grid service providers, to test new solutions in this rapidly changing industry. The program would serve as a clearinghouse for new ideas, which currently might be put forward ad hoc if at all, i.e., through a rate case, a non-wires alternative proceeding, integrated grid plans, or an interconnection request. A powerful model comes from Connecticut, where the Innovative Energy Solutions Program is administered by the Public Utilities Regulatory Administration.[4] The redline includes a new subsection 4, requiring the PUC to consider establishing a program to identify, demonstrate, and scale such proposals.

- **Establish an Emerging Issues Division at the PUC**. As we expand the roles and responsibilities of our utility regulators, it is crucial that we provide them with commensurate resources to focus on long-term initiatives and emerging issues. Across the U.S., Public Utilities Commissions are

[2] The language in the redline was inspired by Connecticut's 2020 statute on performance-based regulation. Pg 4, https://www.cga.ct.gov/2020/ACT/PA/PDF/2020PA-00005-R00HB-07006SS3-PA.PDF
[3] https://www.raponline.org/wp-content/uploads/2023/10/rap-improving-utility-performance-incentives-in-the-united-states-2023-october.pdf
[4] Connecticut Innovative Energy Solutions Program, https://portal.ct.gov/pura/electric/office-of-technical-and-regulatory-analysis/clean-energy-programs/innovative-energy-solutions-program

finding that they occupy a very unique position for orchestrating the clean energy transition—because they have decision-making authority over electric utilities. We need to modernize the grid, but we also need to modernize our regulatory commission to meet this challenge. Maine took a solid step in this direction when, in 2021 with LD 1682, it expanded the mandate of the PUC to include alongside traditional duties of ensuring reliability, affordability and safety, a new priority of facilitating greenhouse gas (GHG) reductions. That statute powerfully added to the legal authority of the PUC, but it also needs staff capacity and expertise dedicated to longer term, forward-looking initiatives to meaningfully implement these new emerging priorities alongside conventional priorities.

Many states are dealing with this by legislating additional staff with new policy initiatives. For instance, in its Energy Transition Act 2020, New Mexican lawmakers authorized nine additional full-time employees at the PUC; Colorado also has a dedicated staff division called the "Research and Emerging Issues Unit" which had eight staff at one point, has been focused climate and grid modernization issues.[5]

Performance-based regulation is complex and success is not guaranteed. The proposed bill presents a crucial opportunity to invest in staff capacity at the PUC, to empower and position our regulators to lead during this incredible time of transition. Our redline revisions make it clear that the function of this new division would apply outside PBR to new emerging issues more broadly.

In closing, our current regulatory framework, which primarily motivates utility capital expenditure, is inadequate for the 21st century. Careful and thorough development and implementation of a performance-based regulatory framework will help Maine craft effective incentives for an affordable and equitable clean energy grid. Maine regulators have a strong foundation on which to build with the minimum service standards and holistic grid planning provisions enacted in 2022 with LD 1959.[6] While using PBR to correct the misaligned incentives inherent in cost-of-service regulation is nothing new, the stakes have truly never been greater.

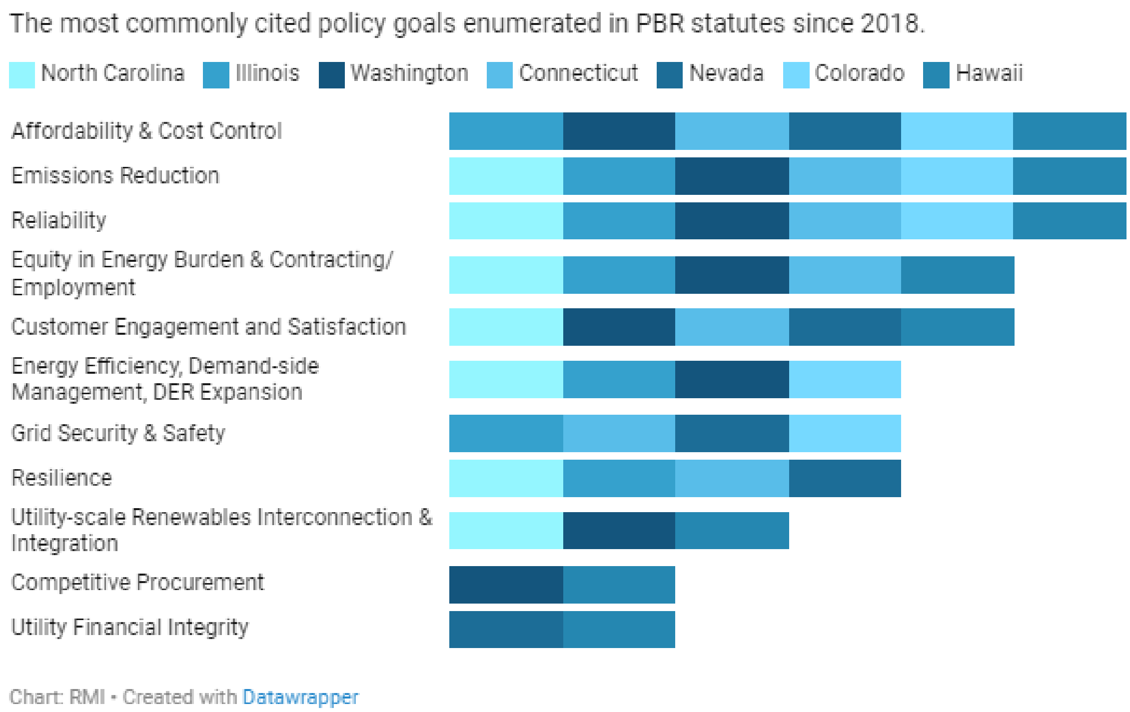
With our suggested revisions, NRCM supports LD 2172 and urges the Committee to vote **Ought to Pass.**

Thank you for this opportunity to provide testimony.

[5] https://rmi.org/wp-content/uploads/2022/01/the_people_element_positioning_pucs_for_21st_century_success.pdf
[6] P.L. 2022, ch. 702, https://www.mainelegislature.org/legis/bills/display_ps.asp?PID=1456&snum=130&paper=&paperld=l&ld=1959

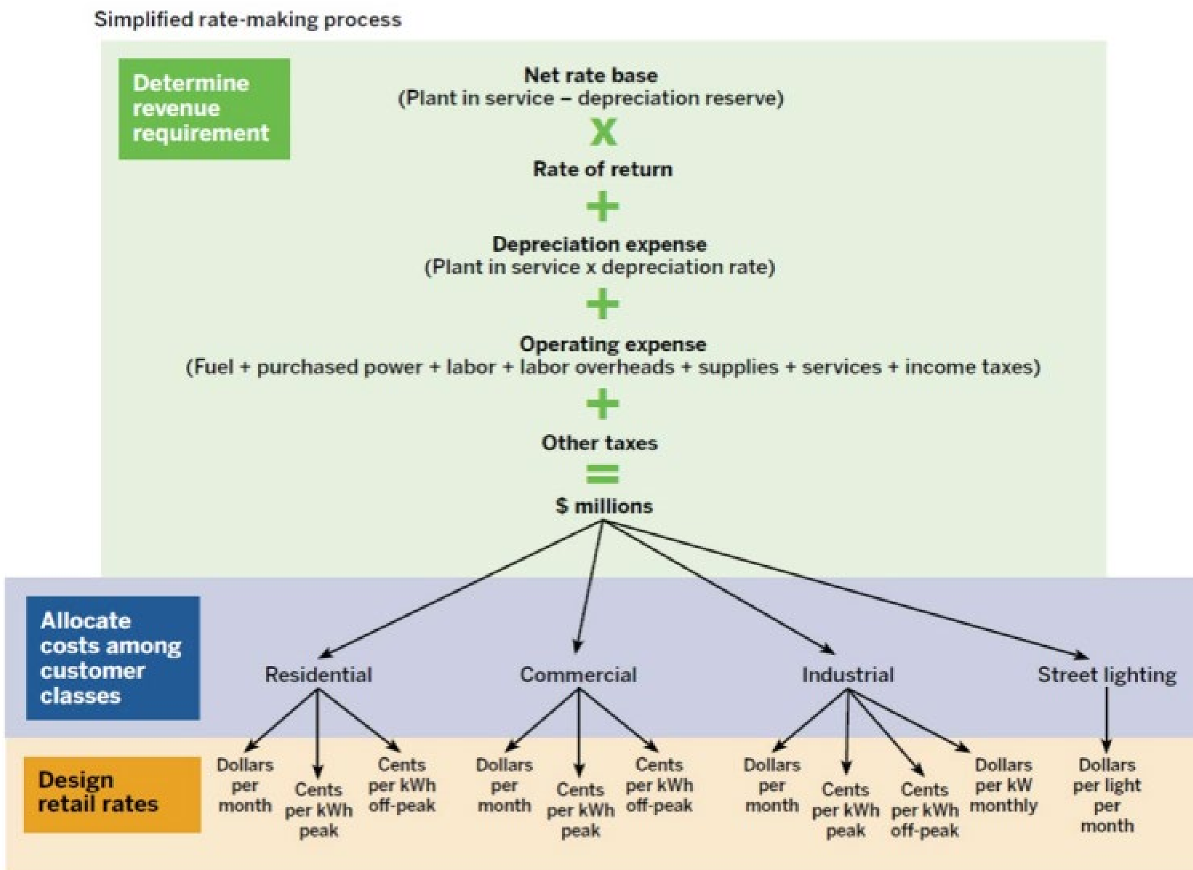
Exhibit A.

Figure 1. Policy goals in PBR enabling legislation since 2018 target emerging areas of power sector transformation.[7]



[7] https://rmi.org/states-move-swiftly-on-performance-based-regulation-to-achieve-policy-priorities/

Figure 2. The term "rate design" refers to customer-facing retail rates (orange band below), to the exclusion of the upstream determination of the revenue requirement (green band). The terminology "performance-based regulation" would appropriately expand the tools available to regulators in evaluating and incentivizing desired outcomes.[8]



[8] https://www.raponline.org/wp-content/uploads/2023/09/rap_lebel_usca_pbr_2021_nov_2.pdf

Figure 3. Rewards and penalties must be carefully designed relative to the existing rate of return to provide sufficient motivation to change utility behavior.[9]

[9] https://www.raponline.org/wp-content/uploads/2023/10/rap-improving-utility-performance-incentives-in-the-united-states-2023-october.pdf

Exhibit B.

Draft Redline from the Natural Resources Council of Maine

LD 2172
PROPOSED SPONSOR AMENDMENT
Offered by Rep. Runte

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 35-A MRSA § 307, sub-§6 is enacted to read:

6. General rate increase; performance metric; rate-adjustment mechanisms. Notwithstanding any other provision of this Title, the commission may establish performance-based incentives ~~metrics~~ or rate-adjustment mechanisms in a proceeding for a general rate increase involving a public utility. In doing so, the commission may evaluate the reasonableness and adequacy of the performance or service of the public utility and determine the reasonableness of the allowed rate of return of the utility based on such performance evaluation.

Strike section 2 of the bill and replace with the following.

Sec. 2. 35-A MRSA § 3196 is enacted to read:

§3196. ~~Review of p~~Performance-based regulation ~~rate designs~~.

1. Commission proceeding. Beginning October 1, 2024, then every 3 years thereafter, the commission shall initiate a proceeding to investigate, develop, adopt, and review a framework for ~~evaluate~~ performance-based regulation ~~rate designs~~, including rate adjustment mechanisms, performance incentives and other incentives for innovation ~~ve rate designs~~, that the commission may implement for an investor-owned transmission and distribution utility.

A. In conducting a proceeding, the commission shall first, in accordance with subsection 2, paragraph A, establish goals for the utility's performance and then develop standards and metrics, in accordance with subsection 2, paragraph B, that may be used to assess the utility's performance towards achieving those goals.

B. In its evaluation, the commission must consider performance-based regulation ~~rate designs~~ to:

(1) Enhance the minimum service standards established pursuant to section 301, subsection 1-A; and

(2) Align utility performance with standards and metrics developed in accordance with subsection 2, paragraph B.

C. The commission shall also consider performance-based rate designs utilized in other states.

2. Goals, standards and metrics; considerations. The commission shall establish goals for a utility's performance and standards and metrics to assess the utility's performance towards achieving the goals in accordance with this subsection.

A. The commission shall establish goals that are consistent with the objectives of the State's climate action plan under Title 38, section 577 and address the elements of a utility's integrated grid planning filing pursuant to section 3147, subsection 4. The commission shall develop ~~also consider~~, at a minimum, goals that would benefit ratepayers and would achieve the following:

(1) The promotion of efficiency and cost-effective utility operations;

(2) Increased planning and preparation for extreme weather events and climate hazards;

(3) The cost-effective and comprehensive response to outages;

(4) Increased affordability, equity, customer empowerment and satisfaction; and

(5) The advancement of the State's greenhouse gas emissions reduction goals established pursuant to Title 38, section 576-A.

B. After establishing goals in accordance with paragraph A, the commission shall establish specific standards and metrics for assessing transmission and distribution utility performance relative to the goals. In developing standards and metrics, the commission shall consider standards and metrics used in other states.

3. Incentive Regulation ~~Innovative rate design~~. As a part of the proceeding pursuant to subsection 1, the commission shall consider implementing regulatory approaches ~~innovative rate designs~~ to align transmission and distribution utility incentives with performance and outcomes consistent with the standards and metrics developed pursuant to subsection 2, paragraph B, including, but not limited to, designs that:

A. Assess the effectiveness and adjust the decoupling of the transmission and distribution utility profits from utility sales where appropriate;

B. Use ~~the total of operations~~ operating and capital expenses as the basis for ratemaking, ~~rather than capital expenses alone~~; and

C. Use of market cost of equity as the minimum to be recovered by utilities in rates, with any recovery above that amount determined by utility performance.

D. Consider limits and incentives regarding executive compensation.

4. Competitive Innovation Program. As a part of the proceeding pursuant to subsection 1, the commission shall consider establishing an innovation program to help identify, demonstrate, and scale proposals to support the transition to a clean, affordable, and equitable grid.

~~4~~ 5. Stakeholder input. The commission shall hold stakeholder workshops to receive stakeholder input and to assist in developing, implementing, and evaluating performance-based regulation ~~rate designs~~.

Nothing in this section prohibits the commission from investigating performance-based regulation ~~rate designs~~ for consumer-owned transmission and distribution utilities.

~~5~~ 6. Report. Beginning January 1, 2026, and then every 3 years thereafter, the Commission shall provide a report summarizing the proceeding, along with any information regarding the utilization of performance-based regulation ~~rate designs~~, and any recommended legislation, to the joint standing committee of the Legislature having jurisdiction over utility matters.

Insert new section 3 in the bill as follows.

Section 3. Technical policy group. The Public Utilities Commission shall create a technical policy group to assist the commission with long-term initiatives and emerging issues. The group shall support development of ~~develop~~ goals, standards and metrics, including those required by the Maine Revised Statutes, section 3196, subsection 2; monitor utility performance and recommend regulatory reforms ~~rate designs~~ based on performance; and draft legislative reports requiring policy-based analysis; and perform other activities to assist the commission with long-term initiatives and emerging issues. ~~that have broader implications related to the commission's regulatory oversight.~~ The commission may hire 3 full-time employees for this purpose.