



# PUBLIC UTILITIES COMMISSION STATE OF HAWAII

## SUMMARY OF PHASE 2 DECISION & ORDER ESTABLISHING A PBR FRAMEWORK

On December 23, 2020, the Hawaii Public Utilities Commission (Commission) issued a Decision and Order adopting a comprehensive framework of utility regulations to align the Hawaiian Electric Companies’ (“Hawaiian Electric”) financial interests with Hawaii’s clean energy goals and customer needs.

The Commission established a portfolio of performance-based regulation mechanisms (“PBR Framework”) that improves the current regulatory framework by incenting cost control efforts and offering rewards for exemplary performance, creating a win-win situation for Hawaiian Electric and its customers. The PBR Framework strengthens the utility’s financial condition and benefits customers by lowering utility costs, accelerating the integration of renewable energy resources, and improving customer service and engagement.

### **PBR Framework Designed to Advance Regulatory Principles, Goals, and Outcomes**

Phase 2 of this proceeding built off the directives included in the Commission’s Phase 1 Decision and Order, which examined the current regulatory framework and identified those areas of utility performance that were deserving of further focus. The decision established three guiding principles to inform the development of an updated 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 Commission adopted three overarching regulatory goals and 12 priority outcomes that served as guideposts for PBR design in Phase 2.

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

### **Collaborative Stakeholder Process**

This decision represents the culmination of over two and a half years of dedicated work by a broad spectrum of key stakeholders, including Hawaiian Electric, the State Consumer Advocate, local governments, clean energy companies, and environmental groups. The proceeding included a collaborative Working Group Process, during which stakeholders utilized working groups and specialized workshops to investigate, discuss, vet, and consider various PBR proposals. Following the Working Group Process, a more formal Briefing Process allowed stakeholders to present their vision of a comprehensive PBR Framework for Hawaiian Electric and advocate for their proposals before the Commission.



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### **New Performance-Based Regulatory Paradigm**

The PBR Framework adopted by the Commission modernizes the legacy regulatory structure through a set of alternative regulatory mechanisms that focus utilities on performance and alignment with public policy goals, as opposed to growth in capital investments or other traditional determinants of utility earnings. Under the new regulatory paradigm, utility revenues will be based on a combination of *annual revenue adjustments*, designed to implement cost control and savings for customers, with the opportunity to earn additional *performance revenues* for delivering exemplary performance towards achieving key regulatory objectives.

### **Annual Revenue Adjustments Will Encourage Cost Control**

**Updated revenue adjustment mechanisms** will establish target revenues over a five-year **Multiyear Rate Period (MRP)** during which there will be no general rate cases. Target revenues will be adjusted according to an **Annual Revenue Adjustment (ARA)**, which will be determined according to a formula that accounts for the effects of inflation, improvements in utility productivity, special adjustments for events that have a material financial impact but are outside of Hawaiian Electric's control, and a Customer Dividend, or "stretch factor," to immediately share with customers the benefits and cost savings expected to accrue to Hawaiian Electric under the PBR Framework.

Hawaiian Electric may achieve additional earnings during the MRP by increasing operational efficiency, pursuing strategic financing, and reducing capital expenditures.

Additional revenues for large, extraordinary projects will be available, as determined on a case-by-case basis, through the **Exceptional Project Recovery Mechanism (EPRM)**.

The **Revenue Balancing Account (RBA)** will be maintained to implement adjustments to Hawaiian Electric's target revenues and ensure that the

utilities recover their approved revenues, regardless of energy sales. Similarly, **existing cost tracking and pass-through mechanisms** will continue to provide recovery of specific costs that are not otherwise recovered through annual target revenue adjustments.

### **Performance Mechanisms Will Advance Key Regulatory Objectives**

Hawaiian Electric will also have the opportunity to earn financial rewards for exemplary performance through the PBR Framework's portfolio of Performance Mechanisms. These include five new **Performance Incentive Mechanisms (PIMs)** designed to drive progress on priority Outcomes such as *Interconnection Experience*, *Customer Engagement*, and *DER Asset Effectiveness*, as well as accelerate achievement of the state's Renewable Portfolio Standard (RPS). These will supplement Hawaiian Electric's existing PIMs that promote *Reliability* and *Customer Engagement*.

The PBR Framework also contemplates project or program-specific **Shared Savings Mechanisms** to incent cost-effective procurement of renewable energy generation and grid services during the MRP.

### **Support for Innovative Pilot Projects**

To foster innovation, a new **Pilot Process** will provide regulatory flexibility and expedite the implementation of pilots that test new technologies, programs, business models, and other arrangements.

### **Safeguards to Mitigate Risk**

An **Earnings Sharing Mechanism (ESM)** will share excessive earnings or costs between Hawaiian Electric and customers to ensure the continued financial health of the utilities, while protecting ratepayers from disproportionate utility profits. A **Re-Opener** mechanism provides for the examination of all or parts of the PBR Framework during the MRP, at the Commission's discretion, to determine if adjustments or modifications to specific PBR mechanisms are appropriate.



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<u>Summary of PBR Framework</u>	
<b>Revenue Adjustment Mechanisms</b>	
<b>Multi-year Rate Period (“MRP”) with Indexed Revenue Adjustment</b>	<p><b>5-Year Control Period</b> beginning with current effective rates and subsequently modified according to an annual review cycle by an <b>externally indexed Revenue Adjustment</b> allowing revenue changes during the MRP:</p> <p><b>Annual Revenue Adjustment = (I-Factor) - (X-Factor) + (Z-Factor) – (Customer Dividend)</b></p> <p>Where:</p> <p style="padding-left: 40px;"><u>I-Factor (inflation)</u> = Gross Domestic Product Price Index</p> <p style="padding-left: 40px;"><u>X-Factor (productivity)</u> = a pre-determined annual productivity factor set at 0%.</p> <p style="padding-left: 40px;"><u>Z-Factor (exogenous events)</u> = ex post adjustment, determined annually, to account for exogenous events outside of the utility’s control.</p> <p style="padding-left: 40px;"><u>Customer Dividend</u> = mechanism to ensure that customers share in the benefits of the PBR Framework, composed of: (1) a 0.22% annual compounding factor; and (2) \$22.16 million, representing the Companies’ prior commitment to return \$25 million in annual savings as a result of the Management Audit recently conducted in HECO’s last general rate case, determined on a cash basis and averaged over the MRP.</p> <p>In the fourth year of the MRP, the Commission will comprehensively review the PBR Framework to determine if any modifications or revisions are appropriate. It is expected that the post-MRP will consist of some refined version of the PBR Framework, rather than a return to traditional COSR.</p>
<b>Exceptional Project Recovery Mechanism (“EPRM”)</b>	<p>The <b>EPRM</b> will continue to provide “above the ARA” relief for extraordinary projects on a case-by-case basis, in an application process that is largely unchanged from the previous Major Project Interim Recovery process it replaces; however, EPRM relief is now explicitly applicable to O&amp;M expenses and program costs, not just capital expenditures, to mitigate capex bias.</p>
<b>Revenue Decoupling and Existing Cost Trackers</b>	<p><b>Revenue decoupling</b> (i.e., the Revenue Balancing Account) will continue to be used to true up collected revenues to an annual revenue target. Likewise, existing <b>cost tracking mechanisms</b> (e.g. PPAC, ECRC, etc.) will continue to track and recover certain approved costs.</p>
<b>Performance Mechanisms</b>	
<b>Performance Incentive Mechanisms (“PIMs”)</b>	<p>A portfolio of <b>PIMs</b> designed to drive achievement of the following priority Outcomes:</p> <p style="padding-left: 40px;"><b>RPS-A</b>: a PIM designed to incent Hawaiian Electric to accelerate the achievement of its Renewable Portfolio Standards goals, promoting the</p>



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	<p>Outcomes of <i>DER Asset Effectiveness, Customer Engagement, Interconnection Experience, Cost Control, Affordability, Grid Investment Efficiency, and GHG Reduction.</i></p> <p><b>Grid Services PIM:</b> a PIM designed to promote <i>DER Asset Effectiveness</i>, as well as <i>Grid Investment Efficiency</i>, by incenting the expeditious acquisition of grid services capabilities from DERs.</p> <p><b>Interconnection Approval PIM:</b> a PIM designed to promote <i>Interconnection Experience</i> by incenting faster interconnection times for DER systems &lt;100 kW, while penalizing underperformance.</p> <p><b>LMI Energy Efficiency PIM:</b> a PIM intended promote <i>Customer Engagement</i>, as well as <i>Customer Equity</i>, and <i>Affordability</i>, by incenting collaboration between Hawaiian Electric and Hawaii Energy, the third-party Public Benefits Fee Administrator, to deliver energy savings for low- and moderate-income (“LMI”) customers.</p> <p><b>AMI Utilization PIM:</b> a PIM intended to promote <i>Customer Engagement</i> and <i>DER Asset Effectiveness</i>, as well as <i>Grid Investment Efficiency</i>, by incenting acceleration of the number of customers with advanced meters enabled to support time-varying rates and next generation DER programs.</p> <p><b>Existing SAIDI/SAIFI and Call Center PIMs:</b> These PIMs will continue and may be updated in the Post-D&amp;O Working Group. The SAIDI and SAIFI PIMs will continue to support <i>Reliability</i>, and the Call Center PIM will continue to support <i>Customer Engagement</i>.</p>
<p style="text-align: center;"><b>Shared Savings Mechanisms (“SSMs”)</b></p>	<p>Incorporation of project/program-specific performance mechanisms, including <b>shared savings mechanisms</b> to incent cost-effective procurement of renewable energy generation and grid services. Alternative incentive structures may also be considered.</p>
<p style="text-align: center;"><b>Performance Mechanism Working Group</b></p>	<p>In recognition of the evolving nature of PBR, the PBR Framework provides for an on-going working group during the MRP to offer a forum to continue examining and developing Performance Mechanisms, which may be implemented during the MRP.</p> <p>The Post-D&amp;O Working Group will begin with finalizing details regarding the Interconnection Approval PIM, LMI Energy Efficiency PIM, and the AMI Utilization PIM, as well as determining an initial portfolio of <b>Scorecards</b> and <b>Reported Metrics</b> to be published by Hawaiian Electric to track, measure, and evaluate performance against targeted performance levels for other priority Outcomes. Thereafter, other Performance Mechanisms may be considered for further development.</p>



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Non-Revenue Initiatives	
<b>Pilot Process</b>	A framework for conducting expedited review for pilot projects to incent development of innovative programs and projects. Annual reports will allow the Commission to monitor progress and ensures appropriate cost recovery. Successful pilots may be considered for expansion.
Safeguards	
<b>Earnings Sharing Mechanism (“ESM”)</b>	<p>A risk-mitigation mechanism which protects the utility and customers from excessive earnings or losses, as measured by Hawaiian Electric’s Return on Equity (“ROE”) as follows:</p> <p>Target ROE of 9.5%, surrounded by a neutral deadband of 300 basis points (“bps”) in both directions (no sharing if actual ROE is between 6.5% and 12.5%).</p> <p>50-50 sharing between customers and the utility of earnings for actual earnings falling within 150 bps outside the deadband in either direction (50-50 sharing if actual ROE is &lt;6.50% to 5.00% or &gt;12.50% to 14.0%).</p> <p>90-10 sharing between customers and the utility for any further earnings and losses (90-10 sharing if actual ROE is &lt;5.00% or &gt;14.00%).</p> <p>Adjustments resulting from <b>downward</b> ESM adjustments (decreases to actual ROE) will come in the following year as a mid-year addition to ARA revenues.</p> <p>Adjustments resulting from <b>upward</b> ESM adjustments (increases to actual ROE) will be shared with customers as a bill credit commencing in the following year.</p>
<b>Re-Opener</b>	<p>In addition to protections provided by the <b>ESM</b>, the PBR Framework will also incorporate a <b>Re-Opener</b> mechanism, under which the Commission will open an examination into all or parts of the PBR framework, at its discretion, to determine if adjustments or modifications to specific PBR mechanisms are appropriate.</p> <p>A <b>Re-Opener</b> investigation will be triggered if Hawaiian Electric’s credit rating outlook indicates a potential credit downgrade below investment-grade status (as determined by one of the three major credit rating agencies), or if its earned ROE enters the outermost sharing tiers of the ESM (actual ROE is &lt;5.0% or &gt;14.0%).</p>

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