

MEMORANDUM

To: Commissioners

From: Todd Bianco and John Harrington¹

Date: April 30, 2020

Re: Docket No 4943 Guidance on Performance Incentive Principles Summary of Public Comment and Recommendations

I. Background

On January 29, 2020, the Public Utilities Commission (PUC or Commission) issued a Notice to Accept Public Comments on the PUC's Draft Guidance on Principles for the Development and Review of Performance Incentive Mechanisms (Draft Guidance Document) in Docket No. 4943. The PUC established a deadline for public comment of February 28, 2020. Five entities provided public comment on the Draft Guidance Document: Handy Law, LLC (Handy Law); The Narragansett Electric Company d/b/a National Grid (National Grid); the Division of Public Utilities and Carriers (Division); Vote Solar; and the Office of Energy Resources (OER). Staff provides the following memorandum, which includes a summary of comments and recommendations to the PUC.

II. Themes and Foundational Assumptions

Staff begins by noting three themes throughout the comments on the Draft Guidance Document and those comments received in response to Commissioner Anthony's March 5, 2019 Memo (Commissioner Anthony's Memo).² Staff provides its understanding of the PUC's intent related to these themes as a foundation for the staff's review below.

A. The Guidance Document is not a vehicle for performance-based regulation.

The first theme regards the Draft Guidance Document as a vehicle that introduces performance-based regulation (PBR), with commenters opining that the document goes too far or not far enough along this purpose. Staff believes these viewpoints misunderstand the primary purpose of this proceeding, which is to clarify and consolidate *existing* PUC policy on the use and design of Performance Incentive Mechanisms (PIMs). To quote Commissioner Anthony's Memo:³

Over the past two years, the frequency, complexity, and policy aim of performance incentive proposals before the Commission have increased. We have unanimously rejected most of these proposals and provided our reasons, but I believe this process has not been efficient for providing stakeholders clear, complete, and consolidated

¹ Cynthia Wilson-Frias and Alan Nault provided internal reviews of this memo.

² Comments on Commissioner Anthony's Memo were submitted by the Division, National Grid, OER, Handy Law, Conservation Law Foundation, The R Street Institute, Sunrun Inc., and Acadia Center. The Discussion Document responded to these filed comments, including the three themes highlighted here. Commissioner Anthony's Memo, the responding comments, and the Discussion document can be found on the docket webpage. <http://www.ripuc.ri.gov/eventsactions/docket/4943page.html>.

³ Commissioner Anthony's Memo at 1. http://www.ripuc.ri.gov/eventsactions/docket/4943-Memorandum_CommAnthony.pdf.

guidance on the Commission's policy for the appropriate use and design of performance incentive mechanisms.

Staff understands the primary purpose of the Guidance Document is to consolidate and clarify existing policy on PIMs. Staff does not equate this with development of new policy on PBR. Given the prevalence of the theme of development of PIMs and PBR in comments, it is appropriate for the PUC to consider *next steps* for development of PIMs and PBR in future work. Staff's review below, however, aligns with the PUC's intention to clarify and consolidate *existing* PIMs policy.

B. The Principles are not firm rules or standards.

The second theme regards the Principles themselves as firm rules or standards that, in practice, will present barriers to advancing public policy. Staff's review below is made with the understanding that the Principles are not firm standards. This understanding is based, in part, on the PUC's Revised Discussion Document released on December 23, 2019 (Discussion Document) and the transcript of the January 22, 2020 Technical Record Session (Technical Session).⁴ But, above all, this understanding is based on Section II.1.4, which makes clear that perfect adherence to the Principles is not necessary for approval of a PIM, and Section III.7, which defines principles as guides for evaluation, rather than standards for rulings. Staff recognizes the PUC's explicit intent to provide guidance on ideals but also to allow something less than ideal in practice.

C. The Principles do not determine the bounds of monopoly business.

The third theme regards the Principles as a screen for determining what business activities (e.g., services, programs) a regulated utility may engage in (or be encouraged to conduct) as part of its monopoly business under the PUC's jurisdiction. Staff again notes that the Draft Guidance Document is focused on determining the appropriate use and design of a PIM; the Draft Guidance document is not intended to provide guidance on what is appropriate business for regulated utilities to conduct. Staff expects the PUC would not allow a PIM to be passed through in regulated rates for a business activity that should not be conducted by a regulated utility.⁵ Staff also expects that this determination would be based on a separate analysis of applicable law rather than analysis of whether a PIM is an appropriate mechanism and is fair to ratepayers and the utility as guided by the Draft Guidance Document.⁶ Section II.1.5 appropriately puts determination of what business activities are included in regulated rates beyond the scope of the Draft Guidance Document.

Having explained Staff's foundational understanding of these themes, staff next provides review of the public comment. While the entire body of comments is useful to the PUC's regulation of utilities, Staff limits its review below to comments with *clear recommendations or concerns about*

⁴ See note 2.

⁵ The Guidance Document on PIMs does not and cannot expand the PUC's authority to set rates into areas prohibited by statute. For example, a PIM designed to lower the cost of energy supply could sufficiently adhere to all Principles but could not confer upon the utility the right to own large scale generation, since such ownership is prohibited by statute.

⁶ Similarly, and in the opposite direction, staff expects that a PUC decision to allow a PIM for some public interest outcome would not represent a determination that any and all actions that achieve the outcome may be conducted by the regulated utility and included in regulated rates.

the content of the Draft Guidance Document. Staff notes that some commenters expressed specific support for sections of the Draft Guidance Document that were helpful for Staff’s review, but that are not addressed here for brevity, unless necessary to address a difference in opinion with another commenter’s concerns.

III. Comments on Section I

Section I describes both the purpose of a guidance document generally, and the purpose of the Draft Guidance Document. The Division, Handy Law, and OER provided recommendations and concerns on Section I.

A. Division Comments

The Division notes on page 1 of its comments that the Draft Guidance Document lacks reference to R.I. Gen. Laws § 42-35-2.12, which establishes the use, limits, and rights associated with guidance documents. The Division recommends reference to the law and the rights afforded to “individuals who may be detrimentally impacted by the PUC’s reliance on” a final Guidance Document on PIMs.

- Staff response: Staff agrees reference to the statute is appropriate.
 - Staff Recommendation 1: Add the following footnote to Section I:⁷

R.I. Gen. Laws § 42-35-2.12 establishes an agency’s issuance and limited use of a guidance document, and further affords rights to individuals who may be detrimentally impacted by an agency’s reliance on a guidance document. An agency that proposes to rely on a guidance document to the detriment of a person in any administrative proceeding shall afford the person an adequate opportunity to contest the legality or wisdom of a position taken in the document. The agency may not use a guidance document to foreclose consideration of issues raised in the document.

B. Handy Law Comments

Handy Law recommends the PUC state which “specific, existing disincentives proposed PIMs are designed to fix” and suggests creating a framework that distinguishes “disincentives that can be remedied through such incentives and those that may require other structural solutions” with consideration of the “impact of scale” in that framework.⁸

- Staff response: As described in Part II of this memo above, it is not the intent of the Draft Guidance Document to develop the PUC’s preferred use of PIMs, and so describing “specific disincentives” would be beyond the scope of this proceeding. Regarding the suggested framework, staff believes that Principle 1 sufficiently addresses the framework Handy Law suggests. To the extent Handy Law is recommending the PUC apply the

⁷ Staff recommended revisions to the Draft Guidance Document will appear in red font, unless otherwise noted. Commenters’ revisions will appear in green font.

⁸ Handy Law Comments at 10. <http://www.ripuc.ri.gov/eventsactions/docket/4943-Handy-Comments 2.6.20.pdf>.

framework as part of this proceeding, this is beyond the scope of this proceeding, but is a future task the PUC should consider.

- Staff Recommendation 2: No change. Consider future proceedings that apply the framework established by the Principles and any other applicable law and policy.

C. OER Comments

OER “strongly encourages the Commission to state in the final Guidance Document that only the language in the final Guidance Document is being considered for formal adoption by the Commission. It should be made clear that previous documents should not be relied upon to properly interpret the final Guidance Document. Instead, each Commissioner may operationalize the principles as they deem most appropriate and prudent”⁹

- Staff response: Staff believes the Draft Guidance Document, with the additional references added at the suggestion of the Division, appropriately sets out the effect of the Draft Guidance Document.
 - Staff Recommendation 3: OER’s comments do not warrant any changes.

IV. **Comments on Section II**

Section II describes the applicability of the Draft Guidance Document. The Division and Handy Law provided comments on Section II.1. The Division, Handy Law, OER, and National Grid provided comments on Section II.2.

A. Division Comments

Regarding Section II.1, the Division recommends that the Draft Guidance Document “be amended to make clear that judicial precedent and ratemaking principles must also govern the PUC’s future assessment of any PIM.”¹⁰

- Staff response: Staff feels neither a strong need to adopt nor reject the Division’s amendment. Staff notes only that, to the extent existing ratemaking principles must guide the PUC’s decision, they are captured by the original language.
 - Staff Recommendation 4: Consider revising Section II.1.5 as follows:
*5. This Guidance Document does not modify existing regulatory or evidentiary standards and guidance **and applicable judicial precedent**. This is additional guidance on the PUC’s application of its ratemaking authority to performance incentive mechanisms.*

Regarding Section II.2, the Division notes “the Document incorrectly characterizes allowed reasonable return on equity, statutory remuneration, and minimum service quality standards as ‘incentives’,” and that it “incorrectly provides that they are ‘reasonably allowed’ rather than that they are legally required.” The Division recommends the Draft Guidance Document “be revised

⁹ OER Comments at 1.

¹⁰ Division Comments at 2. <http://www.ripuc.ri.gov/eventsactions/docket/4943-DPUC-Comments-2-28-20.pdf>.

to correctly denote the legal status of a reasonable return on equity, statutory remuneration, minimum service quality standards, and other legal requirements in the ratemaking process.”¹¹

- Staff response: The wording of Section II.2.b could be misinterpreted in that it does seem to suggest that a return on equity, statutory remuneration, and service quality standards are not legal requirements.¹²
 - Staff Recommendation 5: Revise Section II.2.a and b as follows:
 - a. This includes ~~an allowed~~ a total return on equity that is based solely on the size of rate-based ~~in rate base~~ investments, ~~statutory~~ remuneration, and minimum service quality standards.
 - b. The PUC recognizes these incentives ~~structures~~ are the current norms and default in utility regulation ~~and are reasonably allowed~~.

Finally, the Division recommends the PUC eliminate the clause “to the extent possible” in Sections II.2.f and g and thereby “make consideration of a reasonable return on equity, statutory remuneration, minimum service quality standards, etc. in any PIM analysis mandatory.”¹³

- Staff response: Staff believes the wording sufficiently makes the analysis mandatory while simultaneously acknowledging that such analysis may not be relevant or practically possible.
 - Staff Recommendation 6: Reject the Divisions proposed amendment to Sections II.2.f and g.

B. Handy Law Comments

Handy Law asks the PUC to be more specific about how the PUC “expects PIMs to relate to the allowed return on equity in rate-based investments.”¹⁴

- Staff response: More specificity on this issue must be provided, and this is worthwhile future work. For the reasons described in Part II of this memo, that work is beyond scope.
 - Staff Recommendation 7: No change. The PUC should consider future work addressing the relationship between PIMS and allowed return on equity in rate-based investments.

Handy Law suggests the PUC revise the numbering of this Section for clarity.

- Staff Response: This is a good suggestion.
 - Staff Recommendation 8: Revise the numbering format.

Handy Law proposes to revise “gradualism” to “gradualism where warranted” in Section II.d.¹⁵

¹¹ *Id.*

¹² Staff notes that, while a return on equity must be reasonable, the PUC is not bound to any specific method to determine a return on equity.

¹³ Division Comments at 2. <http://www.ripuc.ri.gov/eventsactions/docket/4943-DPUC-Comments-2-28-20.pdf>

¹⁴ Handy Law Comments at 11. <http://www.ripuc.ri.gov/eventsactions/docket/4943-Handy-Comments-2.6.20.pdf>.

¹⁵ *Id.*

- Staff response: Gradualism may not always be warranted, but consideration of gradualism is always warranted, and this is the intent of the Section II.d.
 - Staff Recommendation 9: Reject Handy Law’s revision to Section II.d.

Handy Law suggests the PUC “recommend reform with regard to existing statutory norms/incentives where and as appropriate...”

- Staff response: For reasons described in Part II of this memo, staff finds this recommendation beyond scope.
 - Staff Recommendation 10: Consider regulatory reform in future work.

Handy Law suggests there is a typo in Section II.e.¹⁶

- Staff response: Staff finds the wording awkward but does not find a typo.
 - Staff Recommendation 11: Revise Section II.2.e as follows:

e. The PUC expects to use these Principles to evaluate proposals that reasonably modify the current norms and default to reduce or eliminate the impact ~~the~~ inconsistencies embedded in the current norms and defaults of these incentives have.

Handy Law finds Section II.2.F “oblique and difficult to understand” and recommends revising the section to read “The PUC will apply the Principles to proposals for other performance incentive mechanisms with consideration of any existing incentives, to remedy apparent disincentives from the existing business structure, including return on equity in rate base, statutory remuneration, and to uphold minimum service quality standards, to the extent possible [emphasis added].”¹⁷

- Staff response: Handy Law’s proposed language implies the PUC is adopting a policy preference for PBR by changing a general *consideration of existing incentives* to a specific consideration of *how to remedy traditional incentives*. While this consideration is allowed for in Section II.2.e, specific policy adoption on preferences for PIMs and PBR is beyond scope for the reasons described in Part II of this memo. Staff agrees, however, that a minor edit could make the language clearer.
 - Staff Recommendation 12: Revise Section II.2.f as follows:

f. The PUC will apply the Principles to proposals for ~~other~~ new ⁴ performance incentive mechanisms...

⁴ “New” proposals are those that require approval or reapproval by PUC order, such as those associated with annual programs and plans.

¹⁶ *Id.*

¹⁷ *Id.*

C. National Grid Comments

National Grid states the “application of the principles to ROE runs counter to the purpose of ROE and raises regulatory risk.” In particular, National Grid “interprets [Section II.2.a] to suggest that PUC intends to evaluate allowed ROE through the [P]rinciples.”¹⁸

- Staff response: Staff reiterates that the language in this subsection could be interpreted in the manner that National Grid and the Division have, and references Staff Recommendation 5 above. However, Section II.2 indicates that tying total return on equity solely to rate-based investments is inconsistent with the Principles. Section II.2 then goes on to make clear that, although these inconsistencies are evident, the PUC *does not intend to eliminate the use of regulatory norms based solely on inconsistencies with the Principles*.
 - Staff Recommendation 13: Staff reaffirms Staff Recommendation 5.

National Grid further references the longstanding *Hope-Bluefield* standard, which sets judicial standards regarding the utility’s right to a reasonable return on equity (and to a reasonable opportunity to recover prudent costs). National Grid “does not believe that there is any additional benefit to customers from applying additional standards to the evaluation of [return on equity] and has not seen one articulated during this proceeding.”¹⁹

- Staff response: Notably, National Grid’s comments will later go on to directly reference the PUC’s articulation of the potential harms to customers caused by capital bias in the Discussion Document²⁰ as well as that of Acadia Center’s in their comments on Commissioner Anthony’s Memo.²¹ National Grid further notes articulation of capital bias presented by the Division in Docket No. 4770.²² National Grid may also be overlooking a report authored by staff of The Brattle Group at the request of National Grid (The Brattle Report) and attached as Appendix A to National Grid’s own comments, which explains

*Traditional rate of return regulation is the predominant form of regulation applied to public utilities, and has stood the test of time. However, analysts have suggested there may be various deficiencies and/or unintended incentives, such as: **incentives to build up utility rate base**, counter-incentives to procure non-utility solutions ... and minimal incentives to engage customers. (emphasis added)*²³

Regardless, staff notes that the total return on equity is not subject to new standards through this guidance document and must be consistent with *Hope-Bluefield*.²⁴ Staff further notes, however, that the Applicability provided in Section II *does* mean that the portion of the

¹⁸ National Grid Comments at 2. http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments_2-28-2020.pdf.

¹⁹ *Id.* at 3.

²⁰ *Id.* at 5.

²¹ *Id.* at 4.

²² *Id.* at 5.

²³ *Id.* Appendix A at 2.

²⁴ This issue is also addressed in the discussion above regarding the Division’s comments.

total return on equity that is based solely on the size of rate-based investment may be impacted by the adoption of PIMs.

- Staff Recommendation 14: Staff reaffirms Staff Recommendation 4, which recognizes judicial precedent.

National Grid cautions that “any adjustment that undermines the relative attractiveness of a utility’s base level of earnings opportunity would increase uncertainty and risk.”²⁵

- Staff response: Taken alone, National Grid’s assertion is correct. However, if the relative attractiveness of a utility’s base level or earnings opportunity increases risk, the utility will have the opportunity to make its case that application of the guidance document will have a detrimental effect on the utility’s relative attractiveness to investors in future cases. Staff again refers to the revisions in Staff Recommendations 4, restates that the total return on equity is not intended to be interpreted by the Principles, and notes appropriate adherence to the *Hope-Bluefield* standard.

- Staff Recommendation 15: Staff reaffirms Staff Recommendations 4 and 5.

National Grid states that the “arguments for an asymmetric adjustment to [return on equity] in the presence of PIMs are flawed.”²⁶

- Staff response: Staff finds no mention of asymmetric adjustment to return on equity in the presence of PIMs in the guidance document.²⁷

- Staff Recommendation 16: No changes related to this comment are warranted.

National Grid states that the “downward adjustment of [return on equity] will... increase company risk.”²⁸

- Staff response: Here National Grid reminds the PUC of the fundamental economics underlying the PUC’s primary function. Staff assumes the PUC is aware that if risks change then adjustments to total return on equity may also have to change.²⁹ The language of the Draft Guidance Document makes no pre-judgement that PIMs reduce rate-base earnings.³⁰ Staff understands that the Draft Guidance Document indicates the total return on equity may be set in consideration of both PIMs earnings and rate-base earnings, and

²⁵ National Grid Comments at 4. http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments_2-28-2020.pdf.

²⁶ *Id.*

²⁷ Staff notes that Handy Law advocates for this explicit preference.

²⁸ National Grid Comments at 7. http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments_2-28-2020.pdf.

²⁹ Staff does not believe that the consideration (e.g., inclusion in target return on equity, inclusion in earnings shearing, etc.) of PIMs revenue when setting a total return on equity necessarily increases risk to investors, although it almost certainly changes risk.

³⁰ Again, this is contrary to the recommendations of Handy Law.

that the Draft Guidance Document does not alter the fact that risk will *always be relevant* in the return on equity.³¹

- Staff Recommendation 17: Staff reaffirms Staff Recommendations 4 and 5.

National Grid states that the “downward adjustment of [return on equity] will undermine PIMs...”³²

- Staff response: National Grid’s point is economically valid. Staff notes, however, that there is no clear language in the Draft Guidance Document stating a downward adjustment of either total return on equity or the portion of return on equity that is based solely on the size of rate-based investments. National Grid’s position is best made when such a proposal is before the PUC. Furthermore, as National Grid acknowledges, there may be other avenues to balance PIMs as part of overall earnings, such as through earnings sharing mechanisms.³³ Finally, staff believes that an appropriate balance in setting overall earnings in consideration of PIMs is set forth in the application of Principle 4.

- Staff Recommendation 18: No changes related to this comment are necessary.

National Grid recommends that statutory incentives be exempt from application of the principles.³⁴

- Staff response: Staff Recommendation 5 strikes the word “statutory” from Section II.2.a. Furthermore, note 3 of the Draft Guidance Document recognizes that the PUC does not set statutory remuneration. Staff believes it remains appropriate to consider all remuneration, including statutory remuneration, *to the extent possible*, including to the extent applicable law allows, when considering proposal for new PIMs.
- Staff Recommendation 19: Staff reaffirms Staff Recommendation 5. Staff further recommends striking “statutory” from Section II.2.f as follows (and keeping Staff Recommendation 5 in magenta):

f. The PUC will apply the Principles to proposals for ~~other new~~ ⁴ performance incentive mechanisms with consideration of any existing incentives, including return on equity in rate base, ~~statutory~~ remuneration, and minimum service quality standards, to the extent possible.

Given the previous comments, National Grid then offers the following edits to Section II.2:

2. The PUC recognizes that some utility incentives have varying degrees of consistency with these principles.

³¹ See *Duquesne Light Co. v Barasch*, 488 U.S. 299, at 314 (1989) (“Admittedly, the impact of certain rates can only be evaluated in the context of the system under which they are imposed. One of the elements always relevant to setting the rate under [*FPC v. Hope Natural Gas Co.*, 320 U. S. 591 (1944)] is the return investors expect given the risk of the enterprise... The risks a utility faces are in large part defined by the rate methodology because utilities are virtually always public monopolies dealing in an essential service, and so relatively immune to the usual market risks.”)

³² National Grid Comments at 7. http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments_2-28-2020.pdf.

³³ *Id.* at 8.

³⁴ *Id.*

(a) This includes ~~an allowed return on equity in rate base investments, statutory remuneration, and~~ minimum service quality standards.

(b) The PUC recognizes these incentives are the current norms and default in utility regulation and are reasonably allowed.

(c) The Principles reveal weaknesses and strengths of the current norms and default.

~~(d) The Principles will be applied to the current norms and default to the extent possible with specific consideration of applicable statutes, gradualism, and fair notice.~~

~~(e)~~(d) The PUC expects to use these Principles to evaluate proposals that reasonably modify the current norms and default to reduce or eliminate the impact the inconsistencies of these incentives have.

~~(f)~~(e) The PUC will apply the Principles to proposals for other performance incentive mechanisms with consideration of any existing incentives, ~~including return on equity in rate base, statutory remuneration,~~ and minimum service quality standards, to the extent possible.

~~(g)~~(f) The PUC will take into consideration any existing performance incentive mechanisms in proposals to set ~~return on equity in rate base investments or minimum service quality standards,~~ to the extent possible.

- Staff response: Staff Recommendations 4, 5, 11, 12 and 18 amend Sections II.2.a, b, e, and f that address, in part, some of National Grid’s concerns and recommendations. These amendments further affect the meanings Sections II.2.d and f that also address, in part, National Grid’s concerns and recommendations.
 - Staff Recommendation 20: Staff reaffirms Staff Recommendations 4, 5, 11, 12 and 19 and finds no further amendments to address National Grid’s comments are warranted.

Finally, National Grid recommends revising Section II.3 to read “The effect of this document is immediate upon adoption by the PUC and will be applied in any case, ~~filed on or after the effective date of this document,~~ that proposes performance incentive mechanisms for an investor-owned utility [emphasis on National Grid’s amendment added].”

- Staff response: Staff believes National Grid’s proposal fair. Staff has removed the commas before and after the new language.
 - Staff Recommendation 21: Section II.3 should be revised as follows:

3. The effect of this document is immediate upon adoption by the PUC and will be applied in any case ~~filed on or after the effective date of this document~~ that proposes performance incentive mechanisms...

D. OER Comments

For clarity, OER recommends the PUC “[p]rovide explanations on when and where each Principle is expected to be applied. It is OER’s interpretation that proposed Principle 1 acts as a threshold review to determine if a PIM structure should be considered further; proposed Principles 2-3 establish guidance for stakeholders on overall PIM structure; and proposed Principles 4-5 establish guidance for stakeholders on PIM incentive levels.”³⁵

- Staff response: Staff believes OER is seeking language that affirms OER’s interpretation of the Principles provided above. The Principles have some overlap and work together, and OER’s language may segment application of the PIMs in an unintended way.
 - Staff Recommendation 22: Reject OER’s proposed additional guidance on applicability.

OER recommends the PUC “[c]onsider adding principles to encourage PIM proposals to provide robust and convincing plans for evaluating causal performance; to present sufficient key metric details; and to include a clear statement of a PIM’s objective.”³⁶

- Staff response: Regarding the first two elements suggested by OER, staff agrees such guidance could be useful. To the extent that these two elements are not already captured in the Draft Guidance Document (or required in the normal course of proving one’s case) then these may represent principles specific to metrics, which might be determined in individual cases or in a future proceeding.

Regarding the third element suggested, Staff agrees that a clear statement of a PIM’s objective should be required, but believes that Principle 1 sufficiently addresses this, along with adherence to Principles 2, 3, and 5.

- Staff Recommendation 23: No revisions are warranted based on OER’s comments.

Finally, OER comments that “[t]he Guidance Document should state explicitly if these proposed Principles are intended to be applied to action-based incentives... OER believes action-based incentives do have an appropriate time and place and should not be subjected to the same review as outcome-based incentives.”³⁷

- Staff response: Section II.1.1 states “[t]he Principles will apply to all proposals of performance incentive mechanism.” This certainly includes action-based incentives, which are not prohibited, although Staff believes there may be significant inconsistencies with multiple Principles. Staff believes OER is recommending a lower bar be set for action-based PIMs, which runs counter to the purpose of setting Principles. For the reasons stated in Part II of this memo, the PUC has appropriately maintained flexibility in the Applicability provided in Section II of the Draft Guidance Document. In addition, the PUC cannot ignore that rejection of proposals for action-based PIMs, in part based on existing and unconsolidated PUC policy, contributed to the need for this proceeding in the first

³⁵ OER Comments at 2. <http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments-3-2-20.pdf>.

³⁶ *Id.* at 3.

³⁷ *Id.*

place.³⁸ Additionally, OER provides no opinion on what, if any, guidance should apply to action-based PIMs.

- Staff Recommendation 24: Reject OER’s recommendation to exempt action-based incentives from the applicability of the Draft Guidance Document.

V. National Grid’s Recommendations on Principles

Staff begins by noting that National Grid’s proposed revisions to Principles 1 through 4 are based on The Brattle Report, which appears to be an analysis on Commissioner Anthony’s Memo. Notably, The Brattle Report is dated after the release of the Discussion Document and Technical Session but does not indicate its analysis included the information contained in these other docket materials. The Brattle Report also does not appear to address the Principles within the context of the Draft Guidance Document.

The Brattle Report makes two broad recommendations, quoted below:

*First, while we fully agree that the Commission should use quantifiable and verifiable analysis to inform its decision making (concerning PIMs and incentive levels) to the extent possible, it should not close the door on using qualitative benefits in determining incentive levels. Second, the Commission should recognize that incentives are set in order to induce action on the part of the utility and that incentives derived from a strict net benefit test as currently articulated in the Principles may not always be sufficient to motivate the desired utility behavior. Accordingly, the Commission should allow itself some leeway in setting incentive levels, including examining the experiences in other jurisdictions and iterating incentives based on recent experience.*³⁹

National Grid explains that “the language of Subsection II.1.4. of the Draft Guidance Document which reads, ‘[p]erfect consistency with the Principles is not required for approval of a performance incentive mechanism,’ is an important step towards ensuring such flexibility exists.”⁴⁰

- Staff response: Consistent with Staff’s discussion in Part II of this memo, Staff believes the Draft Guidance Document provides appropriate flexibility to the PUC, and National Grid Consistent with the procedures for departing from a guidance document, the PUC would need to explain that departure. Furthermore, Staff believes the premise that incentives are set in order to induce action is not shared by the Draft Guidance Document. The PUC’s intent embodied in the document is to induce net positive outcomes. The

³⁸ Commissioner Anthony’s Memo at 1. <http://www.ripuc.ri.gov/eventsactions/docket/4943-MemorandumCommAnthony.pdf>. See also Minutes of Open Meeting, March 18, 2019 at 1. <http://www.ripuc.ri.gov/eventsactions/docket/4943-minutes-March18,2019.pdf>.

³⁹ National Grid Comments Appendix A at 10. <http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments2-28-2020.pdf>.

⁴⁰ *Id.* at 10.

difference between The Brattle Report's view and the PUC's seems nuanced but it represents a significant departure.

- Staff Recommendation 25: Consider affirming the purpose of incentives is to induce net positive outcomes.

National Grid also urges adoption of The Brattle Report's following revision to Principle 1:⁴¹

*Principle 1. A performance incentive mechanism can be considered when the utility lacks an incentive (or has a disincentive) to better align utility performance **or services** with the public interest and there is evidence of underperformance, ~~or~~ evidence that improved performance will deliver incremental benefits **or evidence that new or expanded utility services will deliver incremental benefits.***

The Brattle Report supports this edit with the following: "Principle 1 may benefit from modification to ensure that such new initiatives are included within its scope."⁴²

- Staff response: Principle 1 is a screen for whether a PIM is an appropriate mechanism to consider for some outcome. National Grid's recommendation would expand Principle 1 into a screen for utility business activity. As described in Part II of this memo, such a screen or principle to determine utility business activity is beyond the scope of the proceeding.
 - Staff Recommendation 26: Staff recommends the PUC reject National Grid's revisions to Principle 1.

National Grid adopts The Brattle Report's following revision to Principle 2:⁴³

*Principle 2. Incentives should be designed to enable a comparison of the cost of achieving the target to the potential quantifiable and cash benefits, **however the resulting net benefits should not be fully determinative of the incentive level to be applied unless benefits and costs are both predominantly quantifiable.***

The Brattle Report supports this edit with the following: "However, sole reliance on quantitative analysis for purposes of setting incentive levels may result in an understatement of the incentive needed to produce sought-after results. As discussed above, this may have a significant impact on the effectiveness of some [of] the emerging PIMs being considered by the Rhode Island Commission... These benefits are difficult to monetize without a specialized study and, even then, would be subject to considerable debate. Customers will undoubtedly benefit from such initiatives..."⁴⁴

- Staff response: Staff admits some confusion over the exact meaning of National Grid's recommended edits but interprets them through the additional text provided by The Brattle Report. As a counterpoint to that discussion, quoted above, Staff notes that reliance on non-

⁴¹ *Id.*

⁴² *Id.* Appendix A at 8.

⁴³ *Id.* at 10.

⁴⁴ *Id.* Appendix A at 8.

quantitative analysis for the purpose of setting incentive levels results in paying the utility for something not known to be delivered and not known to be used and useful. Staff believes that avoiding paying the utility for things not delivered is a policy that is at least as important as any other “sought after result” to which The Brattle Report refers, and that opinion seems shared by the Division.⁴⁵ Additionally, Principle 2 puts the utility in the position of having to innovate ways to quantify and provide evidence of such unquantified outcomes, so that shareholders may share in a portion of the verifiable benefits. This pressure may in itself drive improved transparency and regulation.

Staff further notes that the final sentences above (“These benefits are difficult to monetize without a specialized study and, even then, would be subject to considerable debate. Customers will undoubtedly benefit from such initiatives...”) contradict each other, and thus the premise is unreliable.⁴⁶

- Staff Recommendation 27: Staff recommends the PUC reject National Grid’s revisions to Principle 2.

National Grid urges adoption of The Brattle Report’s following revision to Principle 3:⁴⁷

Principle 3. Incentives should be designed to maximize ~~customers’ share of total quantifiable, verifiable net benefits~~ total 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.

The Brattle Report asserts that maximizing total net benefits is preferable.⁴⁸

- Staff response: The Brattle Report appears unaware of the PUC’s response to this proposal by National Grid in the Discussion Document which said⁴⁹

The underlying intent of this language in Principle 3 is to design PIMs that 1. maximize total net benefits; and 2. simultaneously maximize customers’ share of total net benefits. Doing either one alone is not always the same as doing both simultaneously. The latter intent assures that PIMs are designed to affect areas and outcomes in which customers have stake and in which customers have an opportunity to share in net benefits.

Staff believes the response in the Discussion Document remains appropriate

⁴⁵ Division Comments at 3. (“The Commission should be wary of approving any PIM where the quantifiable and verifiable, cash net benefits to ratepayers are relatively small even though non-cash system and societal benefits are relatively large.”) <http://www.ripuc.ri.gov/eventsactions/docket/4943-DPUC-Comments 2-28-20.pdf>.

⁴⁶ Staff wonders, rhetorically, why parties would engage in “considerable debate” about something customers would “undoubtedly benefit from.” How could one be sure of customer benefits when such a thing is subject to considerable debate? Unquantified benefits are a known unknown and should be treated as such.

⁴⁷ National Grid Comments at 10. <http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments 2-28-2020.pdf>.

⁴⁸ *Id.* Appendix A at 10.

⁴⁹ Discussion Document at 26. <http://www.ripuc.ri.gov/eventsactions/docket/4943-PPIMs PUC Discussion Doc Rev12-23-19.pdf>

- Staff Recommendation 28: Staff recommends the PUC reject National Grid’s revisions to Principle 3.

National Grid urges adoption of The Brattle Report’s following revision to Principle 4:⁵⁰

Principle 4. ~~An incentive should offer the utility no more than necessary to align utility performance with the public interest.~~ Incentive designs should consider practical constraints and be set at levels that align utility performance and services with providing the highest net benefits in the public interest.

National Grid appears to be relying on The Brattle Report’s understanding that “Principles 3 and 4 are primarily concerned with the split of net benefits: customers should receive as much as possible, and utilities should receive no more than is necessary for them to engage as needed to produce the intended result. This sharing guidance is reasonable on an overall basis, but should be secondary to the goal that performance incentives produce the greatest net benefit possible.”⁵¹

- Staff response: The Brattle Report recognizes the “guidance is reasonable on an overall basis” but then recommends that fair cost and benefit allocation be secondary to maximizing net benefits. Staff first notes that equity and proper cost and benefit allocation *are themselves in the public interest* and should not be subordinate to maximizing whatever other set of benefits or public interest The Brattle Report was imagining when this statement was written.

Second, the statement fails to explain any flaw in the idea that the utility be paid no more than necessary, and Staff notes that it has not heard argument that the opposite is fair: that the utility be paid more than necessary. Staff believes this is an attempt to increase flexibility in the Principles. Staff relies on the discussion in Part II of this memo and restates the understanding that the PUC intends to provide flexibility in the application of the Principles, rather than in the wording of the Principle themselves.

- Staff Recommendation 29: Staff recommends the PUC reject National Grid’s revisions to Principle 3.

VI. Division Recommendations on Principles

The Division notes that Principle 1 “could allow PUC consideration of a PIM even if the ‘underperformance’ is due to program mismanagement or incompetence,” which the Division interprets to be a low bar.⁵² The Division recommends that Principle 1 “be revised to allow for PUC consideration of a PIM only if it will produce material, incremental utility performance as measured from a level of excellent performance *and* delivers incremental benefits to ratepayers and the utility [emphasis theirs].”⁵³

⁵⁰ National Grid Comments at 10. http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments_2-28-2020.pdf.

⁵¹ *Id.* Appendix A at 10.

⁵² Division Comments at 2. http://www.ripuc.ri.gov/eventsactions/docket/4943-DPUC-Comments_2-28-20.pdf.

⁵³ *Id.*

- Staff Response: Staff does not disagree with the Division’s point that a positive performance incentive should only be available for excellent performance. Staff notes, however, that positive-only incentives are not the only form of performance incentive possible. Furthermore, the Division’s recommendation is focused on setting a standard for a baseline, which is beyond the scope of the proceeding, and which is further problematic because the Division offers no reliable definition or standard for “excellent performance.” Staff agrees baseline setting will be a subject of intense debate in designing and evaluating future PIMs proposals, but that the recommended language is not appropriately within the scope of the Draft Guidance Document.
 - Staff Recommendation 30: Reject the Division’s revision to Principle 1 and consider whether a future proceeding to develop how to set baselines in a manner consistent with, and building from, the Principles is necessary.

The Division cautions that the PUC “should be wary of approving any PIM where the quantifiable and verifiable, cash net benefits to ratepayers are relatively small, even though non-cash system and societal benefits are relatively large.”⁵⁴

- Staff response: Staff reads this as a comment on Principles 2 through 4, collectively. Staff understands the comment as a caution of the applicability of these Principles, in that the Principles allow consideration of non-cash system and societal benefits. Staff believes the Division’s caution is appropriate, but that this caution must occur in application of the Principles to an actual proposal for a PIM. Staff also notes that the Division’s concern of rewarding a utility for producing non-cash system and societal benefits in the absence of quantifiable and verifiable, cash net benefits to ratepayers is in stark contrast to the concerns of OER⁵⁵ and National Grid⁵⁶ that the PUC’s Principles pay too much attention to quantifiable, cash, and customer benefits. Staff agrees with the Division’s position on this matter.
 - Staff Recommendation 31: No revisions are warranted based on these Division comments.

Regarding Principle 3, which starts “Incentives should be designed to maximize customers’ share of total quantifiable, verifiable net benefits,” the Division “recommends that the word ‘should’ be replaced by the word ‘shall’ to ensure maximum net benefits inure to ratepayers.”⁵⁷

- Staff response: Staff believes the Division uses the word “shall” to indicate “must” in its proposed revision. Thus, the Division appears to support a stricter application of Principle 3 than that supported by National Grid⁵⁸ and OER.⁵⁹

⁵⁴ *Id.* at 3.

⁵⁵ OER Comments at 1. <http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments 3-2-20.pdf>.

⁵⁶ *For example, see* National Grid Comments Appendix A at 11. <http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments 2-28-2020.pdf>.

⁵⁷ Division Comments at 3. <http://www.ripuc.ri.gov/eventsactions/docket/4943-DPUC-Comments 2-28-20.pdf>.

⁵⁸ *For example, see* National Grid Comments Appendix A at 11. <http://www.ripuc.ri.gov/eventsactions/docket/4943-NGrid-Comments 2-28-2020.pdf>.

⁵⁹ OER Comments at 2. <http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments 3-2-20.pdf>.

Based on the understanding provided in Part II of this memo, staff assumes Principle 3 is intended to represent the ideal, which appears to have the Division's support. Staff, therefore, would not argue against the Division's edit *per se*, since in an ideal situation, a principle *must* be held to. Staff, however, believes that adopting the word "shall" or "must" will mislead stakeholders to believe the PUC *has adopted a different* (i.e. stricter) view of the application of Principle 3 through this revision. Staff believes that would be confusing because the application of Principle 3 is not within the wording of the Principle itself, but in Section II of the Draft Guidance Document.

- Staff Recommendation 32: Staff recommends the PUC reject the Division's proposed revision to Principle 3 and affirm that the Principles (including Principle 3) represent an ideal and affirm that the application of the Principles is provided in Section II of the Draft Guidance Document.

VII. Handy Law Recommendations on Principles

Handy Law proposes "to add to [P]rinciple 1, that PIMs should not be used where the incentive cannot be expected to have a marked impact on resolving the underlying disincentive (deep structural problems/interests require deep structural remedies, not just gratuitous compensation). Maybe this is a revision to indicate that merely "incremental benefits" are inadequate..."⁶⁰

- Staff response: Handy Law has identified an approach to sizing PIMs worth considering, but the PUC's preference for the focus area or size, of PIMs is beyond the scope of this proceeding.
 - Staff Recommendation 33: Staff recommends the PUC reject Handy Law's revisions to Principle 1 and consider future work on PIMs preferences.

Handy Law proposes adding at the end of both Principles 2 and 3 "at optimal scale for transformation and as evaluated both within and across sectors."⁶¹ Handy Law similarly suggests adding "and achieve the intended transformation" to the end of Principle 4.

- Staff Response: Staff again believes Handy Law has identified an approach toward implementing or determining preferences for PIMs that is worth consideration but that is beyond the scope of this proceeding.
 - Staff Recommendation 34: Staff recommends the PUC reject Handy Law's revisions to Principles 2, 3, and 4 and consider future work on PIMs preferences.

Further regarding Principles 2 and 3, Handy Law provides its understanding that "the dialogue at the [Technical Session] was that the Commission was going to be more receptive to some of the less quantifiable benefits addressed in the [Docket 4600A Guidance Document] than the language of that principles suggests." Handy Law suggests that discussion of the implementation provided in the Docket 4600A Guidance Document could help clarify the consideration of non-quantifiable benefits.⁶²

⁶⁰ Handy Law Comments at 12. <http://www.ripuc.ri.gov/eventsactions/docket/4943-Handy-Comments.2.6.20.pdf>.

⁶¹ *Id.*

⁶² *Id.*

- Staff Response: Staff agrees that any Principle should mean what the language of the Principle suggests. Since Handy Law does not explicitly state what difference between the language and intent they detect, it is hard to provide a clearer response.

That said, Staff believes stakeholder attention to the definitions of cash benefits, customer share, and verifiable that are provided in Section III of the Draft Guidance Document may provide the additional clarity Handy Law seeks. Importantly, a benefit can be simultaneously quantifiable, verifiable, and *non-cash*. The last sentence of Principle 3 appropriately includes that the increased risk associated with *non-cash* benefits should be considered when analyzing to which entity *non-cash* benefits were allocated. For example, allocation of higher risk benefits should be associated with a greater allocated share of such benefits.⁶³

Finally, Staff notes that the extent to which non-quantifiable benefits are considered is largely the result of the details of actual PIMs proposals, and will be certainly affected by the strength of individual positions and evidence within individual proposals for PIMs.

- Staff Recommendation 35: Staff recommends the PUC affirm the Principles should be read to mean their plain language (informed by definitions in Section III and to the extent possible) and make no further changes to Principle 3.

Finally, Handy Law recommends striking the first sentence in Principle 5.⁶⁴ Handy Law is not clear on the intent of the language marked for deletion, but reads it to mean that “the utility shouldn’t be paid more than customers are paid to achieve the specified benefits...” Handy Law finds the second sentence “seems to say more and say it more clearly.”⁶⁵

- Staff response: Upon significant reflection, Staff believes the two sentences of Principle 5 have the same meaning, with the first sentence supplying an affirmative form, and the second a negative form. Keeping both may provide more clarity to some stakeholders, while providing confusion to others.

There are two ideas that must be conveyed in Principle 5. First, 1. if regulators approve an incentive for an outcome or benefit, they should not deny an incentive for that same outcome or benefit because it is produced by different actions.⁶⁶ Second, performance incentives should be designed to incent the utility to provide the greatest benefits for the least cost, and otherwise be indifferent to any other qualities of different actions. Staff finds either sentence in Principle 5 promotes both ideas, but that the first sentence better stresses the former, while the second sentence better stresses the latter.

- Staff Recommendation 36: Staff recommends the PUC affirm both sentences in Principle 5 mean the same. Staff does not have a recommendation on whether

⁶³ Unquantified benefits have unbounded risk.

⁶⁴ Handy Law Comments at 12. <http://www.ripuc.ri.gov/eventsactions/docket/4943-Handy-Comments 2.6.20.pdf>.

⁶⁵ *Id.* at 13.

⁶⁶ Staff reaffirms its understanding that the PUC would not approve a PIM that is not eligible to be included in regulated rates.

Principle 5 is clearer with or without the first sentence. The PUC should consider whether the Principle is clearer without the first sentence, and, if so, strike it.

VIII. Vote Solar Recommendations on Principles

Vote Solar recommends that “the PUC balance Principles 2-5” so that they “would not have any primacy over one another.”⁶⁷ Vote Solar further recommends that because “[P]rinciple 1 asks threshold questions, it should be treated differently than the other principles.”⁶⁸

- Staff response: Staff is not entirely sure what Vote Solar is recommending. For example, Vote Solar does not provide how Principle 1 should be treated differently. In consideration of Vote Solar’s intent, Staff believes that Vote Solar has raised an interesting and important point that may not have been specifically addressed in the proceeding.

It is possible Vote Solar expects that a PIM should be required to adhere to Principle 1, and then, on balance, adhere separately to the remaining Principles. Or, it may be that Vote Solar imagines an individual Commissioner might examine a proposal’s adherence to Principles 2 through 5, and find that, for example, the proposal’s inconsistencies with Principles 2 and 3 is more than made up for by its adherence to Principles 4 and 5. Staff notes that this type of balance can be appropriate when goals work against each other or have overlap. Staff does not believe the Principles work against each other but do believe it is possible for there to be some overlap.

Regardless, staff refers to the discussion in Part II of this memo. The Principles are not adopted as strict standards. Faced with a proposal for a PIM, Staff’s understanding is that the PUC does not intend to vote on whether each Principle has been met or whether the Principles on a whole have been met, since the Principles are not themselves standards. Rather, the Principles will be used to guide the analysis used to make a decision on the applicable standard. Also, Staff believe the Draft Guidance Document does not confer primacy on any Principle or group of Principles.

Considering all of this, staff believes the PUC should maintain individual Commissioner’s ability to balance their application of the Principles. Where one Commissioner finds an objectionable flaw in a PIM because it lacks adherence to a single Principle, another Commissioner may find the same PIM sustainable because it adheres on balance to all five Principles. Staff believes this flexibility should be provided *until the PUC gains more experience with the Principles and PIMs that warrants adjusting this flexibility*. Future amendment to the applicability of the PIMs in line with Vote Solar’s recommendation may be necessary.

- Staff Recommendation 37: Affirm that no Principle is specifically given primacy over others and that application of the Principles is at the discretion of individual Commissioners.

⁶⁷ Vote Solar Comments at 3. <http://www.ripuc.ri.gov/eventsactions/docket/4943-VoteSolar-Comments 2.28.20.pdf>

⁶⁸ *Id.*

Regarding Principle 1, Vote Solar “strongly supports the threshold questions” therein and offers that “proponents should have to demonstrate that (1) the monopoly IOU is the appropriate entity to take action, rather than entities operating in a competitive environment, and (2) a PIM is the appropriate regulatory option to effectuate the outcome.”⁶⁹

- Staff response: Vote Solar’s latter point is correct; Principle 1 screens whether a PIM is the appropriate regulatory option. Staff believes the former point is incorrect; Principle 1 does not screen whether the regulated utility is the appropriate entity. For the reasons stated in Part II of this memo, Staff assumes the PUC will address the utility’s role in certain outcomes and activities separately from the guidance considered in this proceeding.
 - Staff Recommendation 38: No changes to Principle 1 are warranted based on these comments.

Vote Solar also recommends that proponents should clearly identify the desired outcome of a PIM.⁷⁰

- Staff response: Staff agrees with Vote Solar, but believes that Principle 1 requires this purpose, and is further supported by adherence to Principles 2, 3, and 5.
 - Staff Recommendation 39: No changes to Principle 1 are warranted based on these comments.

Vote Solar finds Principle 2 is “reasonable and appropriate” but recommends the PUC may want to allow for exceptions in narrow circumstances.⁷¹

- Staff response: Staff agrees with Vote Solar that exceptions in narrow circumstances should be allowed and believes that this is the PUC’s explicit intent as provided in Section II.1.⁷²
 - Staff Recommendation 40: The Draft Guidance Document affirms that exceptions are allowed in narrow circumstances. No changes to Principle 2 are warranted.

Regarding Principle 4, Vote Solar proposes adding “to the maximum extent practicable” to Principle 4. Vote Solar explains that it “supports the objective of [P]rinciple 4” but “determination of the appropriate incentive level could be exceedingly difficult in circumstances of information asymmetry.”⁷³

- Staff response: Staff agrees with Vote Solar. However, for the reasons expressed in Part II of this memo, staff understands the PUC intends to express the ideal in the Principles while allowing flexibility through the Applicability provided in Section II. Staff believes, therefore, that no standard of precision is implied by setting ideals in the Principles.

⁶⁹ *Id.* at 4.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² Staff wants to be clear that it expresses no opinion on whether an exception for the specific example provided by Vote Solar is appropriate.

⁷³ Vote Solar Comments at 5. <http://www.ripuc.ri.gov/eventsactions/docket/4943-VoteSolar-Comments 2.28.20.pdf>

- Staff Recommendation 41: No changes to Principle 4 are warranted because no standard of precision is implied in the Draft Guidance Document, whereas flexibility is provided in Section II.

IX. OER Recommendations on Principles

OER begins by expressing that “the first question for consideration should be whether the utility is the appropriate entity to deliver the proposed benefits... Without this first filter, it would be hypothetically possible for a PIM to adhere to all the proposed Principles while also promoting the expansion of a monopoly business model into markets that are not, nor should be, natural monopolies.” OER recommends inclusion of the following new principle:⁷⁴

A performance incentive mechanism can be considered for any action that is an appropriate function or service for a utility to perform.

- Staff response: Supervision of what business activities can be included in regulated rates is beyond the scope of the Draft Guidance Document. Staff affirms that it does not believe the PUC would approve a PIM for a cost that the PUC finds should not be included in regulated rates.
 - Staff Recommendation 42: Reject OER’s suggested new principle on the basis that authority and guidance on approving monopoly expansion is beyond the scope of the Draft Guidance Document.

Regarding Principles 2 and 3, OER expresses concerns that the terms “quantifiable” and “cash” “exclude qualitative benefits from the Commission’s decision-making process.”⁷⁵

- Staff Response: Before going further into OER’s concerns with Principles 2 and 3, Staff initially notes that OER may be interpreting the Principles as a screen for utility business cases, when in fact the Principles are used to determine how to incentivize net positive outcomes (after the scope of the utility’s role has already been, or is separately, established). As discussed in Part II of this memo, the PUC’s review of business cases is beyond the scope of the proceeding.⁷⁶

OER continues that it does not believe “benefits that have been quantified or monetized should be explicitly favored over qualitative and/or non-quantified benefits. By explicitly preferring quantification, the Commission may inadvertently limit stakeholder participation to only those stakeholders with access to quantitative experts and/or financial resources to hire those experts.”⁷⁷

- Staff response: Staff does not believe it is controversial to explicitly favor, particularly, in principle, quantified and monetized benefits over qualitative and non-quantified benefits. Moreover, the OER’s position is at odds with the Division, which serves as the ratepayer

⁷⁴ OER Comments at 1. <http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments-3-2-20.pdf>.

⁷⁵ *Id.*

⁷⁶ Staff provides below a single staff recommendation responsive to all OER’s comments related to Principles 2 and 3.

⁷⁷ *Id.* at 2.

advocate.⁷⁸ Staff also notes that Section II.1.5 explicitly states that the Draft Guidance Document does not modify existing regulatory or evidentiary standards and guidance.

OER continues “if the process of accurately quantifying a benefit would cost more than the service/effort proposed, and the likelihood of success for the service/effort is high, it is unclear why the Commission would seek quantification.”⁷⁹

- Staff response: The cost to advance a position is always a consideration in the value of the outcome to a stakeholder. Regardless, Section II.1.5 explicitly states that the Draft Guidance Document does not modify existing regulatory or evidentiary standards and guidance.⁸⁰ Additionally, Staff questions OER’s premise that one could establish that “the likelihood of success... is high” without some underlying quantification. Within the context of OER’s total comments, Staff believes OER envisions PIMs as a vehicle to incent specific utility actions. This viewpoint is fundamentally at odds with the ideals embodied in the Principles.

OER also explains that “it would be logical to tie incentive levels to only verifiable and measurable things. In other words, although the Commission may support a PIM structure due to qualitative benefits, the payment or penalty to a utility should be tied explicitly to measurable, verifiable outcomes.”⁸¹

- Staff response: Staff believes it is inappropriate to provide incremental profits to the utility when incremental benefits cannot be proven—for example, if the net benefits are only qualitative, tying incentives levels to some measurable metric does nothing to ensure ratepayers are actually getting net benefits (since these net benefits remain unquantified).

OER then recommends that Principles 2 and 3 be applied to “the overall structure of a PIM” and “the level of incentive.”⁸²

- Staff response: Staff believes “incentive,” as used in Principles 2 and 3 is equal to or includes “the level of incentive” and “the overall structure of a PIM” that OER refers to. Staff therefore believes it agrees with OER. Staff does not, however, see benefit to adding “and performance incentive levels” to Principles 2 and 3.

Based on these comments, OER provides the following amendments to Principles 2 and 3.⁸³

Principle 2: Performance Incentives Mechanisms and performance incentive levels should be designed to enable a comparison of the cost of achieving the target to the

⁷⁸ Division Comments at 3. (“In the Division’s opinion, the Commission should be wary of approving any PIM where the quantifiable and verifiable, cash net benefits to ratepayers are relatively small, even though non-cash system and societal benefits are relatively large.) http://www.ripuc.ri.gov/eventsactions/docket/4943-DPUC-Comments_2-28-20.pdf.

⁷⁹ OER Comments at 2. http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments_3-2-20.pdf.

⁸⁰ Furthermore, when ratepayer money is used to provide profits to the utility, the PUC should be wary of lowering its standards rather than maintaining or raising its standards.

⁸¹ OER Comments at 2. http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments_3-2-20.pdf.

⁸² *Id.*

⁸³ *Id.*

potential ~~quantifiable and cash~~ benefits. Incentive disbursements should be tied to measurable, verifiable outcomes.

Principle 3: Performance Incentives Mechanisms and performance incentive levels 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.

- Staff response: Staff's final response on this section of comments is related to OER's recommendation to strike "quantifiable" from Principle 3 while maintaining "verifiable net benefits" at the end of the first sentence. Staff can envision a quantified net benefit that is not strictly verifiable (such as all the benefits described in the annual energy efficiency plans), but staff cannot envision a *net* benefit that is verifiable yet *is not quantifiable*. Herein lies the flaw in arguments to pay the utility for unquantified benefits: there is no certainty that ratepayers are enjoying a share of net benefits because no net value can be reliably provided.
 - Staff Recommendation 43: For the reasons above, the PUC should reject OER's proposed revisions to Principles 2 and 3.

OER finds Principle 5 is unclear for three reasons. First, OER believes that it is likely that "benefits will be created in suites and one suite may be considered more valuable than another suite of benefits."⁸⁴

- Staff response: Staff is unclear on what the problem is. If it is possible to determine that one suite of benefits is considered more valuable than another, as OER posits, then the suites would not be the same. Regardless, Principle 5 is designed to cause analysis and reflection on whether a utility stands to earn different incentives for the same outcome. With no further recommendation from OER, Staff believes Principle 5 is appropriately worded.⁸⁵

Second, OER explains that "the phrase 'the same benefit' is very difficult to define. Does this phrase refer to who gets the benefit, the type of benefit, how the benefit is delivered, when the benefit is delivered, or where the benefit is delivered?"⁸⁶

⁸⁴ *Id.*

⁸⁵ Ultimately, if all costs and benefits could be expressed in dollars, then Principle 5 might be taken to mean that if the PUC were willing to give a utility five cents on one dollar of net benefit, it should offer an opportunity to earn five cents on *any* dollar of net benefit. This approach, of course, may not produce appropriate and sustainable diversity in innovation and would fail to align the utility with the public interest, which is diverse (for example, the Docket No. 4600A Goals and Benefit Cost Framework illustrate diverse public interest affected by the electric distribution system). Either unintended consequence could represent poor regulation of a utility.

⁸⁶ OER Comments at 2. <http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments-3-2-20.pdf>.

- Staff response: Staff believes that any of the characteristics described by OER may, or may not, render benefits different. No single answer can be given because the answer must be determined on a case-by-case basis.⁸⁷

Finally, OER explains that “Principle 5, as written, may limit the Commission’s ability to prefer one action over another. There may be a scenario in which one action is more desirable than another, even if both actions result in the same benefit. OER encourages the Commission to retain flexibility in determining if certain means of achieving a benefit are preferred.”⁸⁸

- Staff response: The Principle is intentionally written to move toward outcome-based incentives, and to specifically deter preference of one action over another when they produce the same results. Within the context of economic regulation and supervision of a monopoly, for-profit utility, staff does not understand the premise of OER’s scenario that posits “one action is more desirable than another, even if both actions result in the same benefit.” A key tenet to utility regulation is that the PUC supervise the utility and not interfere with its day to day management. By focusing on outcomes rather than specific actions, the PUC will provide the environment in which the utility can meet those outcomes at least cost, thus maximizing benefit to customers and its shareholders.

Finally, Staff notes that OER provides no specific edit to Principle 5, and OER is the only entity challenging the propriety of Principle 5.

- Staff Recommendation 44: No changes are warranted based on OER’s comments, but the PUC should consider a way for stakeholders to gain experience with application of Principle 5.

X. Revised Draft Guidance Document

Based on the all the materials provided in this proceeding, including the discussion above and all stakeholder comments, Staff provides a Draft Guidance Document with recommendations for revisions inserted and noted.

- Staff Recommendation 44: The PUC should consider all staff recommendations and vote to adopt and issue a final Guidance Document.

⁸⁷ Of the example list of characteristics OER provides, it seems that the type of benefit and when it is delivered will more likely affect whether two benefits are the same than the others (i.e., who gets the benefit, how it is delivered, and where it is delivered).

⁸⁸ OER Comments at 2. <http://www.ripuc.ri.gov/eventsactions/docket/4943-OER-Comments-3-2-20.pdf>.

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

IN RE: GUIDANCE DOCUMENT REGARDING :
PRINCIPLES TO GUIDE THE DEVELOPMENT : DOCKET NO. 4943
AND REVIEW OF PERFORMANCE :
INCENTIVE MECHANISMS :

DRAFT GUIDANCE DOCUMENT FOR PUBLIC COMMENT

**Public Utilities Commission's Guidance on Principles for the Development and Review of
Performance Incentive Mechanisms**

I. Purpose of a Guidance Document

A guidance document is a record of general applicability developed by an agency that lacks the force of law but states the agency's current approach to, or interpretation of, law or describes how and when the agency will exercise discretionary functions. It has also been defined as an agency statement of general applicability and future effect that sets forth a policy on a statutory, regulatory, or technical issue.¹ This guidance document provides direction on how the PUC will apply its general and specific authority to set rates, tariffs, tolls, and charges in Title 39 to proposals for performance incentives for public utilities under the PUC's jurisdiction.²

Commented [BT(1): Staff Recommendation 1

II. Applicability

1. To guide its review of performance incentive mechanisms, the PUC adopts the Principles in Section IV of this document.
 1. The Principles will apply to all proposals of performance incentive mechanisms.
 2. Regulators will apply all Principles to the body of evidence in the record.
 3. Proponents or opponents of a performance incentive mechanism proposal bear the burden of proof that the proposal is consistent or inconsistent with the Principles.
 4. Perfect consistency with the Principles is not required for approval of a performance incentive mechanism.
 5. This Guidance Document does not modify existing regulatory or evidentiary standards and guidance **and applicable judicial precedent.**³ This is additional

¹ R.I. Gen. Laws § 42-35-2.12 establishes an agency's issuance and limited use of a guidance document, and further affords rights to individuals who may be detrimentally impacted by an agency's reliance on a guidance document. An agency that proposes to rely on a guidance document to the detriment of a person in any administrative proceeding shall afford the person an adequate opportunity to contest the legality or wisdom of a position taken in the document. The agency may not use a guidance document to foreclose consideration of issues raised in the document.

² Including, but not limited to R.I. Gen. Laws § 39-1-1; § 39-1-3; §39-1-38; § 39-1-27.7.1 (e)(1); § 39-1-27.7.1 (e)(3); § 39-26.6-12 (j)(3); § 39-26.1-4; § 39-26.3-4.1(e); § 39-3-7; §39-3-12

³ For example, this Guidance Document does not modify the application of the Rhode Island Benefit-Cost Framework, goals for the future electric system, and rate design principles adopted as guidance for National Grid's electric business in Docket No. 4600A. See Public Utilities Commission's Guidance on Goals, Principles and Values for Matters

guidance on the PUC’s application of its ratemaking authority to performance incentive mechanisms.

6. This Guidance Document is not intended to expand or detract from the current rights and obligations of the parties before the PUC, but to provide clarity to parties presenting a case before the PUC.
2. The PUC recognizes that some utility incentives have varying degrees of consistency with these principles.
 1. This includes ~~an allowed~~ a total return on equity that is based solely on the size of ~~rate-based in rate base~~ investments, ~~statutory~~ remuneration, and minimum service quality standards.
 2. The PUC recognizes these incentives ~~structures~~ are the current norms and default in utility regulation ~~and are reasonably allowed~~.
 3. The Principles reveal weaknesses and strengths of the current norms and default.
 4. The Principles will be applied to the current norms and default to the extent possible with specific consideration of applicable statutes, gradualism, and fair notice.
 5. The PUC expects to use these Principles to evaluate proposals that reasonably modify the current norms and default to reduce or eliminate the impact ~~the inconsistencies embedded in the current norms and defaults of these incentives~~ have.
 6. The PUC will apply the Principles to proposals for ~~other new~~⁴ performance incentive mechanisms with consideration of any existing incentives, including return on equity in rate base, ~~statutory~~ remuneration, and minimum service quality standards, to the extent possible.
 7. The PUC will take into consideration any existing performance incentive mechanisms in proposals to set return on equity in rate base investments or minimum service quality standards, to the extent possible.⁵
3. The effect of this document is immediate upon adoption by the PUC and will be applied in any case ~~filed on or after the effective date of this document~~ that proposes performance incentive mechanisms for an investor-owned utility.

Commented [BT(2)]: Staff Recommendation 8 (renumbering)

Commented [BT(3)]: Staff Recommendation 5

Commented [BT(4)]: Staff Recommendation 11

Commented [BT(5)]: Staff Recommendation 12

Commented [BT(6)]: Staff Recommendation 19

Commented [BT(7)]: Staff Recommendation 21

III. Definitions

1. Costs and benefits: A category of value that can be reasonably and reliably shown to exist and is reasonably related to state policy.⁶

Involving The Narragansett Electric Company d/b/a National Grid issued in Docket No. 4600A. <http://www.ripuc.org/eventsactions/docket/4600A-GuidanceDocument-Final-Clean.pdf>.

⁴ “New” proposals are those that require approval or reapproval by PUC order, such as those associated with annual programs and plans.

⁵ The PUC does not set statutory remuneration.

⁶ The list of costs and benefits considered in evaluating National Grid’s electric business is the Rhode Island Benefit Cost Framework in Docket No. 4600A. See Public Utilities Commission’s Guidance on Goals, Principles and Values

2. Risk: Exposure to the possibility of gain or loss.
3. Verifiable: Able to be checked and proved.
4. Cash benefits: Benefits, avoided costs, or costs that are credited in dollars.
5. Statutory remuneration: Payment to the utility specifically defined in applicable statute.
6. Minimum service quality standards: A standard which the quantity, quality, or character of products or services furnished by a public utility and conditions of furnishing products or services must meet or exceed.
7. Principle: A guide for evaluation.
8. Customer share: For a given utility, the share of costs and benefits related to the utility's service that are allocated to the customers of the utility.

IV. Principles

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.
2. Incentives should be designed to enable a comparison of the cost of achieving the target to the potential quantifiable and cash benefits.
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.
4. An incentive should offer the utility no more than necessary to align utility performance with the public interest.
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.

Commented [BT(8)]: Staff Recommendation 36 (consider striking the first sentence)