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Jeffrey R. Gaudiosi, Esq.
Executive Secretary
Public Utilities Regulatory Authority
10 Franklin Square
New Britain, CT 06051

Re: Docket No. 21-05-15RE01, PURA Investigation Into Revenue Adjustment Mechanisms For A Performance-Based Regulation Framework

Dear Mr. Gaudiosi:

Acadia Center appreciates the opportunity to submit written comments in response to Public Utilities Regulatory Authority (PURA) Docket 21-05-15RE01, "Investigation Into Revenue Adjustment Mechanisms for a Performance-Based Regulation Framework," specifically regarding Earnings Sharing Mechanisms (ESM), the Revenue Decoupling Mechanism (RDM), and Capex/Opex Equalization.

Earnings Sharing Mechanism

Earnings Sharing Mechanisms are an important tool that can support a Performance-Based Regulation (PBR) framework. At a basic level, an ESM can incentivize electric distribution companies (EDCs) to pursue cost-saving measures by allowing the utility to keep a portion of savings as profit. At the same time, an ESM can protect ratepayers by capping the portion of savings that are kept by the utility. By capping the earnings that an EDC can retain as profit, an ESM helps to reduce the risk that an EDC will overestimate future costs and therefore result in ratepayers overpaying.

Although ratepayers share in any cost savings, because the EDCs retain 50% of over-earnings, they may continue to face an incentive to pursue capital expenditures that offer the highest returns, rather than investments that may be most beneficial for ratepayers but not the most lucrative for shareholders. While a 100% share of savings with ratepayers would eliminate the cost-containment incentives that an ESM provides, Acadia Center urges the Authority to consider whether the current 50%-50% split is appropriate in all circumstances, or whether there may be certain conditions in which a different split is more beneficial for ratepayers. Acadia Center also recommends consideration of a tiered savings mechanism depending on the amount of savings achieved.

Revenue Decoupling Mechanism

Revenue Decoupling remains a vital regulatory mechanism for providing revenue stability and reducing financial risk for the EDCs. There may be concerns about the continued role for revenue decoupling as the electrification of end uses accelerates. Revenue decoupling removes disincentives against energy efficiency, which is an essential building decarbonization tool. However, by making EDCs neutral towards increased load, revenue decoupling may work against what is needed to motivate EDCs to pursue transportation and building electrification. Nevertheless, as Connecticut electrifies its building and transportation sectors, revenue decoupling will remain essential in order to make sure that the state only increases load as much as is necessary after energy efficiency measures have been implemented.

Revenue decoupling can enable *efficient* electrification. Electrification must be pursued in combination with energy efficiency in order to maximize savings. If deployed together, energy efficiency and electrification can deliver greater emissions reductions while improving indoor air quality. Not only does weatherization conserve energy in its own right, but it also makes building electrification easier and less expensive.

Moreover, as electrification accelerates and more fixed costs are potentially recovered through variable rates, revenue decoupling will be an increasingly important tool for reducing the risk of over-recovering fixed costs.

Capex/Opex Equalization

One of the central motivating factors for Performance-Based Regulation is to overcome the misaligned incentives that stem from Cost-of-Service Regulation (COSR). COSR creates an incentive for EDCs to potentially choose capital expenditures (Capex) over operating expenses (Opex) because Capex provides the opportunity to earn an approved rate of return, unlike Opex which is passed through the customers without an added return. This creates an implicit Capex bias, potentially leading EDCs to choose more expensive Capex investments over projects that may help to reduce emissions or be more beneficial for customers but do not provide a similar financial incentive because they are defined as operating expenses. PURA's Non-Wires Solutions program is an important step in helping third-party solutions that may historically fall into Opex compete on a level playing field, but by pursuing Capex/Opex equalization, PURA can further reduce the barriers of Capex bias under COSR.

There are several forms of Capex/Opex equalization. One version involves treating one or several operating expenses as Capex and therefore allowing EDCs the opportunity to earn a return on those specific investments (also referred to as "regulatory asset treatment"). Alternatively, PURA could consider full "Totex" ratemaking, in which all capital and operating expenses are considered Totex and then categorized with different capitalization rates.

Acadia Center believes all forms of Capex/Opex equalization are worth consideration. In considering allowing regulatory asset treatment of operating expenses, Acadia Center urges the Authority to carefully consider potential unintended consequences in terms of unfairly restricting the ability of third-party solution providers to compete alongside the EDCs.

Under Totex, if a greater number of possible expenditures offer an allowed rate of return, there is a potential risk of ratepayers ultimately overpaying for services, despite the original intentions of Totex implementation. Any form of Capex/Opex equalization must be paired with robust cost-containment measures.

While Totex itself does not necessitate a particular outcome in terms of setting the appropriate allowed rate of return, under a PBR framework, an EDC may have a higher number of discrete opportunities to earn a return—depending on performance—compared to traditional COSR, given a combination of Capex/Opex equalization measures, performance incentive mechanisms, shared savings mechanisms, among other regulatory tools. As such, it may no longer be appropriate to set the base allowed rate of return as high as the Authority has historically approved.

Determining a return on equity should be based on a utility's performance in providing a public service. Utilities that perform well in a public interest sense should receive authorized returns on equity higher than the estimated cost of equity, while those that underperform should receive returns on equity closer to the cost of equity.

While each EDC faces unique business risks, firm-specific risks are diversified away in investment portfolios and should not be considered when setting the return on equity. While firm-specific risks may affect a company's stock price, they do not affect its cost of capital. Expected returns on a stock are a product of the systemic, macroeconomic risks a company faces, not the expected return on equity.

Conclusion

Regardless of the Revenue Adjustment Mechanisms that are implemented as part of PBR, Acadia Center recommends that PURA conduct a utility management audit, similar to that done by the Hawaii PUC for the Hawaiian Electric Company. Hawaii's management audit identified changes that could lead to $25 million in savings.[1] Thank you for the opportunity to submit written comments.

Sincerely,

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[1] Munro Tulloch, "Management Audit of the Hawaiian Electric Company (HECO), Final Report," May 12, 2020. https://dms.puc.hawaii.gov/dms/DocumentViewer?pid=A1001001A20E14A90058F00755