

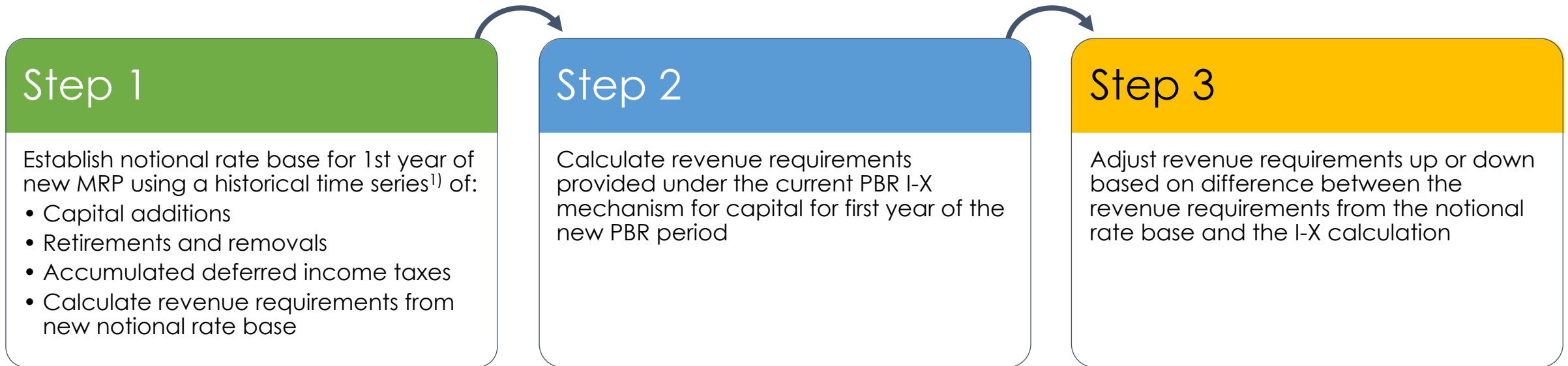
Regulatory PBR Renewal

Re-Basing Recommendations

August 30, 2024

PBR Re-basing Mechanism (PRM)

Ulupono Initiative recommends a modified K-bar approach (K-bar used in Alberta and Massachusetts PBR re-basing) to re-base target revenues at the start of the MRP2



PBR Re-Basing Mechanism benefits

- Eliminates need for extensive and imprecise capital spending forecasting
- Eases the regulatory and administrative burden
- Retains incentives in PBR for cost control due to regulatory lag
- Limits the incentive to push capex into test case years

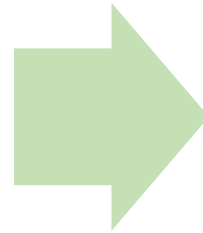


1) Prior MRP (5 years)

PBR Re-Basing Mechanism Breakdown

Capital

- Policy-based capital is recoverable through EPRM
- Exogenous factor (including disasters) is recoverable through Z factor
- BAU capital including baseline capital additions (and retirements) has guaranteed catch-up at new MRP

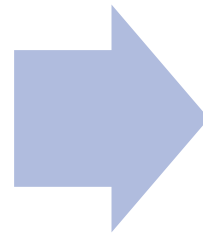


Result

- Policy-based capital and exogenous events receive timely recovery with a built-in regulatory lag for BAU
- Policy-based investments are advantaged over BAU
- Effectively provides an incentive to retire fossil fuel plants early in MRP

O&M

- Generally increases by Annual Revenue Adjustment (ARA)
- Retiring old plants and replacing them with new ones should lower O&M needs
- Retiring old plants and replacing with IPP projects significantly lowers O&M need



Result

- O&M treatment should be net positive for the utility

Administrative Efficiency & Accuracy








- Past capital additions and retirements are **known**
- Future test year capital needs are **speculative**
- Past BAU capital costs—**cost control** through regulatory lag
- Future cost estimates have **misaligned interests**
- With unbiased, careful forecast, future test year capital estimates are admittedly more likely to approximate actual, future needs

PBR Re-Basing Mechanism, fashioned after the K-Bar process, is another element to ensure the utility a 'just and reasonable return'

Comparison of PBR to COS regulation





PBR with PBR Re-Basing Mechanism

5-year stay-out period

-  Annual increases directly tied to inflation
-  Symmetrical ESM—upside available to utility
-  Targeted PIMs supporting policy
-  Administrative efficiency / Significantly lower regulatory burden
-  PBR rebasing mechanism—catch-up on non-policy capex
-  Policy-capex advantaged over BAU capex
-  O&M treatment should be net positive to utility

Pre-PBR mechanisms under traditional COS

3-year stay-out period

-  Annual increases limited to RAM cap
-  Asymmetrical ESM—no upside for utility
-  Limited performance incentive mechanisms
-  Some policy-capex advantaged through MPIR

The PBR Rebasing Mechanism ensures utility has the opportunity to earn a just and reasonable return on excess non-policy capex expended during the last MRP through a 'catch-up' during the rebasing period

Questions

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Developed in collaboration with

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Backup Slides

Regulatory PBR Renewal Presentation
(June 26, 2024)



Regulatory PBR Renewal

Rebasing Recommendations



June 26, 2024

Ulupono Initiative recommends adopting a simplified K-Bar like process for rebasing – renamed the PBR Rebasing Mechanism

Executive Summary

- 1** **Goal:** Ulupono and other intervenors aim to continue the PBR mechanism without going through an extensive rate case to rebase rates. The goal would be to have a mechanism that is **administratively simple** and **decreases capital bias**, however State and Federal laws require a **"just and reasonable"** standard that must ultimately allow for sufficient revenue to recover prudent costs.
- 2** We examined all the PBR renewals in North America, all of which had proceedings to examine PBR effectiveness and suggest improvements
 - All had rebasing options. Half rebased with full cost of service studies while the other half had simplified measures
 - Capital treatment was the most difficult issue with various mechanisms and efforts to address additional capex needs
- 3**
 - Alberta and Massachusetts use a K-bar methodology to forecast incremental capex during the next stay-out period using historical data
 - An adjusted version of this methodology could be applied to the rebasing process to adjust the historical rate base and revenue requirements for past incremental capital without a full cost of service proceeding
- 4** The **PBR rebasing mechanism** will ensure the utility has the opportunity to earn a just and reasonable return on excess capital expended during the prior MRP through an adjustment before the next MRP but maintains the pressure on the utility to manage incremental capital expenditures not mandated by policy. This mechanism supports the PBR framework which includes achieving renewable energy policy objectives.

We examined the precedents for PBR plan renewals in North America

Summary of PBR renewals

There are five PBR renewal precedents in North America:

- Alberta Gen I to Alberta Gen II
- Alberta Gen II to Alberta Gen III
- Massachusetts Gen I to Massachusetts Gen II
- British Columbia Gen I to British Columbia Gen II
- Ontario – multiple generations

All had proceedings evaluating the past plans and recommended PBR changes going forward.

Rebasing did occur

- ~ Half had "simplified" measures looking at historical data for updates
- ~ Half had full litigated cost of service for new "cast off rates"

Capital treatment was the most difficult issue for plan renewals, both in rebasing and adjusting for incremental capex in the subsequent stay-out period.

The K-Bar mechanism is used to estimate needs for incremental funding during the subsequent stay-out period – a go-forward mechanism using historical data

K-Bar mechanisms in PBR

Alberta

2nd Generation Renewal in 2017 contained new K-Bar approach to account for incremental capital not recovered under policy-enabled capital trackers

The 2018-2022 PBR term introduced the K-bar mechanism, providing utilities with additional capital funding using the average of 2013-2016

Recoverable capital expenditures are obtained from the differential between the utility's escalated historical capital needs and what each utility would collect under the I-X formula - the differential is called the "K-Bar"

The K-Bar was used to adjust revenue requirements annually throughout the 2018-2022 period

The K-Bar adjustment could be positive or negative, but typically K-Bar is an adder, as capital requirements have outpaced typical I-X recovery

Massachusetts

New K-bar methodology included for capital treatment in 2017 renewal

The K-bar revenue requirement calculated plant additions, cost of removal, and retirements that occurred during the prior PBR plan (2013-2017) and rolled those forward into the subsequent stay-out period.

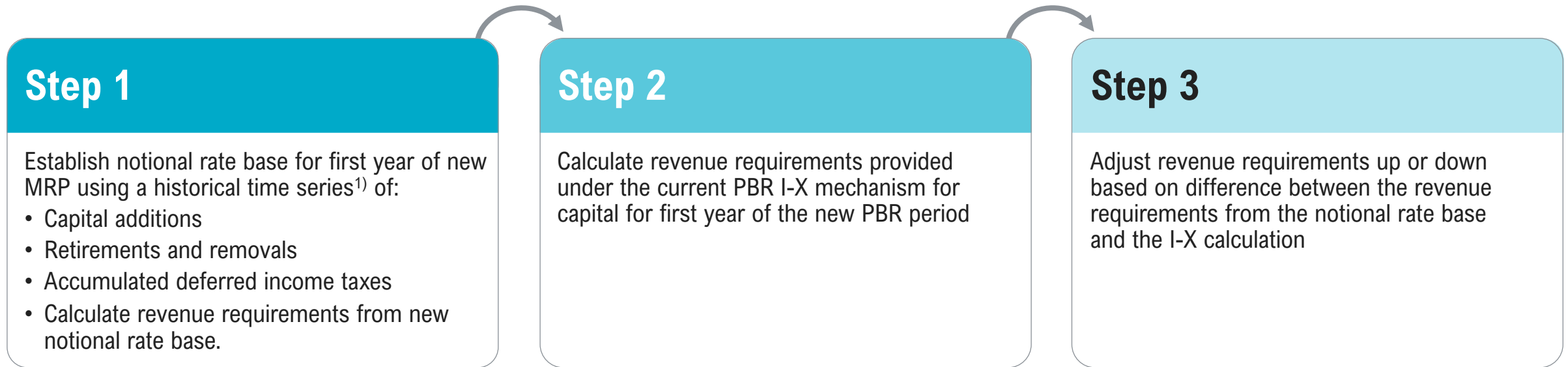
A revenue requirement is calculated for each year of the stay-out period (2018-2022) based on that theoretical rate base calculation.

The K-bar revenue requirement was then compared to the capital investment costs approved in the proceeding and adjusted to 2023 costs to establish the incremental K-bar revenue support

The K-Bar is used in Alberta and Massachusetts to adjust on a go-forward basis additional revenue requirements for capital beyond the I-X formula.

We envision using this methodology to adjust the rate base before the start of the next MRP

PBR Rebasing Mechanism Methodology



PBR Rebasing Mechanism benefits

- Eliminates need for extensive and imprecise capital spending forecasting
- Retains incentives in PBR for cost control due to regulatory lag
- Eases the regulatory and administrative burden
- Limits the incentive to push capex into test case years



1) Prior MRP (5 years)

The PBR Rebasing Mechanism is similar to the K-Bar, but it is used to rebase before the next MRP

Key differences between K-Bar and PBR Rebasing Mechanism



Precedent K-Bar

- Calculated during a PBR renewal to estimate annual incremental capital funding requirements during a subsequent stay- out period
- **Forward looking – adjusts revenues annually through the stay-out period**



PBR Rebasing Mechanism

- Calculated during rebasing to adjust revenue requirements for year 1 of the MRP, if capital expenditures during the prior MRP were in excess of the I-X formula
- **A one-time adjustment of revenues during the renewal period**

- Policy-related capex continues to be full COSR recovery through EPRM, MPIR and other mechanisms
- Non-capital costs (O&M, etc.) continue to be increased by the ARA, including in the rebasing year








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PBR mechanisms

5-year stay-out period

-  Annual increases directly tied to inflation
-  Symmetrical ESM – upside available to utility
-  Targeted PIMs supporting policy
-  Administrative efficiency
-  PBR rebasing mechanism – catch-up on non-policy capex

Pre-PBR mechanisms under traditional COS

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The PBR Rebasing Mechanism ensures utility has the opportunity to earn a just and reasonable return on excess non-policy capex expended during the last MRP through a 'catch up' during the rebasing period

The PBR Rebasing Mechanism offsets the utility's financial risks while addressing capital bias and administrative efficiency needs



Policy-driven capex is recovered and/or rewarded in a timely basis via PIMs and EPRM treatment



Business-as-usual capex will have an effective regulatory lag to address capital bias...



...paired with a guaranteed "catch up" at the start of every 5-year MRP...



...in exchange for dramatically better administrative efficiency

Roland
Berger



Using the PBR Rebasing Mechanism as part of a comprehensive review avoids a COSR rate case – efficiencies more important now given the recent Maui fires

PBR Comprehensive Review

Past perspectives on comprehensive review

"Although anticipating some modifications to the PBR Framework may be appropriate, the Commission does not envision returning to COSR after the initial MRP"¹⁾

Commission Staff

"PBR Review, rather than a formal rate case, should be undertaken at the conclusion of the initial or any subsequent five-year MRP period"²⁾

Ulupono Initiative

"Utilities file proposed revisions to MRP/PIM terms in fourth year based on adjusted actual earnings in preceding calendar year(s); no return to COSR."³⁾

Consumer Advocate

Increased importance of streamlined process

- Rate cases are extremely burdensome for utilities and stakeholders. External expenses for legal fees and consultants for a rate case for one operating company was over USD 2 million in 2014.³⁾ This excludes internal costs and costs for the Commission and other stakeholders involved in the process
- HECO is also currently facing other challenges in the aftermath of the wildfires in Maui, noting recently that their "...ability to support [the comprehensive review] with internal and external resources will be somewhat constrained because of budget considerations...and potential competition for limited resources to support other Event related efforts, such as, for example, rebuild and restoration, pending litigation and wildfire mitigation efforts."⁴⁾

HECO

1) D&O 37507 at 34, 2) Ulupono Initiative LLC's Phase 2 Reply Statement of Position filed Aug. 20, 2020 at 7-8, 3) Division of Consumer Advocacy's Phase 2 Initial Statement of Position filed June 18, 2020, 3) Estimated 2014 Regulatory Expenses, HECO 1328, DOCKET NO. 2013-0373, 4) Letter From: D. Matsuura To: Commission Re: Docket No. 2018-0088 - Performance-Based Regulation ("PBR") Investigation; Hawaiian Electric Companies Status Update

Hawaiian Electric has laid out what it considers key elements of a comprehensive review before the next MRP

HECO's elements of a comprehensive review

Rebase base rates

- Prior year revenue adjustments (e.g., RAM, ARA) go to zero
- Adjust rate design of base rates

Reset mechanisms

- EPRM/MPIR (unless otherwise approved)
- REIP (unless otherwise approved)
- Pension Tracker
- DSM/DRAC surcharges
- Cost deferrals

Other Considerations

- Adjust ARA parameters (e.g., X-factor, customer dividends)
- Update cost of capital/ROE
- New depreciation rates
- PIMs

We have focused on the rebasing elements – these additional broader elements would need to be further discussed to determine how they would interplay with our proposal, if at all