



## OUTCOMES-BASED REGULATION (OBR)

Aligning utility incentives with policy goals and consumer benefits

### THE PROBLEM

Over the past four years, Virginia energy policy has undergone a dramatic transformation. The Grid Transformation and Security Act (GTSA) prioritized the modernization of Virginia's electric infrastructure. The Virginia Clean Economy Act (VCEA) established binding standards to decarbonize the grid, expand energy efficiency, and deploy energy storage, as well as unlock rooftop solar and other forms of distributed generation. Then in 2021, Virginia policymakers took aim at the transportation sector, seeking to slash emissions through electrification – a transition with significant ramifications for the grid.

Despite the 21<sup>st</sup> century transformation of Virginia energy policy, the regulatory model that guides our utilities remains rooted in the 20<sup>th</sup> century. Under this traditional "cost-of-service" regulatory system, Virginia's utilities are still incentivized to maximize capital investments (inputs) and drive up electricity usage. This model can leave them out-of-step with Virginia's energy policy goals and may fail to incentivize the deployment of innovative, less costly solutions, such as energy efficiency, distributed generation, battery storage, and intelligent energy management.

### THE SOLUTION

**Outcomes-based regulation (OBR)** (also called performance-based regulation, or PBR) is a regulatory framework that aligns the financial interests and actions of regulated utilities with public policy objectives and customer interests. OBR rewards utilities for achieving specific outcomes while ensuring grid reliability and enabling deployment of new, innovative technologies. Simply put, OBR transitions the utility from a focus on "inputs" to a focus on "outcomes".

**OBR facilitates opportunities for customer and third-party value creation and innovation.** For example, if a substation is reaching its capacity, the utility should look for the most cost-effective way to address this need. Under traditional regulation, the utility is incentivized to invest in additional transformers and other equipment to increase the capacity of the substation. OBR, however, can help guide the utility towards customer-sited solutions, such as reducing energy use through greater energy efficiency, shaving peak demand with various demand management technologies and services, or serving load behind-the-meter with distributed generation or energy storage. OBR would not specify which solution to use, but instead would put all of these options on a level playing field by aligning utility earnings with intended *outcomes* (e.g., greater energy savings). A comprehensive OBR framework also balances short-term needs with future grid evolution and public policy goals.

## EFFECTIVE IMPLEMENTATION

Transitioning from a traditional “cost-of-service” model to OBR should occur in a deliberate manner, tailored to the unique goals and regulatory structure of each state. In Virginia, this process could start with the Attorney General and lawmakers in the General Assembly, who would *define the broad outcomes on which OBR is grounded. Examples of these outcomes could include energy efficiency, decarbonization, operational reliability, reducing energy burden, and market innovation.* Policymakers would then empower the State Corporation Commission (SCC) to convene a stakeholder process that further focused these outcomes, the metrics to measure success, appropriate incentives tied to performance, and other regulatory changes needed to facilitate the implementation of OBR. Each jurisdiction should develop metrics relevant to its goals and that are consistent with the clean energy transition of the electricity system. **A strong OBR framework usually includes a multi-year rate plan developed with broad stakeholder input via a transparent planning process.**

### Where is OBR working?

Several states such as Illinois, Massachusetts, and Nevada have established strong foundations to enable OBR implementation. Following enabling legislation and a robust stakeholder process, in December 2020, the Hawaii Public Utilities Commission issued a decision to establish a comprehensive OBR framework that include a multi-year rate period and creates new performance incentive mechanisms. The framework aligns electric utility incentives with the state’s goal for a 100% renewable grid by 2045 and improved customer offerings. The Commission adopted performance metrics in three main areas that include both traditional issues, such as affordability and reliability, and emerging issues, such as greenhouse gas reduction and customer engagement. The metrics fall into three broad areas: enhance customer experience, improve utility performance, and advance societal outcomes. There are also safeguards to mitigate risk including an earnings sharing mechanism, and a “re-opener” mechanism that provides for the examination of all or parts of the framework during the multi-year plan period.

Where to learn more: AEE’s OBR Issue Brief found [here](#), or at <https://info.aee.net/hubfs/PDF/PBR.pdf>