Submitted By: Rod Williamson
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Commissioner Peretick and Joy Wang,

Thank you for serving in a leadership role for this important workgroup! ABATE certainly supports the expansion and utilization of clean, distributed energy resources in Michigan. The first workgroup meeting provided some good information and I want to follow-up with you on some of that discussion. As noted in the problem statement for this workgroup, "there is the need to adapt the regulatory framework to allow for different applications of DER and to define the appropriate roles of utilities and other entities in supporting a more decentralized energy system that is clean, affordable, reliable, and accessible."

In addressing the regulatory framework Cory Felder, Senior Associate of Rocky Mountain Institute presented that the incorporation of performance-based ratemaking (PBR) tools (e.g., performance incentive metrics, earnings sharing mechanisms, multi-year rate plans and revenue decoupling) into the determination of utility rates can facilitate the deployment of DERs and counteract some of the utility disincentives with respect to DERs. While we think a discussion of PBR is important, before it can be determined what utility reform options need to be changed / improved we think it is fundamentally important to understand the current state of the regulatory framework in Michigan including what reform options and what components of PBR have already been put in place.

First, it's important to understand that PBR is one element of utility reform options focused on adjustments to the cost of service model. This report, also from Rocky Mountain Institute, discusses the broader set of reform options:

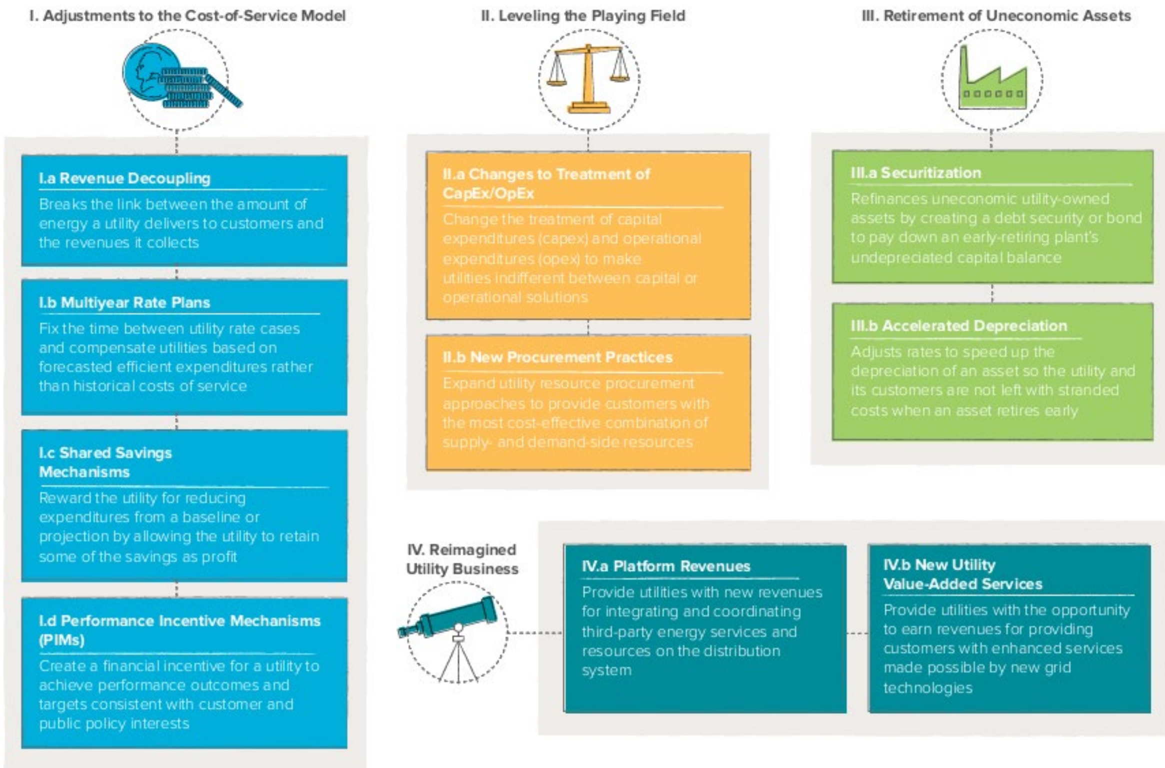
NAVIGATING UTILITY BUSINESS MODEL REFORM: A PRACTICAL GUIDE TO REGULATORY DESIGN
Rocky Mountain Institute
https://rmi.org/insight/navigating-utility-business-model-reform/


Although these reform options defy easy groupings, we provide a suggested categorization that organizes options according to similar approaches or objectives:

- Adjustments to the cost-of-service model include policy tools that shift regulation away from a backward-looking focus on costs and sales to a forward-looking approach that rewards utility performance.
- Options categorized as leveling the playing field emphasize technology and resource neutrality in utility planning and procurement.
- Mechanisms included under retirement of uneconomic assets support the utility financial transition away from aging, no longer competitive assets to cleaner, less expensive resources.
- Reforms for a reimagined utility business include opportunities to holistically rethink the utility role and business in the larger electricity system.

## REFORM OPTIONS

**A GROWING STABLE OF REFORM OPTIONS IS AVAILABLE TO REALIGN UTILITY BUSINESS PRACTICES**




This Regulatory Assistance Project report also provides a good foundational understanding of PBR and modifications to the COS model:

Next-Generation Performance-Based Regulation: Volume 1 (Introduction—Global Lessons for Success)
https://www.raponline.org/knowledge-center/next-generation-performance-based-regulation-volume-1-introduction-global-lessons-for-success/
All regulation is incentive regulation. Regulated entities respond to the incentives they are provided. Traditional cost of service (COS) regulation looked at performance in terms of sales, revenue, and rate (price) and often service reliability, safety, and quality. Regulated entities responded to the incentives inherent in traditional COS regulation and provided service according to the performance requirements implicit in traditional utility regulation. Changes in the electric energy system and in customer preferences mean there is an increasing interest in motivating regulated entities in areas beyond traditional COS performance. Modifications to the COS model, called PBRs, are not new. Multi-year rate plans, a first effort at PBRs, were first used in the 1980s for railroads, telecommunications, and other industries facing competition and changing demand, and they were introduced for U.S. electric utilities in the 1990s. A PBR represents a significant modification to historical COS utility regulation paradigms, wherein

performance incentives can operate as an incremental add-on to traditional regulation or state-owned models to influence management to align utility planning, investments, and operations with societal goals. This report defines PBRs and performance incentive mechanisms (PIMs) as:

- *PBRs provide a regulatory framework to connect goals, targets, and measures to utility performance or executive compensation.* For some enterprises, PBRs determine utility revenue or shareholder earnings based on specific performance metrics and other non-investment factors. Non-investment factors can be particularly important for state-owned entities, such as by providing low-cost service and being responsive to government mandates. For utilities of all types, PBRs can strengthen the incentives of utilities to perform in desired ways.

- *PIMs are components of PBRs that adopt specific performance metrics, targets, or incentives to affect desired utility performance and represent the priorities of the jurisdiction.* PIMs can be specific performance metrics, targets, or incentives that lead to an increment or decrement of revenues or earnings around an authorized rate of return to strengthen performance in target areas. PIMs can act as an overlay on a traditional COS regulatory framework for privately owned utilities in which a return on rate base is computed in a rate case. For state-owned entities and investor-owned utilities, a PIM can take on the form of manager performance reviews (on specific criteria) that are linked to manager income or promotion.

ABATE is concerned that over the last several years Michigan has moved forward with different elements of reform options in an uncoordinated manner such that we currently do not have a good balance between utility and customer benefit from most of the existing reform mechanisms that have been implemented. For instance when reviewing the list below of alternative ratemaking mechanisms that make incremental revisions to traditional cost-of-service ratemaking, Michigan has implemented all of the mechanisms except the earnings sharing mechanisms. We recommend that a starting point for this work group activity needs to be a report (from staff or a consultant) documenting all of the current/existing reform options that are being utilized/implemented by Michigan utilities with a description of how each one works. As stated above we need to understand the current state of the regulatory framework in order to provide a foundation for a discussion on regulatory reform options that either need to be changed or should be added to meet the goals.

*Christensen Associates Energy Consulting, LLC* vii *5/25/2016* [https://www.caenergy.com/wp-content/uploads/2016/02/Kirsch_Morey_Alternative_Ratemaking_Mechanisms.pdf](https://www.caenergy.com/wp-content/uploads/2016/02/Kirsch_Morey_Alternative_Ratemaking_Mechanisms.pdf)
The alternative ratemaking mechanisms that make incremental revisions to traditional cost-of-service ratemaking are as follows:

·***Future test years*** can be used as the source of the projected data used in rate cases. The future test year approach has the advantage of using data that are appropriate for the period to which the data will apply. States are fairly evenly divided between those that use future test years and those that use historical test years.

·*Earnings sharing mechanisms* allow rate adjustments outside of general rate case proceedings when actual ROEs would otherwise fall outside of specified bands around authorized ROEs. No rate adjustment is made when actual ROEs fall within the band;
and rates are adjusted to share between customers and shareholders the excess or deficient earnings outside of the band. Earnings sharing mechanisms help hold down procedural costs of assuring that utilities' actual ROEs do not stray far from authorized ROEs due to the operation of automatic rate change mechanisms or to changing business conditions.

·*Cost trackers* allow utilities to use a formula or predefined rule to recover specific costs from customers outside of general rate cases. They provide timely recovery of significant costs that are beyond utility control, which reduces utilities' financial risk without compromising their performance and without, in the long run, increasing costs to consumers. Cost trackers are ubiquitous throughout the U.S.

·*Infrastructure surcharges* allow some capital cost recovery prior to the completion of a facility's construction. By spreading capital cost recovery over a longer period of time than is traditional, infrastructure charges mitigate rate shock, improve utilities' cash flow during construction, and avoid delays in capital cost recovery.

·*Performance incentive regulation* provides incentives for utilities to maintain or improve service quality. Performance incentives can help make regulatory goals and incentives explicit, improve performance, and focus regulatory attention on the achievement of desired outcomes rather than on the means of obtaining those outcomes. Many states have adopted performance incentives of one type or another.

Thank you

**Rod E. Williamson**