AARP

AARP's comments on alternative regulation for the PBR docket -10/4/17

Our Policy Book has specific concerns with such alternative regulation and recommends consumer protections if enacted:

Cost of Service Ratemaking and Alternative Regulation Federal and state governments share responsibility for regulating utilities. Federal jurisdiction primarily relates to any interstate transmission and wholesale sales of electricity and transmission of natural gas between states. States and their public utility commissions generally regulate retail rates (i.e., charges to ratepayers) and approve construction of new power plants. They also often decide which power plants may be built in their state and other resource planning matters.

Before allowing utilities to change rates, regulators traditionally require a rate case review. Under "cost of service" (also called rate of return) regulation, state regulators determine, based on test-year evidence, the amount of revenue that must be collected in rates for the utility to recover its costs and earn a reasonable rate of return on investments. Once set, the rates remain in place until a new rate case is filed and approved. A rate case ensures scrutiny of all of a utility's costs. Regulators can review costs, applying decreases that might partially offset a proposed rate increase. This process ensures a transparent examination of utility costs based on intervenor participation, evidence and analysis.

Alternative ratemaking is often described as procedures designed to streamline the current regulatory process, and give utilities revenue stability and an incentive to be more efficient, while also reducing regulatory expenses. These alternatives include mechanisms that adjust rates automatically outside of a full rate review, or with limited review. A related concept is "piecemeal ratemaking" where a rate change is made in isolation, outside a full rate case review. Alternative ratemaking typically provides a benefit to the utility by limiting risk and often includes opportunities for bonus earnings.

Among the most common types of alternative ratemaking are:

• Formula rate plans—allow for automatic rate adjustments using predetermined formulas that are based in whole or in part on the utility's earnings.

• Earnings-sharing mechanisms—allow for rate adjustments outside of a full rate case, based on the level of the utility's earnings; if earnings fall or rise above a predetermined level, rates are increased or decreased.

• Performance based ratemaking—gives utilities earnings incentives for achieving certain pre-determined performance goals.

• Revenue decoupling and lost revenue adjustment mechanisms—adjust rates between rate cases to account for lost revenues due to lower sales (see this chapter's section on Energy Efficiency Programs).

• Multi-year rate plans—allow for automatic rate changes in years between full rate reviews.

• Future test years—use projected costs to set rates rather than actual costs.

• Cost trackers—allow the recovery of specific costs outside of a rate case.

• Infrastructure surcharges—provide a utility with the recovery of capital costs outside of a rate case, similar to cost trackers.

Among the criticisms of alternative regulatory models are the following:

• They undermine the comprehensive review of utility costs and prudence of investment decisions; consumers cannot be assured they are paying just and reasonable rates.

• Formulas and rate changes made in isolation without regard to overall costs are unlikely to result in just and reasonable rates.

• Allowing the utility to earn higher profits through cost-cutting creates an incentive to increase profits by decreasing quality.

• Rate-case cost savings are questionable; although the number of rate cases may be reduced, those savings can be offset by costs of tracking, monitoring and evaluating alternative mechanisms.

• They create unintended results in which utilities pursue strategies to maximize their revenues under the alternative ratemaking, rather than through actual improvements in overall service and reliability.

Policymakers should not move away from fully contested rate cases under the traditional cost-of-service regulatory model.

At a minimum the following principles should guide rate reviews:

• The utility's revenue requirement should be based on just and reasonable expenses necessary to provide service and investments that are prudent and used and useful to ratepayers.

• The utility's rate of return should be fair and based on current market conditions.

• Rates should be stable, predictable, and understandable, with costs allocated fairly among customers.

• Ratepayers should not subsidize the costs of competitive market products and technologies.

If alternatives are proposed, they should be done under limited-term pilots and include the following minimum consumer protections:

• Regular full rate case reviews should be used to determine whether the alternative achieved its intended result;

• Performance data should be publicly reported;

• Annual limits should be put in place for capital expenditures;

• Proceedings should be transparent, open to the public, and include an evidentiary record;

• Recovery should be limited to clearly defined costs for a limited period of time;

• The authorized rate of return should be downwardly-adjusted to reflect the reduced business risk from the alternative regulation; and

• The utility should absorb any cost overruns related to investments financed through alternative methods such as trackers, and any underspending should be returned to ratepayers.

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Consumers Energy and DTE Energy

Michigan Public Service Commission

Study of Performance Based Regulation

Per PA 341 of 2016, Sec. 6u

Report outline (September 15, 2017 Draft)

1. Introduction and Executive summary~~/abstract~~
    a. ~~Introduction~~Impetus for Study & Change
        i. How regulation can be used to better align incentives and drive outcomes
        ii. Targeting inefficiencies in the current system to create win/win scenarios
        iii. Capitalizing on new & evolving options with new technologies
    b. Definition of "Performance Based Regulation"
    c. Key Considerations:
        i. What are the goals and outcomes that are desired?
            1. ~~(i~~Including key drivers: customer satisfaction, safety, reliability, environmental impact & social obligations~~)~~
        ii. How to best incent changes & actions:
            1. Create an incentive environment
            2. Customer Incentives
            3. Utility Incentives
            4. Stakeholder Incentives
    d. Required Investments
        i. What investments will be required to support desired goals and outcomes?
    ~~i.~~e. Overview of MPSC Study and Report and Work with Stakeholders
2. Underpinnings of MPSC performance based regulation study
    a. 2016 PA 341 mandate: "the commission shall review PBR systems … including but not limited to RIIO… and shall evaluate:"
        i. Methods for estimating revenue needed…during a multi-year pricing period that uses forecasts of efficient total expenditures (i.e. TOTEX)
        ii. Methods to increase the time between rate cases …to provide the utility with opportunity to retain cost savings…and to encourage investments that have extended payback periods
        iii. Options (i.e. mechanisms) for establishing incentives and penalties that pertain to customer satisfaction, safety, reliability, environmental impact, and social obligations
        iv. Profit sharing provisions that can spread efficiency gains among consumers and utility stockholders and reduce the degree of downside risk associated with innovation
    b. "… shall report and make recommendations in writing to the legislature"

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3. **Economic regulation of public utilities in Michigan**
    a. **Summary of enabling legislation defining the form of economic regulation in Michigan [PA 419 of 1919; PA 3 of 1939, PA 141 of 2000, PA 295 & 286 of 2008.]**
4. **The UK's RIIO [revenues-incentives-inputs-outputs] mechanism**
    a. **RIIO – a broad based incentive structure administered by OFGEM**
    b. **Enhanced ratepayer and stakeholder engagement**
    c. **Efficient total expenditures i.e. TOTEX**
    d. **Establishing allowed revenues via TOTEX – mitigating the incentive to invest rather than expense**
    e. **Profit-sharing under broad-based incentive regulation – sharing cost efficiency gains between consumers and utility stockholders**
    f. **Program improvements from learning**
5. **Cost-of-service (COS) regulation with added targeted-incentives**
    a. **How targeted incentive mechanisms fit into such broader definition of PBR**
    b. **Performance-incentive-mechanism's (PIM's) and how PIM's could allow realization of outcome based goals, while retaining an established COS regulation framework**
    c. **Public reporting obligations as a transition to fully developed PIM's with incentive associated metrics**
    d. **(PIM) structure [RAP report attached as Appendix C]**
    e. **Innovation and market transformation through PIM's**
    f. **Standards setting with penalties as an alternative approach**
    g. **Profit-sharing under targeted incentive mechanisms - reducing the degree of downside risk associated with innovation.**
    h. **Positive and negative PIM's may be a useful regulatory approach to ensure that approved capital investments/projects/programs are actually made by regulated utilities**
    i. **Output goals (delineated by PA 237 Sec. 6u), including but not limited to "customer satisfaction, safety, reliability, environmental impact, and social obligations" may be achieved via PIM's under a COS construct**
6. **Other regulatory mechanisms providing incentives [mentioned in the Conclusion section – 9.a. iv.]**
    a. **Tracking mechanisms for capital expenditures and associated riders**
~~6.~~7. **Survey of key incentive/PBR mechanisms and associated implementation details in the United States**
    a. **Michigan history of implementation of incentive regulation mechanisms**
    b. **New York's "Reforming the Energy Vision" (REV)**
    c. **Other states considering/adopting PBR mechanisms of various forms including Massachusetts and Pennsylvania**
~~7.~~8. **Multi-year rate cases as a PBR approach**
    a. **Goals and objectives of multi-year rate-setting periods**
    b. **How are new grid infrastructure investments evaluated/approved for purposes of a multi-year rate case?**

c. Distinguish those elements of a multi-year rate setting approach requiring a change in law from those elements that can be implemented under existing law
d. States implementing multi-year rate-cases and lessons learned

~~8.~~9. Potential applicability of broad-based PBR in Michigan

a. RIIO structure requires a substantial administrative apparatus and years of regulatory, utility and stakeholder work
b. Legal authority impacting PBR implementation in Michigan
c. Pros and Cons of different approaches and conditions for successful implementation

~~9.~~10. Conclusions/Recommendations

a. Summary of specific mechanisms that could be used to extend time between rate cases, create efficiency gains that could be financially shared between customers and utilities, and best methods to drive innovation
    i. PIM's
    ii. Multi-year rate plans
    iii. U.K.'s RIIO method
    iv. Other mechanisms
b. Summary of MI statutory provisions relevant to PBR mechanisms
c. Implications of longer term forecasted operating and capital expenditures in general rate cases
d. Implications of PBR related regulatory costs and impacts on small MI utilities and their customers

Appendix A – Economic regulation of public utilities – fundamental concepts relevant to economic incentives and regulatory efficacy

Appendix B - The UK's RPI –X mechanism: a second-generation performance incentive framework

Appendix C – Regulatory Assistance Project / National Renewable Energy Laboratory 2017 report on Performance Based Ratemaking

Appendix D – Regulatory Assistance Project Performance Based Regulation Options 2017 report to the Michigan Public Service Commission