Incentives and Performance Mechanisms

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May 23, 2014

Purpose of Performance Mechanisms

- Performance Mechanisms can be used to:
  - Guide utilities toward desired behavior
  - Control costs/expenditures
  - Remove utility disincentives
  - Induce utilities to meet or exceed minimum performance standards

Alternative Regulatory Mechanisms

- Mechanisms can take several forms:
  - Reasonable and prudent cost recovery
  - Revenue decoupling (revenue tracker)
  - Revenue sharing
  - Cost index
  - Performance Incentive (performance standard)
- Most mechanisms include an annual reconciliation

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Gas Cost Recovery Mechanism

- Concurrent recovery of expenditures via surcharge
- Guaranteed recovery of “reasonable and prudent” expenditures
- Annual reconciliation
  - Financial reconciliation
    - Interest on over/under recoveries
  - Prudency review

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Revenue Decoupling Mechanism

- Simple Revenue Tracker with Caps
- Breaks the connection between throughput and revenues (between rate-cases)
  - Removes the dis-incentive to promote energy efficiency
- Base revenues from most current rate case (revenue requirement) less actual revenues
  - Cap on surcharges or refunds

Revenue Sharing Mechanism

- Example: Natural Gas Storage (excess gas storage capacity)
- General rate case excludes revenues
- Annual reconciliation
- 90% of revenues returned to customers
- 10% of revenues retained by stockholders
- Incentive to maximize revenues (win/win)

Cost Index

- O&M Indexing Mechanism
- Control costs during high inflation periods
- Provide simultaneous recovery of expenses
- Base O&M adjusted by monthly Consumer Price Index

Energy Efficiency Program (Performance Incentive Mechanism)

- Incentive payment: smaller of 15% of annual spend or 25% of net benefits
- Performance standard: set by Commission
  - Quantitative
    - Exceed energy savings standard (1% of retail sales)
  - Qualitative
    - Low income; peak reduction; multi-utility coordination; etc.

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Distribution Service Quality Incentives and Penalties

- Legislation passed in 2000 required the Commission to adopt generally applicable service quality and reliability standards for the generation and distribution systems of electric utilities:

  This law stated:

  – ***"The commission is authorized to levy financial incentives and penalties upon any jurisdictional entity which exceeds or fails to meet the service quality and reliability standards."***

Distribution Service Quality Incentives and Penalties

- The Commission's response was to approve administrative rules:
  - The incentive provides that the Commission may authorize an electric utility to receive a financial incentive if it exceeds all of the service quality and reliability standards adopted by the Commission.
  - No Michigan utility has ever received an incentive.

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Distribution Service Quality Incentives and Penalties

- The Commission also approved penalties in the nature of customer credits in these administrative rules:
  - The **penalty** is a bill credit of $25 (or the amount of the monthly customer charge, whichever is greater) if any of these service quality and reliability standards occurs:
    - Failure to restore service to a customer within 120 hours after a catastrophic storm.
    - Failure to restore service to a customer within 16 hours during normal conditions.
    - A customer experiences more than 7 interruptions in a 12-month period due to a same-circuit repetitive interruption

Questions?