Incentives and Utility Business Model Reform

Boston Bar Virtual Energy Law Conference

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All regulation is incentive regulation

- Understand what the incentives are and how they affect behavior
- Traditional cost-of-service regulation often considered the baseline
- Range of alternatives and additions around for decades; new options being explored around U.S.
Issues with “traditional” regulation

- Throughput incentive
  - Traditional regulation sets *prices*, not *revenues*
  - More kilowatt-hours sold = more $ utility makes

- Capital investment bias
  - Utility profits based on capital investments in rate base

- Asymmetric information
  - Utilities have more information than the regulators or other stakeholders
Menu of solutions

- Restructuring and competition move away from traditional cost of service model
- Decoupling and “revenue regulation” can break link between sales and profits
- Multi-year rate plans and integrated planning can mitigate bias toward capital projects
- Financial incentives for service quality and energy efficiency programs exist in many places
What is performance-based regulation?

- Financial incentives and metrics linked to outcomes
- Multi-year determination/formula for allowed revenue
- Decoupling
- Earnings sharing mechanisms

_Not all of these will be present in every PBR established_
Multi-year rate plans

• The incentives to control costs can be independent from level of revenue
• Multi-year rate plans that increase over time are not unusual
• Negative productivity factors in a revenue formula appear to be unusual
Productivity factors

• Theoretical issues
  - Why would you see a negative productivity factor?

• Analytical issues
  - What is the right analysis?

• Application issues
  - How should the analysis be used?
Carte blanche for cost cutting
Pacific Northwest Bell

- Customer service cut
- Charged for customer service phone access
- Incentive to keep customers on hold
Figure 6. Metrics continuum

- Metrics are publicized on a publically available "dashboard."

- Metrics are publicized and ranked
  - Examples: Denmark DSO efficiency ranking, RIIO

- Metrics are publically available, and utilities receive financial awards or penalties depending on achievement of the metrics.
  - Examples: NY REV
Going from metrics to incentives

• Set baseline performance level
• Determine incentive type
  • Penalty only
  • Rewards only
  • Penalties and rewards
• Establish formula for penalties/rewards
Current status in Massachusetts

- Service quality standards and penalties
  - Reliability and customer service
- Grid modernization metrics
  - Framework established in 2014 order
  - Statewide performance metrics approved July 2019
- PBR metrics
  - New proceeding for Eversource compliance filing began in June 2018
Reforming the Energy Vision in NY

• Modest reforms to date
  • Multi-year rate plans and decoupling
  • Requirements for non-wires alternative solicitations
  • Earnings adjustment mechanisms
  • Platform service revenues

• Earlier orders included longer term vision for broader reform, including Distribution System Platform Provider
NY Earnings Adjustment Mechanisms

- Modestly sized reward-only outcome-based performance incentives
- ConEd January 2020 settlement approved EAMs for:
  - Deeper EE lifetime savings
  - Beneficial electrification GHG reductions
  - DER utilization
  - Electric system peak reductions
  - Load factor in constrained areas of network
Vision for revenue within NY REV

Takeaways

• PBR is a package of reforms that differs from place to place
• Broader context is effort to remedy deficiencies in traditional cost of service regulation for utilities
• Massachusetts has implemented multi-year rate plans and service quality standards
  • Slow progress on other metrics
Resources

- Next-Generation Performance-Based Regulation: Volume 1 (Introduction—Global Lessons for Success)
- Next-Generation Performance-Based Regulation: Volume 2 (Primer—Essential Elements of Design and Implementation)
- Next-Generation Performance-Based Regulation: Volume 3 (Innovative Examples from Around the World)

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