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The Second Annual Conference
of the
Organisation of
Caribbean Utility Regulators

November 2nd, 2004 – November
5th, 2004
Montego Bay, Jamaica



Performance Based Ratemaking

The Rhode Island Experience

Statutory Basis in Rhode Island

- Section one of the RI Restructuring Act provides that it is in the public interest to establish performance based ratemaking for regulated utilities.

What Are Performance Based Rates (PBRs)?

- PBRs are an alternative rate of return regulation designed to foster innovation.
- PBRs give the utilities the opportunity to earn more as long as service quality is not compromised.
- Excess earnings can be controlled by earnings sharing mechanisms.

The Rhode Island Experience with PBRs for Electric Distribution Companies

- In May, 1999 RI's largest electric utility filed for a rate reduction of \$5.4 million.
- RI Attorney General responded seeking a decrease of \$10.4 million.
- After extensive discovery and negotiations, a settlement was filed and approved...

Narragansett Electric Settlement

- Reduced distribution rates by \$13.1 million
- Froze those reduced rates for 5 years.
- Continued and Expanded low-income rates, which are 65% of the existing distribution rate.
- Established a Return on Equity (ROE) of 10.5%.
- Allowed the company to increase Revenues to the Extent the CPI exceeds 4% per annum.

Narragansett Settlement - Earnings Sharing Mechanism

- Earnings to 12% ROE retained by the Company.
- Earnings from 12% ROE to 13% shared 50/50 with ratepayers.
- Earnings over 13% ROE – 75% to ratepayers 25% to company.

Narragansett Settlement -Service Quality Program

- Up to \$2.4 Million in annual penalties if service quality falls below specified levels.
- Service Quality Measures – 1. Frequency and duration of outages. 2. Response time to customer calls and complaints. 3. Customer satisfaction based on survey of customers.

Results to Date of Electric PBR

- \$20 Million in Earnings Sharing with Customers.
- \$1.8 Million in penalties assessed to company for service quality deficiencies.

Performance Based Rates of the Local Gas Distribution Company

- In November, 2000, New England Gas Company Filed for a rate increase of \$7.2 million providing for a 12.5% ROE.
- The Attorney General filed testimony supporting a rate decrease of \$8 million.
- Following discovery and negotiations between the parties a settlement was filed and approved with minor modifications.

Features of the New England Gas Settlement

- \$3.9 million reduction in base rates.
- Rate freeze at reduced rate levels until June, 2005.
- Return On Equity of 11.25%
- Earnings sharing mechanism 11.25 ROE to 12.25% ROE – 50% to ratepayers and 50% to the company.
- 12.25% and above 75% to ratepayers -25% to company.
- Penalties of up to \$1.25 million annually if there are deficiencies in service quality.

Service Quality Standards

- Company response to telephone calls.
- On cycle meter reading and meter testing.
- Service appointments met.
- Leak Response Performance.

Results to Date

- Earnings sharing - \$5.2 million has been returned to ratepayers
- \$5.4 million more is to be given back.
- No penalties for service quality shortfalls to date.



Framework for Designing and Evaluating a PBR

Step 1 – Identifying the Goals

- Identifying, Articulating and Prioritizing Goals.
- Understanding how well or poorly goals are met by conventional rate of return/cost of service regulation.
- If, for example, increased cost cutting incentives are a high priority compare the effectiveness of the proposed PBR to the effectiveness of existing ROR/COS regulation.

Step 2 – Design a Structure to meet the Identified Goals.

- The need for targeted incentives results from the absence of customer choice in distribution expense.
- If distribution were a competitive market distribution companies would compete on the basis of service quality and customer service.
- Since there is no meaningful competition for distribution service the quest for lower cost and higher profits may drive utilities to reduce service quality and customer service

Step 3 – Getting the Numbers Right

- Getting the numbers right is essential to prevent windfall gains or losses and assure the long-term viability of the PBR.
- A “Right” number should allow a highly efficient utility to raise or lower costs only to changes in the underlying cost of the industry.

Other Thoughts

- Try to keep the PBR Simple and Understandable to the Public.
- Focus on Limiting Revenue Growth to Protect Ratepayers.