STATE OF MICHIGAN
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ATTORNEY GENERAL

September 22, 2023

Ms. Lisa Felice
Executive Secretary
Michigan Public Service Commission
7109 West Saginaw Highway
Lansing, MI 48917

Dear Ms. Felice:

Re: <u>MPSC Case No. U-21400</u> – *In the matter, on the Commission's own motion, to establish a workgroup to investigate appropriate financial incentives and penalties to address outages and distribution performance moving forward.*

In its August 23, 2023 order in Case No. U-21400, the Commission requested comments from interested parties regarding a straw proposal to implement financial incentives and penalties along with establishing performance metrics aimed at reducing power outages, improving service restoration time, and increasing the overall reliability of the electric distribution grid operated by electric utilities in Michigan. The Commission also requested that interested parties propose appropriate mechanisms to measure performance, award incentives and assess penalties based on outcomes against established performance targets or goals.

The Attorney General is pleased to provide comments and a proposed mechanism that will assist the Commission in authorizing an appropriate mechanism to achieve the stated objectives. In providing comments and input to the Commission, the focus will be on service reliability, power outage restoration time, and other service quality levels of the electric distribution systems, with an emphasis on urgency to achieve significant performance improvement from current levels. In this regard, paramount in the Attorney General's comments below are the principles that standards and rules must be fair and reasonable and that the failure to achieve the stated performance goals has financial consequences for the utilities. Utilities that exceed the stated performance targets have an opportunity to achieve an incentive. This symmetry in both rewards and penalties is essential to properly focus the attention of the utilities to meet and exceed those performance targets and service quality levels.

In its order of August 23, 2023, the Commission did not specify if the financial incentives and penalties proposal also applied to electric cooperatives under the Commission's jurisdiction. If the order also applies to electric cooperatives, the Attorney General's comments and proposed mechanism in referring to utilities would apply equally to them.

Because the Commission's order in U-21400 asked interested parties to respond to the straw proposal, the Attorney General's comments focus narrowly on the issue of an appropriate mechanism to improve reliability. Thus, the Attorney General uses the current service quality rules recently adopted by the Commission. The Attorney General, however, disagrees with the amount of the outage credits in the current service quality rules and disagrees with the various catastrophic and normal condition parameters as stated in her prior comments filed in the docket dealing with service quality rules as well as the several dockets addressing storm response and electric reliability generally. With those caveats, the Attorney General provides the following response.

PART 1, AG COMMENTS TO THE COMMISSION STRAW PROPOSAL

The Attorney General will not repeat the performance shortfalls in the distribution systems operated by Michigan electric utilities and identified by the Commission in Exhibit A to the August 23 order. The shortfalls have been adequately identified by the Commission and are well known. They can be summarized in four basic areas: (1) too many power outages, (2) long restoration time, (3) large capital and O&M expenditures, and (4) insufficient accountability for performance given the higher expenditures and increasing customer rates. During the most recent five years, from 2018 to 2022, the two largest electric utilities in Michigan spent nearly $16 billion on their electric distribution systems and have forecasted additional capital spending of $9 billion over the next two years. In addition, the two utilities are spending in excess of $300 million annually on tree trimming and vegetation management to prevent power outages.

These capital and O&M expenditures have been significant drivers of the revenue requirement and rate increases that the utilities bill their customers. However, to date there has not been any direct link between the revenue collected by the utilities from those capital investments and O&M expenses directed at the distribution system and the results achieved in terms of performance improvement in power outages, distribution grid reliability and resilience, and reductions in power outage restoration time and costs. The Service Improvement Incentive Mechanism that the Attorney General will describe in Part II below will correct the current lack of accountability while concurrently providing both a financial incentive to improve performance and financial penalties for falling short of specific targets for improvement.

The Attorney General offers the following comments to the Commission straw proposal.

Key Objectives for a properly designed performance incentive and penalty mechanism:

1. ***Focused*** – The mechanism should be focused on the electric distribution system problems currently facing electric utilities and customers. Attempts to expand the mechanism to include other items outside of the distribution systems should be avoided. They would distract utility management from the main focus and "water down" or diminish the effectiveness of the targeted distribution performance metrics.

2. ***Simplicity*** – The number of performance metrics should be limited to a dozen or less, should avoid or minimize duplication, should reflect general industry known performance metrics, should be easily understood and reported, and should be meaningful to customers.

3. ***Accountability*** – The incentive rewards and penalties need to be linked to and reflect the revenue collected by the utilities for the capital and O&M spending on the distribution grid. This direct link is essential to hold utilities accountable to achieve the targeted performance improvements for the revenue collected in customer rates. If the utilities achieve the targeted performance levels, they retain the distribution-related revenue reflected in customer rates. If they fall short of the targeted performance, they will pay penalties, and if they exceed targeted performance, they are rewarded with incentive payments.

4. ***Industry Comparison*** – Bench marking against a group of other utilities in the Great Lakes region would be useful to establish the performance of Michigan utilities relative to their closest peers.

5. ***Performance Metrics*** – In order to set realistic and achievable annual performance metrics, the chosen metrics must reflect the current level of performance of each utility with stretch goals to achieve improvement in future years. However, with some metrics a basic threshold of performance needs to be established, below which the utility will be subject to penalties. Certain performance metrics can vary significantly from year to year due to weather events. Therefore, performance in some areas needs to be determined over a longer period of time, such as three or five years, by measuring average performance and trends over those time periods.

   If the Commission's intent in establishing a mechanism of incentives and penalties is to reduce power outages and the restoration time when power outages occur, the performance metrics need to include measures that are directed at achieving those objectives. As shown in Part 2 of this document, the Attorney General has included metrics in her proposed mechanism aimed at reducing multiple power outages and reducing the service restoration time when power outages occur. Some of the metrics borrow from the Service Quality and Reliability Standards for Electric Distribution Systems that the Commission approved on March 23, 2023 in Case No. U-20269. The Attorney General's mechanism would make utilities accountable for achieving and surpassing some of the standards for multiple power outages and service restoration time through financial incentives and penalties.

6. ***Limits on Rewards and Penalties*** – Some limit on the amount of annual incentive payments or penalties needs to be established to minimize the impact of unexpected or unusual circumstances that may arise in any year.
7. ***No Dead Bands*** – Performance dead bands, where no incentive payments or penalties are made, complicate the mechanism, are arbitrary, and are unnecessary.

The Attorney General recommends that these key objectives guide the Commission's review, development, and approval of an effective performance incentive and penalty mechanism.

Attorney General Comments to Commission Straw Proposal

In Table 1 and subsequent pages of Exhibit A in its August 23, 2023 order, the Commission presented its straw proposal and related descriptions of current performance by DTE and Consumers, Target Performance goals (both interim and long-term), and a general concept of incentives and/or penalties for certain metrics.

CAIDI and SAIFI - The straw proposal includes CAIDI (excluding MEDs), CAIDI (only MEDs), and SAIFI (excluding MEDS).[1] It appears that with the proposed CAIDI indices, the Commission seeks to measure the average duration of power outages during major event days and during normal days that occurred during the year. With the SAIFI (excluding MEDs), the Commission proposes to measure the number of power outages on average per customer only during normal days. According to page 3 of Exhibit A, the SAIFI performance of DTE and Consumers is generally in line with industry averages and should not be a high priority of focus in a proposed mechanism. Instead, the Attorney General recommends that the Commission adopt the SAIDI[2] indices with and without MEDs in place of the proposed CAIDI and SAIFI indices. SAIDI is a more commonly tracked index of distribution performance industry-wide and combines both the CAIDI and SAIFI indices into one single score.

The Attorney General recommends that the annual SAIDI performance target level, with and without MEDs, for each utility for the first five years of the incentive/penalty mechanism be set at an annual improvement of at least 5% over the average historical SAIDI for the five years ended in the calendar year prior to the start of the mechanism. For example, if the mechanism starts in 2025, the target SAIDI index for 2025 would be set at 95% of the average five-year index ended December 2024 and each of the subsequent four years set at 95% of the prior year target. Over the five-year period, this would be approximately a 25% cumulative

[1] CAIDI = Customer Average Interruption Duration Index. SAIFI = System Average Interruption Frequency Index. MEDs = Major Event Days when CAIDI, SAIFI or SAIDI exceed normal expected event days, such as extreme or catastrophic weather days.
[2] SAIDI = System Average Interruption Duration Index.

reduction in the SAIDI indices. After five years from the start of the mechanism, the annual target performance level for each utility would be set at the average of the SAIDI indices, with and without MEDs, for the electric utilities in the five surrounding Great Lakes states of Illinois, Indiana, Ohio, Pennsylvania, and Wisconsin (Utility Peer Group).

CEMI$_4$ and CEMI$_7$ [3] – The Commission's straw proposal includes performance metrics for the number of customers experiencing both 4 or more interruptions and 7 or more interruptions in a year. The metrics are somewhat duplicative, given that CEMI$_4$ also incorporates CEMI$_7$ interruptions and therefore seems unnecessary. The Attorney General recommends that the Commission instead adopt a single metric of CEMI$_5$ as a reasonable middle point. From a customer viewpoint, 5 power outages in a year would be perceived as excessive. Alternatively, the Commission could select only CEMI$_4$.

The straw proposal did not recommend a target performance level for the interim period and stated a long-term goal of less than 5% of total customers for CEMI$_4$ by 2030 or meeting an industry benchmark for CEMI$_7$. The proposal also would impose only penalties and no incentives for better performance than target. The Attorney General recommends that the CEMI$_5$ performance target for each utility for the first five years of the incentive/penalty mechanism be set at an annual improvement of at least 5% over the historical average for the three years ended the calendar year prior to the start of the mechanism. After five years from the start of the mechanism, the annual target performance level for each utility would be set at the average of the CEMI$_5$ of the industry Peer Group or 3% of total customers of the utility, whichever is lower.

Worst Performing Circuits – The Commission's intent with this metric is to avoid having the same electric circuits on the list of the top 10 worst performing circuits for more than two years. The Commission proposes to penalize the utility if a circuit ranked in the top 10 for 3 or more years within the past five years with the penalty being a bill credit to the affected customers. Although this is an issue to be addressed, the scope of the metric is very granular and specific to a relatively small group of customers. It should not be included in a broad-based incentive and penalty mechanism and instead addressed within the Service Quality and Reliability Standards.

Rule 460.746 of the Commission's Service Quality and Reliability Standards addresses penalties through a bill credit for customers experiencing 6 or more sustained power interruptions within a 12-month period. The bill credit is currently $38 for each repetitive outage after 5 outages in a year. The Attorney General recommends that Rule 460.746 be amended to include a doubling of the bill credit for those customers who are in the top 10 worst performing circuits for more than two years within the past 5 years. This credit will provide specific relief to the affected

[3] CEMI – Customers Experiencing Multiple Interruptions.

customers and concurrently provide an incentive to the utility to upgrade those worst performing circuits.

PART 2, ATTORNEY GENERAL PROPOSED SERVICE IMPROVEMENT INCENTIVE MECHANISM

To address the Commission request for interested parties to submit a detailed incentive and penalty mechanism, the Attorney General proposes the Service Improvement Incentive Mechanism (SIIM). The SIIM was designed to establish a performance-based regulatory mechanism to reward superior performance in the management and operation of the utility's electric distribution grid and assess penalties for failing to meet expected performance targets.

The incentive mechanism and the performance metrics identified below are structured so that the utility must improve its level of service to keep 100% of the rate increase it received in the past five years pertaining to investments made in the electric distribution system. If the utility maintains the status quo and does not meet the improvement metrics, it will be penalized and will need to return a portion of the rate increase received in the past five years pertaining to those investments and related O&M costs. If the utility exceeds the performance metrics, it will be rewarded with additional revenue.

Performance Metrics:

The target performance metrics are focused on improvement in electric service reliability, service restoration time, and reduction in restoration costs from historical levels.

The following definitions will assist in explaining the proposed metrics.

Catastrophic Conditions: Means severe weather conditions that result in sustained service interruptions for 10% or more of an electric utility's total customers.

$CEMI_5$: Customers Experiencing 5 or more Multiple service Interruptions in one year.

SAIDI: System Average Interruption Duration Index stated in minutes used as an industry standard.

Major Event Days (**MEDs**): Days in which SAIDI exceeds normally expected event days, such as extreme or catastrophic weather days.

Sustained interruption: Any power interruption that lasts more than 5 minutes.

The Attorney General proposes that the annual incentive Target Metrics be set as follows and be based initially on the utility's historical performance with improvement targets.

1. **SAIDI with MEDs**: Each annual Target should be set at a 5% cumulative annual reduction from the most recent 5-year historical average just prior to the start of the mechanism. This 5% cumulative annual reduction in the SAIDI would apply for the first five years of the incentive/penalty mechanism. After five years from the start of the mechanism, the annual target performance level for each utility would be set at the average of the SAIDI with MEDs for the Utility Peer Group. At the end of each year, the utility would calculate the rolling 5-year SAIDI index for comparison to the Target level.
2. **SAIDI excluding MEDs**: Each annual Target should be set at a 5% cumulative reduction from the most recent 5-year historical average just prior to the start of the mechanism. This 5% cumulative annual reduction in the SAIDI would apply for the first five years of the incentive/penalty mechanism. After five years from the start of the mechanism, the annual target performance level for each utility would be set at the average of the SAIDI excluding MEDs for the Utility Peer Group. At the end of each year, the utility would calculate the rolling 5-year SAIDI index for comparison to the Target level.
3. **$CEMI_5$**: Each annual Target should be set with a 5% annual reduction in the average number of customers experiencing 5 or more power outages in the most recent 3 years just prior to the start of the mechanism. This 5% cumulative annual reduction in the SAIDI would apply for the first five years of the incentive/penalty mechanism. After five years from the start of the mechanism, the annual target performance level for each utility would be set at the average of the $CEMI_5$ of the Utility Peer Group or 3% of total customers of the utility, whichever is lower.
4. **Customers with outages of 5 hours plus** – Each annual Target for the number of customers with one or more interruptions of 5 hours or more should be set at a 3% cumulative annual reduction from the average number during the most recent 3 years just prior to the start of the mechanism. After five years from the start of the mechanism, the annual target performance level for each utility would be set at the average of the Utility Peer Group or 5% of total customers of the utility, whichever is lower.
5. **Catastrophic Conditions 24-hour Restoration Time** – The annual Target for the percentage of customers with sustained service interruptions restored within 24 hours of a Catastrophic event should be set at a minimum level of 70%. Any Catastrophic event that does not meet the 70% level during the year will be considered a failure to achieve this performance metric.
6. **Catastrophic Conditions 48-hour Restoration Time** – The annual Target for the percentage of customers with sustained service interruptions restored within 48 hours of a Catastrophic event is set at a minimum level of 90%. Any Catastrophic event that does not meet

the 90% level during the year will be considered a failure to achieve this performance metric.

7. **Catastrophic Conditions 72-hour Restoration Time** – The annual Target for the percentage of customers with sustained service interruptions restored within 72 hours of a Catastrophic event is set at a minimum level of 95%. Any Catastrophic event that does not meet the 95% level during the year will be considered a failure to achieve this performance metric.

8. **Non-Catastrophic (All Other Conditions) 24-hour Restoration Time** – the annual Target for the percentage of customers with sustained service interruptions restored within 24 hours of All Other Conditions sustained service interruptions is set a minimum level of 99%. Any non-Catastrophic event that does not meet the 99% level during the year will be considered a failure to achieve this performance metric.

9. **Service Restoration Costs** – The annual Target for average cost per customer for O&M and capital restoration costs is set at a 5% cumulative reduction from the historical average cost for the most recent five years prior to the start of the mechanism, adjusted for annual inflation in future years based on the Detroit Metropolitan Area Urban Consumer Price Index. As the distribution grid becomes more reliable and power outages diminish, service restoration costs should decline. The purpose of this metric is to incentivize the utility to reduce those costs over time.

10. **Tree Trimming/Line Clearing Miles** – The annual Target for miles of electric lines cleared from tree trimming and vegetation management is set at the level approved in the most recent rate case. The purpose for this metric is to ensure that the targeted miles of vegetation clearing and related spending included in customer rates actually occur or are exceeded.

Calculation of Achieved Performance:

Each Target Metric will have an equal weight of 10% with the total of the 10 metrics equal to 100%. Within 60 days from the end of the calendar year, the utility will calculate the achieved results for each performance metric against the established target and will inform the Commission. The performance achieved will be calculated as a percentage of the target level rounded to the nearest percentage point.

For example, if the SAIDI-MEDs is actually achieved at 530 minutes in 2025 instead of a target level of 567, the percentage performance achievement is 7% (37/567) or 107% of target. This percentage multiplied by its weight of 10% will contribute 10.7 percentage points to the total performance score of the 10 metrics. Similarly, if the actual $CEMI_5$ number of customer in 2025 is 105,000 instead of 96,982, the utility underperformed by 8% (8,018 / 96,982) or 92% of target. This percentage multiplied by the 10% weight will contribute 9.2 percentage point to the total performance score.

To prevent large variances within each metric in case of unusual circumstances, the performance results for each metric will be limited to a range of 80% to 120%. The sum of all metrics multiplied by the 10% weight will provide the Total Metrics Performance Score. The following table provides an example.

Sample Calculation of SIIM Total Performance Score

	Performance Metric	Actual Performance Achieved of Target	Limit 80% to 120%	Weight	Performance Score
1	SAIDI MEDs	107%	107%	10%	10.7%
2	SAIDI NON-MEDs	95%	95%	10%	9.5%
3	CEMI-5	87%	87%	10%	8.7%
4	Outages of 5 hours plus	135%	120%	10%	12.0%
5	CAT 24-hour Restoration Time	110%	110%	10%	11.0%
6	CAT 48-hour Restoration Time	90%	90%	10%	9.0%
7	CAT 72-hour Restoration Time	70%	80%	10%	8.0%
8	Non-CAT 24-hour Restoration Time	101%	101%	10%	10.1%
9	Service Restoration Costs	90%	90%	10%	9.0%
10	Tree Trimming Miles	99%	99%	10%	9.9%
	Total Performance Score as percentage of target				**97.9%**

In this example, the utility's performance for the year was 2.1% below target.

Calculation of Financial Incentive and Penalty:

The utility would calculate the Performance Award or Penalty by applying the overall percentage under-performance or over-performance of target to the Award and Penalty Revenue Requirement Base (APRR Base). The APRR Base amount is equal to 50% of the Revenue Requirement calculated from the capital additions to rate base in the most recent five years pertaining to electric distribution plant, which includes the return on investment, depreciation expense, deferred taxes, property taxes, plus the distribution O&M expense included in customer rates.

For example, if the actual Total Performance Score is 97.9%, or 2.1% less than the 100% target, and the APRR Base amount is $75 million, the utility would calculate a Performance Penalty of $1,575,000 ($75 million x 2.1%). Similarly, if the Total Performance Score is 103%, or 3% above the 100% target, the utility would calculate a Performance Award amount of $2,250,000 ($75 million x 3%).

The Attorney General also recommends that the Commission set a maximum annual award or penalty amount of $10 million. This limit will ensure that no significant award is earned or penalty is assessed in case of unusual circumstances that may occur in any year.

SIIM Procedures:

The Attorney General; proposes that within 60 days after the end of each calendar year the utility file a report with the Commission detailing the SIIM performance goals for the upcoming year and the results for the prior calendar year, including the amount of Performance Award earned or Performance Penalty to be assessed for the prior year.

In the general rate case following the most recent SIIM annual filing, the Commission will review the accuracy of the Performance Award or Penalty amounts filed since the last rate case and will determine the cumulative or net amount of Annual Performance Awards or Penalty to be reflected in the utility's customer rates, including the proper allocation of those amounts to customer classes. The Commission should allow the utility to apply interest, compounded monthly, to the principal amount owed to the utility or owed to customers at the utility's short-term interest rate approved in the last rate case. Interest should be calculated from the date of filing of the SIIM Award or Penalty amount until the beginning date of the rate case projected test year.

Performance Data and Results:

In any incentive and penalty mechanism, the Commission and parties to the performance assessment proceeding will be highly dependent on data gathered and reported by the utility. To ensure the accuracy and legitimacy of the performance results, the Attorney General recommends that the Commission direct the utility to engage an outside firm with expertise in utility operations to audit the data gathering process and the calculations of performance metric targets and results. In addition to validating the data gathering and calculations, the audit firm should report and explain how and through what means the utility gathered the performance metrics data.

Summary:

After recent power outages, there has been a groundswell of interest to ensure that utilities are held accountable through performance measures for ever-increasing capital expenditures and operating costs reflected in customer rates. The SIIM strikes a fair balance in holding the utility accountable for performance related to capital investments and operating costs directly related to the distribution system. It provides for both incentive awards and penalties, within reason, and challenges the utility to improve service reliability and outage restoration time, among other goals. The Attorney General recommends that the Commission give strong consideration to the SIIM proposed herein. Any mechanism approved by the Commission should be revisited after three years following implementation to assess whether any modifications are necessary to improve its effectiveness.

The Attorney General appreciates the Commission's leadership in undertaking this project for implementation of financial incentives and penalties directed at improving the electric distribution grid in Michigan and stands ready to assist further through its experts in defining a mechanism that can be implemented as early as 2024. The Commission should adopt the Attorney General's proposed mechanism at least on an interim basis until the workgroup finishes its work on a final mechanism. Accountability for performance results is long overdue and utility customers expect to see action sooner than later.

Sincerely,

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