

ENERGY EFFICIENT MICHIGAN ACT

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 5525 (Substitute H-3)

Sponsor: Rep. Kathy Angerer

Committee: Energy and Technology

Complete to 2-13-08

A SUMMARY OF HOUSE BILL 5525 AS REPORTED FROM COMMITTEE:

The bill would create the "Energy Efficient Michigan Act" to do the following:

- Define key terms. (See detailed summary below).
- Authorize the Public Service Commission (PSC) to promulgate administrative rules regarding the development and submission of an "energy efficiency programs plan" (also called an "EEPP" or "plan" in this summary) by certain electric and gas utilities.
- Require a natural gas or electric utility, as defined in the act, to submit an EEPP with the PSC for its approval within 90 days of the act's effective date and every two years thereafter.
- An EEPP would have to include: 1) programs for all the utility's customer classes—but efforts for classes could vary based on the utility's service territory characteristics; (2) specification of necessary funding; (3) adequate programs and funding levels; (4) cost-effective programs, viewed collectively; (5) a designated administrator for each program (the utility, one or more utilities acting jointly, a state agency, or a nonprofit organization); and (6) independent expert verification of the energy savings from each program.
- Establish deadlines for the PSC's initial review of an EEPP and for the resubmission and subsequent review of a rejected plan. A utility would have to revise and resubmit its plan until it was approved, and meet performance standards even if its plan is rejected.
- Establish separate performance standards for electric and gas utilities beginning with an initial two-year period or biennium (2008-2009) and increasing annually thereafter. A performance standard would be defined as the expected energy efficiency savings from programs expressed as a percentage reduction of the utility's total sales in the preceding year. The required savings would be somewhat higher for electric utilities than for natural gas utilities. Efficiency savings exceeding the applicable performance standard could be carried forward and used to satisfy up to one third of the next year's standard, but a utility electing the carry forward credit could not also apply for the financial incentives described in Section 11(3).
- An electric utility with up to 200,000 customers and below average residential electricity rates could petition the PSC to lower its performance standards after

two years, but if its performance standards were lowered, the utility would lose eligibility for the financial incentives described in Section 11(3).

- Allow a utility to recover the actual costs of its efficiency programs in its rates up to the approved funding levels in its EEPP and to recover "reasonable" costs exceeding approved levels.
- Allow a utility that annually spends at least 0.5 percent of its total revenues—including electricity or natural gas commodity costs—on PSC-approved efficiency programs to implement a "revenue decoupling true-up mechanism that adjusts for sales volumes that are above or below forecasted levels." Expenditures exceeding **two** percent of total revenues would require PSC approval.
- Allow a utility to recover an additional financial incentive of up to **15** percent of the actual costs of its programs if it met or exceeded its performance standard. An additional amount up to **2 percent** could be recovered (**for a total of up to 17 percent**) if the utility's EEPP used Michigan-based companies.
- Allow either natural gas or electric utilities to opt out of compliance with Sections 5 through 11 of the act by making specified payments to an independent program administrator selected by the PSC, and allow the utility to pass along its payments to the program administrator in its rates. (In other words, a utility making this choice would simply make payments to an independent administrator to run efficiency programs for its customers.)
- Allow the PSC to investigate violations of the act and sanction a utility that does not make a good faith effort to comply with the act, including possibly reducing its authorized rate of recovery.
- Require a utility that falls short of its performance standard to make up the shortfall in the subsequent two years in addition to the savings otherwise required during those years.
- Require municipally-owned and "member-regulated" cooperative utilities to submit plans to the PSC for its review and recommendations (but not approval).
- Require municipally-owned utilities and "member regulated" electric cooperatives to comply with performance standards. The act would be enforced against municipal and "member-regulated" electric cooperatives not by the PSC but by lawsuits brought by a customer of the utility or the attorney general. The act would allow awards of attorney and expert fees to the substantially-prevailing party in such a suit.
- Require municipally-owned and "member-regulated" cooperative electric utilities to report to its customers, its governing body, and the PSC on its efficiency efforts.
- Allow large customers—those with electricity demand of more than **five megawatts**—to submit efficiency projects proposals to the PSC and the relevant utility within 30 days of the act's effective date. Three years after a utility began implementing its efficiency plan, customers with an electric billing demand greater than **two megawatts** would qualify as a large customer. The PSC would have to approve a project if it provided new electricity or natural gas savings and had a payback period of more than one but less than eight years. Savings from an approved large customer project could be used to satisfy a utility's performance

standard and the large customer could apply its expenditures to satisfy surcharges on its bills relating to the utility's efficiency programs.

- Require the PSC to promote load management.
- Require utilities to make an annual statement to their customers indicating the reduction of energy usage in Michigan as a result of the act and encouraging customers to compare their current and previous year's energy usage.
- Require the PSC to report to the Legislature on implementation of the act and make recommendations for improvements.

Tie bars. House Bill 5525 is tie-barred to the following bills, meaning that unless all are enacted, the bill will not take effect:

House Bill 5383 (Brown) (allow electricity co-ops to set rates without PSC approval)
House Bill 5384 (Nofs) (loosen restrictions on municipal utility joint action agencies)
House Bill 5520 (Miller) (limited or no PSC approval of sale of utility generation assets)
House Bill 5521 (Gaffney) (PSC certifications, including certificates of need)
House Bill 5522 (LaJoy) (reallocate costs of service to different customer classes)
House Bill 5523 (Clemente) (rate increases effective unless PSC approves in 90 days)
House Bill 5524 (Accavitti) (modify choice program)
House Bill 5548 (Mayes) (renewable portfolio standards)
House Bill 5549 (Palsrok) (renewable portfolio standards)

DETAILED SUMMARY

Title. [§1, p.1] The bill would create the "Energy Efficient Michigan Act."

Definitions. [§3, pp.1-3]

"Cost-effective" would mean that the program being evaluated meets the "utility system resource cost test," as defined in the bill. [§3(b), p.1]

"Electric utility" would mean "a person, partnership, corporation, association, or other legal entity whose transmission or distribution of electricity is regulated by the PSC" under specified laws, but *not* a municipally-owned utility, a so-called "member-regulated" electric cooperative (under House Bill 5583), an affiliated transmission company, or an independent transmission company. [§3(c), pp.1-2]

"Energy efficiency" would mean "a decrease in the consumption of electricity or natural gas achieved through measures or programs that target customer behavior, equipment, or devices without reducing the amount or quality of energy services." Energy efficiency would not include "load management." [§3(d), p.2]

"Energy efficiency programs plan" (also called an "EEPP" or "plan" in this summary) would mean a plan under Section 5 of the bill. [§3(e), p.2]

"Large customer" would mean "a utility customer at a single, contiguous site, location, or facility, regardless of the number of meters at that site, location, or facility, with an electric billing demand greater than five megawatts." Three years after a utility began implementing its EEPP, a customer with an electric billing demand greater than two megawatts would qualify as a large customer. [§3(f), p.2]

"Load management" would mean "measures or programs that decrease peak electricity demand or shift demand from peak to off-peak periods." [§3(g), p.2]

"Natural gas utility" would mean "an investor-owned business engaged in the sale and distribution of natural gas within [Michigan] whose rates are regulated by the [PSC]." [§3(h), pp. 2-3]

"Utility" would mean an electric utility or natural gas utility, except as used in Section 17 (concerning municipal and so-called member-regulated cooperative electric utilities under House Bill 5383). [§3(i), p.3]

"Utility system resource cost test" would mean "a standard that is met if, for an investment in energy efficiency, on a life-cycle basis the total avoided supply-side costs to the utility, including representative values for electricity and/or natural gas supply, transmission, distribution, and other associated costs to the utility, are greater than the total costs to the utility of administering and delivering the energy efficiency programs, including any costs for incentives paid to customers." [§3(j), p.3]

Administrative rules. [§5(1), p.3] The PSC would be required to promulgate administrative rules under the Administrative Procedures Act specifying procedures for a utility to develop and submit an EEPP designed to meet the standards of Section 7.

Submission of utility EEPPs to PSC. [§5(1), p.3] A utility, as defined in the bill, would have to submit an EEPP with the PSC within 90 days after the act's effective date and every two years thereafter.

EEPP requirements. [§ 5(1)(a)-(f). pp.3-4] Each plan would have to:

- Offer programs for all customer classes, although utilities would have flexibility to tailor the effort devoted to each customer class based on the specific characteristics of their service territory.
- Specify necessary funding levels.
- Demonstrate that the proposed energy efficiency programs and funding are sufficient to achieve applicable performance standards.
- Demonstrate that the programs, viewed collectively, would be cost-effective.
- Include a plan for the "practical and effective" administration of the programs. A program could be administered by the utility (alone or jointly with other utilities), by a state agency, or by an "appropriate experienced nonprofit organization" selected after competitive bidding.

- Provide for independent expert verification of the incremental energy savings from each actual program, subject to public review and commission oversight.

PSC review of plans. [§5(2), pp.4-5] Within 120 days of receiving a plan, the Commission would have to approve or reject it. A utility would have 30 days to revise and resubmit a rejected plan, and the Commission would have to approve or reject a revised plan within 30 days. The PSC would have to state its reasons for rejection a plan or revised plan. A utility would have revise and resubmit its plan until it was approved. Performance standards, described below, would still apply to a utility even if the PSC has rejected a utility's plan.

Electric utility performance standards. [§7(1), p.5] Unless a utility is eligible under Section 9 to petition for alternative standards, an electric utility's energy efficiency programs would have to collectively meet the following minimum performance standards:

- Biennial incremental savings in 2008-2009 equal to 0.3 percent of 2007's total annual weather-normalized electricity sales in kilowatt hours.
- Annual incremental savings in 2010 equal to 0.5 percent of 2009's weather-normalized total.
- Annual incremental savings in 2011 equal to 0.75 percent of 2010's weather-normalized total.
- Annual incremental savings in 2012 (and each year thereafter) equal to 1.0 percent of the preceding year's weather-normalized total.

Natural gas utility performance standards. [§7(2), pp.5-6] A natural gas utility would have to meet the following minimum performance standards using energy efficiency programs:

- Biennial incremental savings in 2008-2009 equal to 0.1 percent of 2007's total annual weather-normalized retail natural gas sales in therms.
- Annual incremental savings in 2010 equal to 0.25 percent of 2009's weather-normalized total.
- Annual incremental savings in 2011 equal to 0.5 percent of 2010's weather-normalized total.
- Annual incremental savings in 2012 (and each year thereafter) equal to 0.75 percent of the preceding year's weather-normalized total.

Carry forward credits. [§7(3), p.6] An electric or gas utility could carry forward incremental savings that exceed the applicable standard to satisfy up to one third of the next year's standard. If the utility accepts the financial incentives under Section 11(3), described below, it could not also take a carry forward credit from the same period.

Determination of incremental savings. [§7(4), p.6] Incremental savings for an electric or a natural gas utility for the 2008-09 biennium (two-year period) or any year thereafter would determined by adding the energy savings expected to be achieved during a one-

year period by the efficiency measures installed during the 2008-09 biennium or any subsequent year under any of the energy efficiency programs consistent with the utility's EEPP.

Petitions for alternative standards. [§9, p.7] Two years after beginning to implement its EEPP, an electric utility with (1) up to 200,000 Michigan customers and (2) average rates for residential customers using 1,000 kilowatt-hours per month that are less than 75 percent of the statewide average per a January 1, 2007 PSC compilation could petition the PSC for lowered performance standards. The utility's petition would have to describe how it tried to meet Section 7's efficiency standards and demonstrate why it could not meet those standards with cost-effective programs. A utility that successfully petitioned for lowered standards would lose eligibility for financial incentives under Section 11(3), described below.

Efficiency program cost recovery. [§11(1), pp.7-8] A utility that undertakes approved energy efficiency programs would be able to recover the actual costs of implementing the programs up to overall funding levels specified in the EEPP. Costs exceeding the overall funding levels would also be recoverable if "reasonable." Cost recovery would be accomplished through a tariff rider or other appropriate volumetric charge applied to distribution company rates. To the extent feasible, charges collected from a particular customer sector would be devoted to energy efficiency programs and services for that sector. All distribution customers would pay the cost recovery charges regardless of the source of their electricity or gas.

Revenue decoupling mechanism; approval for spending more than two percent. [§11(2), p.8] [In general, for-profit utilities maximize revenues by selling as much energy as possible. Revenue decoupling, generally speaking, is a ratemaking approach that decouples revenues from sales to some degree to encourage a utility's cooperation with efficiency or conservation programs designed to reduce consumption.]

Under the bill, a utility that annually spends at least 0.5 percent of its total revenues, including electricity or natural gas commodity costs, on PSC-approved efficiency programs would have to be allowed to implement a "symmetrical revenue decoupling true-up mechanism that adjusts for sales volumes that are above or below forecasted levels." Expenditures exceeding **two** percent of total revenues would require PSC approval.

Financial incentives up to 17 percent of expenditures for meeting or exceeding standards. [§11(3), pp.8-9] If an electric or natural gas utility met or exceeded its performance standard under Section 7—and this was documented through a commission-approved program evaluation—the PSC could allow a "financial incentive" of **up to 15 percent** of the utility's actual energy efficiency expenditures (**plus up to 2 percent** more if the utility's EEPP used Michigan-based companies, **for a total of up to 17 percent**) of its actual program expenditures for a given year. The financial incentive would have to be proposed in the utility's EEPP. The incentive could be calculated as a percentage of the net savings customers receive from the energy efficiency programs. The bill provides

that, as a general principle, the highest incentives should be associated with success that exceeds minimum standards or otherwise "demonstrates extraordinary benefits" to customers. A financial incentive would be subject to the requirement that a utility's energy efficiency programs be collectively cost-effective.

Independent administration option. [§13(1), p.9] A utility company could opt out of complying with the previously-described sections of the bill (Sections 5 through 11) by paying a specified percentage of the previous year's revenues to an independent energy efficiency program administrator selected by the PSC. The required payments for both electric and natural gas utilities would be:

- In 2009, 0.75 percent of total utility sales revenues for 2007.
- In 2010, 1.0 percent of total utility sales revenues for 2008.
- In 2011, 1.5 percent of total utility sales revenues for 2009.
- In 2012 and each year thereafter, 2 percent of total utility sales revenues for the preceding year. [The term "weather-normalized" sales, used in Section 7, is not used here.]

Use of funds and carry forward of unspent funds. [§13(2), pp.9-10] The energy efficiency program administrator would use the funds it receives to administer energy efficiency programs for the utility. Funds unspent in any given year would be carried forward to be spent in the next year. [It is unclear whether a utility could subtract funds carried forward from the amount otherwise required to be paid to the administrator the following year.]

Cost recovery of payments to an independent administrator. [§13(3), p.10] A utility would be able to recover the amount of money transferred to an independent administrator through a tariff rider or other appropriate volumetric charge applied to distribution company rates.

Selection of administrator. [§13(4), p.10] The PSC would select a qualified nonprofit organization through competitive bidding to administer energy efficiency programs for utilities that choose to make payments to an independent administrator.

Enforcement of act against utilities, except for municipal and cooperative utilities. [§15, p.10] The PSC would monitor utility performance to ensure compliance with the requirements of the act. If a utility violated the act, the PSC would investigate the reasons for the violation. If due to a lack of good faith effort, the PSC would have to implement regulatory sanctions, such as a reduction in the utility's authorized rate of return.

If a utility failed to meet a performance standard in any particular year, the utility would have to make up the shortfall over the next two years in addition to the required efficiency performance standards in those years.

Application of act to municipal and "member-regulated" cooperative electric utilities. [§17(1)-(2), pp.10-11] Municipally-owned and "member-regulated" electric cooperative utilities would have to comply with Section 5(1) which requires the submission of an EEPP meeting specified requirements. The PSC could recommend changes to the municipal utility's plan. [Unlike other utilities, however, it would appear that a municipally-owned or "member-regulated" cooperative electric utility would not need PSC approval for its plan, nor would it necessarily have to adopt PSC-recommended changes to its plan.] In addition, the performance standards set forth in Section 7 apply to municipal and "member-regulated" electric cooperative utilities, and if not met, the municipal or cooperative electric utility would have to make up the shortfall over the next two years under Section 15(3), as would other utilities. Municipal and "member-regulated" electric cooperative utilities, like other utilities, could opt out of meeting the act's performance standards by making specified payments to an independent program administrator under Section 13.

Enforcement of act against municipal and "member-regulated" cooperative electric utilities. [§17(1)-(4), pp.11-13] The attorney general or a customer could bring an action in a state circuit court for injunctive relief against a municipally-owned electric utility or "member-regulated" cooperative utility if it (1) fails to meet its performance standards under Section 7, (2) fails to make up a shortfall under Section 15(3), or (3) fails to make alternative payments to an independent program administrator under Section 13. The suit would have to be brought in the circuit in which the alleged violation occurred. Before bringing suit, the attorney general or customer of the utility would have to provide at least 60 days' written notice to the municipal utility and the PSC of intent to sue, the basis for the suit, and the relief sought. Within 30 days after receiving written notice of intent to sue, the plaintiff and the governing body of the municipal or cooperative utility would have to meet and make a good faith attempt to determine if a credible basis for the action exists. If both parties agree that a basis for the action is credible, the utility would have to take "all reasonable steps" to comply with the act within 90 days of the meeting.

"Loser pay" provision. [§17(5), p.12] In its final award, the court could award a substantially prevailing party its costs of litigation, including reasonable attorney and expert witness fees. [In other words, if the attorney general or an individual customer lost all or most of its suit against a municipal or cooperative electric utility, the attorney general or individual customer could be ordered to pay the utility's costs of litigation, including attorney and expert witness fees. Conversely, if the attorney general or an individual customer prevailed or substantially prevailed, the utility could be ordered to pay the plaintiff's litigation costs, including attorney and expert witness fees.]

Reporting obligations of municipal and cooperative electric utilities. [§17(6), pp. 12-13] Within one year after the act's effective date, and every two years thereafter, a municipally-owned utility or "member-regulated" cooperative electric utility would have to report to its customers or members, the PSC, and its governing body of the municipality on the following: (1) its expenditures on energy efficiency programs during the previous calendar year, (2) details of each program, and (3) the overall effectiveness of each program. [Although after the first year of the act, these reports would cover two-

year periods, as written, the bill would technically only require a report on the utility's expenditures in the previous year, not the preceding two-year period.]

Large customer efficiency projects. [§19, pp.13-14] A large customer—defined, initially, as one with an electric billing demand of **more than five megawatts**, and after three years, as one with an electric billing demand of more than **two megawatts**—would be eligible to obtain a credit against energy efficiency program charges included in its bill by completing an approved energy efficiency project in accordance with Section 19. [Although the size of a customer's *electricity* demand would qualify it as a "large customer," it would appear that the project could involve either electricity or natural gas.]

A large customer seeking a credit under this section would have to submit an energy efficiency project proposal to the PSC and the relevant utility within 30 days of the effective date of the act. [Read literally, the bill would only allow large customers to submit proposals during the first 30 days after the act took effect. It is unclear whether this is what is intended.] A customer's proposal would have to include a description and documentation of the proposed project, including anticipated project expenditures and expected annual megawatts or megawatt hours or decatherms of energy savings. The PSC would have to approve the large customer project if it would provide new electricity or natural gas savings with a simple payback period of more than one but less than eight years (calculated as project costs divided by annual energy cost savings).

When the project was complete, the large customer would submit verification of its installation and an update of the information submitted in its proposal (e.g., project expenditures and energy savings) to the PSC and the relevant utility. A utility could count the large utility's savings toward its performance standards under Section 7 or 9. A large customer with a completed project would be entitled to a credit against the relevant utility's volumetric energy efficiency program charges that the large customer would otherwise incur under Section 11 or 13 in the year in which the energy project was completed. The amount of the credit would equal the large customer's actual project costs, up to the amount the PSC used to calculate the payback period less an amount representing the cost of the PSC's review of the project, up to four percent of the volumetric charges that the large customer would otherwise incur under Section 11 or 13.

The PSC could develop additional procedures to accomplish the objectives of this section in an efficient and effective manner. As used in Section 19, "relevant utility" means the "utility providing the service the demand for which will be affected by the energy project."

Load management. [§21, p.14] The Commission would have to promote load management in appropriate circumstances, including allowing rate recovery for prudent load management expenditures. "Load management" would mean "measures or programs that decrease peak electricity demand or shift demand from peak to off-peak periods."

Utility statement to customers. [§23(1), pp. 14-15] A utility would have to submit an annual statement to customers in their bills specifying the reduction in electricity or natural gas usage in Michigan attributable to the act during the previous year. [It is unclear whether the utility would have to report the reduction in energy usage only by its own customers in Michigan or by all Michigan customers, no matter who provides their electricity.] The required statement would also have to encourage each customer to compare their usage during the current and preceding year and indicate that the statement was being made to comply with the act.

PSC reports. [§23(2)-(3), p.15] Within one year after the act's effective date, and every two years thereafter, the PSC would have to report to the Legislature about results under the act. The PSC would make copies of the report available to the public, and the Department of Labor and Economic Growth would have to post the report on its website. By March 31 of every odd-numbered year beginning in 2009, the PSC would have to submit a report to the Legislature evaluating the act and suggesting improvements.

Tie bars. [Enacting §1]

House Bill 5525 is tie-barred to the following bills, meaning it will not take effect unless all are enacted:

House Bill 5383 (Brown) (allow electricity co-ops to set rates without PSC approval)
House Bill 5384 (Nofs) (loosen restrictions on municipal utility joint action agencies)
House Bill 5520 (Miller) (limited or no PSC approval of sale of utility generation assets)
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House Bill 5523 (Clemente) (rate increases effective unless PSC approves in 90 days)
House Bill 5524 (Accavitti) (modify choice program)
House Bill 5548 (Mayes) (renewable portfolio standards)
House Bill 5549 (Palsrok) (renewable portfolio standards)

FISCAL IMPACT:

House Bills 5520-5525 are expected to be tie-barred to other pending bills in both Chambers, so this analysis is preliminary. This group of six bills is expected to require the addition of 25 to 30 staff to the Michigan Public Service Commission to administer the new programs and standards and the resulting caseload. The cost of this additional staff is estimated to be \$1.5 million to \$1.8 million, assuming that this many staff can be added to the existing MPSC office space.

Legislative Analyst: Shannan Kane
Fiscal Analyst: Richard Child

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.