



Michigan Energy Policy Recommendations



Continuous Improvement

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Dear State Official:

Manufacturing is a key building block of the Michigan economy. According to the National Association of Manufacturers, “Manufacturers in Michigan account for nearly 19.8 percent of the total output in the state, employing 14 percent of the workforce. Total output from manufacturing was \$92.55 billion in 2015. In addition, there were 598,000 manufacturing employees in Michigan in 2015, with an average annual compensation of \$77,277 in 2015.”¹

However, manufacturing is energy intensive. It requires a significant amount of energy to manufacture vehicles, melt metal, fabricate metal products, produce chemicals, manufacture food and beverage products, plastic and rubber products, furniture, etc. All of these manufacturing activities are used to improve our quality of life.

Although utilities’ manufacturing customers are sophisticated and highly motivated to reduce energy consumption and costs, we simply cannot offset the increasing energy rates in Michigan through energy efficiency alone.

Michigan must do better and the solution is not complicated. In order to achieve competitive energy pricing, Michigan needs:

¹ “Michigan Manufacturing Facts” <http://www.nam.org/Data-and-Reports/State-Manufacturing-Data/State-Manufacturing-Data/October-2016/Manufacturing-Facts--Michigan/>

1. **“Effective” regulatory cost control, and**
2. **Market competition (Electric Choice) where utilities must compete for our business.**

Although Michigan just passed significant energy legislation, it does not mean all is done. Just as we do in the businesses that the ABATE members operate, we encourage the legislature to measure, verify and make continuous improvements where needed. This report summarizes several recommendations that we believe will continue to move Michigan in the direction of reliable, competitive energy supply.

Sincerely,

Rod Williamson

Executive Director - ABATE

Establish Qualifications and a Selection Process for Gubernatorial Appointments to the Public Service Commission

There are several attributes that are essential for a Commissioner to possess in order to be successful:

- Protect all ratepayers and recognize the PSC is the purchasing agent for the utilities' customers. The utilities are provided with a legal monopoly; therefore, the Commissioners are the ratepayers' first line of defense against excessive rates.
- When presenting a rate case, the burden of proof for why an increase is needed should be squarely placed on the utility. The burden of proof should not be on the ratepayers to prove why a rate increase is not reasonable. This is a subtle, but very important distinction.
- The financial health of all rate classes, as well as the utilities, needs to be considered when determining regulations. A Commissioner must understand that his or her role is to ensure regulations and rate cases serve to emulate a properly functioning energy market because of the protected monopoly status the State has provided to the utilities. ABATE does not dispute that it's important to have financially healthy utilities, but it's imperative that the PSC's regulatory actions find a balance so ratepayers are not disadvantaged by having the utilities' business and financial risks unfairly shifted to ratepayers while still providing the utilities a rate of return that compensates utilities for those risks.
- Energy rates must be based on cost of service. It is understandable to utilize a phase-in approach to move towards cost of service rates to avoid sharp increases to any class of customers. However, it is improper to simply refuse to make changes to achieve cost of service rates because it will increase rates for certain customers.

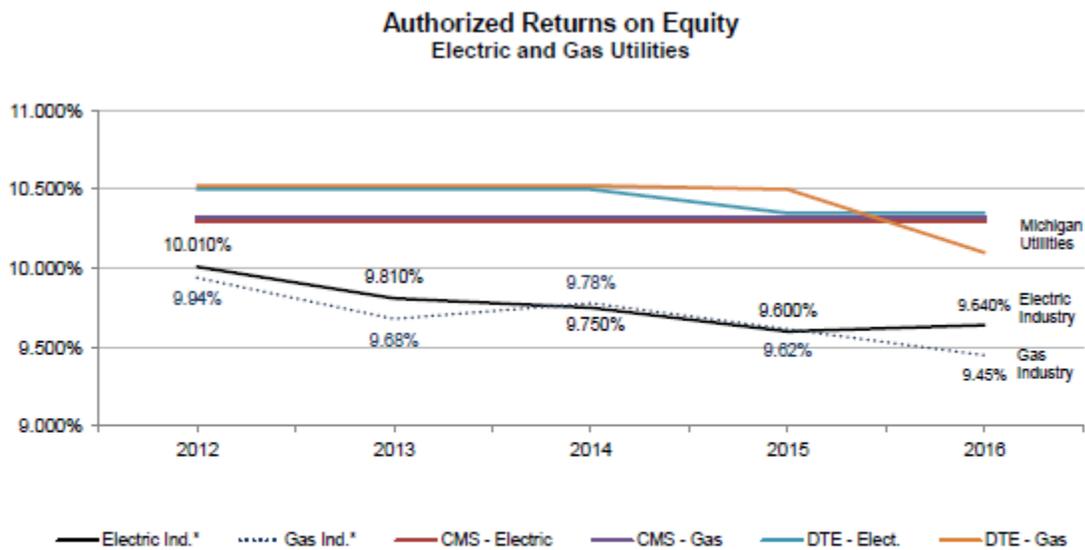
Given the importance and impact that a Commissioner's decision can have on the energy rates and hence the economy of Michigan, it is imperative that we have qualified people serving in these positions.

- ✓ Establish a set of qualifications for Public Service Commissioners.
- ✓ Establish a Public Service Commissioner selection process consisting of:
 - Formation of an independent selection committee that would interview and recommend three possible candidates that meet with Commissioner qualifications
 - Governor selects and appoints a Commissioner from the selection committee candidates.

Stop Utility Over Earning

The energy rates Michigan utilities charge their customers are designed to recover fuel cost, operating and maintenance cost, and the capital utilities spend on things like electric generation, environmental equipment and distribution systems, etc. These energy rates, however, are also designed so that the utilities may collect a return on equity “ROE” (i.e., profit) on the equity/money that they invest in their operation.

As shown in Chart 1 below, the authorized ROEs for Michigan utilities have been approximately 60 basis points to 80 basis points higher than that awarded for similar electric and gas utilities in the United States.



Source and Note:
Regulatory Research Associates, Inc., Regulatory Focus, Major Rate Case Decisions – January - September 2016, October 14, 2016 at pages 5 and 6.
SNL Financial, Electric and Gas Rate Case History, downloaded 1/17/2017.
* The data for 2016 Electric and Gas Industry includes the period Jan - Sep.
Note: CMS - Gas case in 2016 was settled with ROE blackboxed, using 2015 authorized return.

In addition, the actual earned ROE/profit for the utilities has been even higher than what has been authorized by the Michigan Public Service Commission for several years. This has a significant impact because for every 1/10th of a percent above the authorized ROE results in over \$6 million in annual rate increases.

- ✓ Pass legislation that requires the Michigan Public Service Commission to:
 - a) Establish utility authorized rates of return in line with the industry average
 - b) Hold a show cause case which specifically determines the reason and requires corrective action if a utility has over-earned their authorized rate of return for two consecutive years.

Use Actual Cost in Setting Utility Rates

The publicly owned utilities in Michigan are regulated monopolies. As such they are provided the opportunity to recover their costs and earn an authorized rate of return. In setting the customer rates for these utilities, the utilities should be required to use cost information from a historical test year with adjustments for only known and measurable changes. This provides greater protection for customers while still providing cost recovery for the utilities. Allowing rates in recent cases to be set on uncertain, projected cost has only resulted in higher rates for customers and the utilities earning more than their authorized rate of return.

- ✓ Amend Public Act 341 to require utilities to use actual costs, which are only adjusted for known and measurable changes, in setting rates.

Provide Actual Refunds

Although PA341 of 2016 has eliminated the utilities' ability to self-implement rates - which had resulted in the need for many refunds due to overearnings over the past 8 years - there are still instances where customers are owed significant refunds from utility over-charges. The PSC practice for these refunds has been to estimate sales in a prospective month and then calculate a refund factor to be applied to all sales made within that month. This method makes it impossible to return the exact amount of over-charges plus interest to individual customers because of the inevitable mismatch between actual sales in that one month and the over-charges actually paid. This is an unfair result for customers, many of whom have waited long periods of time to receive any refund at all. With available technology, it should be straight forward for an utility to refund to a customer the amount overpaid. Providing actual refunds is both equitable and practical.

- ✓ Amend Public Act 341 to require utilities to issue actual refunds to customers.

Energy Optimization Volumetric Charges

Industrial customers are required to pay a volumetric natural gas energy optimization surcharge under PA342 with no ability to seek an exemption. Even though most manufacturing customers do not even purchase gas from the utilities, this volumetric charge on the delivery of the natural gas has resulted in significant energy optimization natural gas costs for manufacturers. The electricity energy optimization surcharges are a per-meter charge and industrial customers can seek an opt-out of the charges by establishing a "self-directed" energy optimization program. There is no reasonable basis to have a different structure for the natural gas energy optimization surcharge.

- ✓ Amend Public Act 342 to require per-meter natural gas energy optimization surcharges and allow for an industrial customer opt-out

Revenue Decoupling

Advocates of utility “revenue decoupling” believe it will remove economic incentives that work against energy efficiency. The rate design for regulated utilities rewards utilities for selling more energy, while energy efficiency projects result in decreased energy sales. “Revenue decoupling” breaks –or decouples –the link between the amount of energy sold and the revenue realized by utilities, thereby supposedly removing the economic incentives against energy efficiency.

While the theory of revenue decoupling sounds good, the practice has not proven as successful when examined from the customer’s perspective decoupling mechanisms automatically increase customer rates if the utilities’ sales are lower than projected regardless of whether the utility still earned its authorized rate of return. The utility rate case timing process established in Public Act 341 already allows for a timely cost recovery and earnings opportunity for utilities. Thus utilities are able to make adjustments for any lost sales/revenue from energy efficiency efforts as part of their overall utility rate case review. Therefore, there is no need for separate decoupling mechanisms. Additionally, decoupling eliminates sales volume as a factor in profitability and thus removes any incentive to encourage consumers to increase consumption. While supporters of energy efficiency see this as a positive, this is in direct conflict with promoting economic development and especially industrial customer growth. Revenue decoupling also allows energy prices to change between rate cases. This creates more utility cost uncertainty for customers and is especially a problem for industrial customers where even small changes in rates result in significant cost.

- ✓ Amend Public Act 342 to eliminate utilities’ use of revenue decoupling mechanisms for natural gas providers.

Promote Self-Generation / Co-generation

Many industrial customers have a need for both electricity and steam for the operation of their facilities. Electricity and steam generation from co-generation facilities is very efficient. Additionally, many times in order to satisfy the steam demand there is excess electricity generated. Currently, industrial customers are limited to only being able to receive electricity supply from an efficient co-generation facility if that facility is located at their site. This means that even if there are several industrial companies within close proximity to each other, the current law prevents these companies from receiving electricity supply from an off-site centrally located efficient co-generation facility.

- ✓ Amend MCL 460.10a(12) to expand the definition of self-generation to include efficient co-generation that is located off-site within close proximity to industrial customers

Electricity Choice

In 2008, the legislature made significant changes to Michigan’s energy law with the enactment of PA295 of 2008 and PA286 of 2008. PA 286 imposed a 10% cap on participation in Michigan’s “electric choice” program established under PA141 of 2000. In 2017, PA341 was enacted and it established new requirements for retail choice suppliers to ensure generation resource adequacy and reliability. Therefore, there is no reason or need for a cap on participation in retail choice. The utilities should be required to compete against other non-utility suppliers to ensure that electricity rates are competitive. The utilities will continue to provide and profit from their transmission and distribution business (as well as all of the generation business that they win through competition). Additionally, the current cap on electricity choice curtails economic development in Michigan so its elimination will help grow the economy. The 10% cap should be eliminated or at least increased to enable more customers to participate in electric choice.

- ✓ Amend Public Act 341 to eliminate or increase the 10% cap on participation in Michigan’s electric choice program.

Securitization of Early Retirement of Coal Generation Facilities

New EPA rules, such as the Cross-State Air Pollution Rule, EGU MACT, Section 316b regulations, and coal combustion by-products or residue rules are forcing electric utilities to shut down coal-fired generating plants. Substantial savings can be achieved for full service customers (i.e., customers who purchase generation from the utilities) by the utilities utilizing securitization bonds to finance the undepreciated balance of any generating plants that are retired from service, if the decision to retire them is reasonable. Securitization is the process by which a utility, following the issuance of a financing order by the PSC, replaces relatively high-cost debt and equity with lower-cost debt in the form of securitization bonds. These savings will benefit the full-service customers of the utility (i.e. customers who purchase generation from the utilities). Securitization is a financing tool that the utilities have used before. “Securitization provides a mechanism for recovering the Company’s prudently incurred costs at a lower cost to Consumers Energy’s customers than would occur through conventional financing methods.”²

- ✓ Create legislation requiring that Michigan electric utilities utilize securitization bonds to finance the undepreciated balance of any generating plants that are retired from service, if the decision to retire them is reasonable.

² Consumers Energy Company, case U-17473, Witness D. Kehoe, p5