

Michigan's Energy Policy Evolution

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What Happened in 2008?

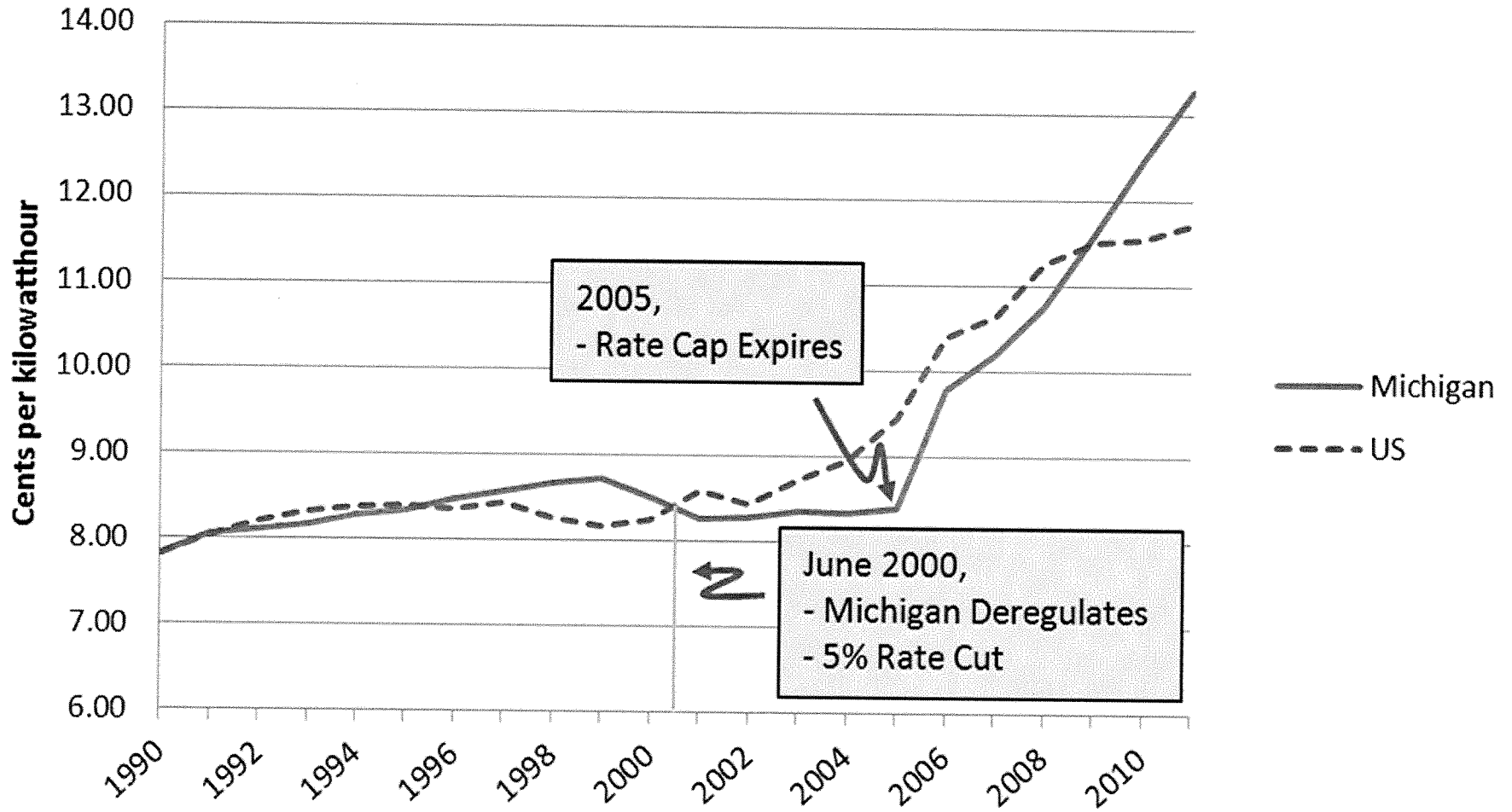
- Some “big” topics in energy policy were addressed with new legislation:
 - Electric market design was changed (PA 286)
 - Likely hear a lot of terms to describe this -- called “Electric Choice” or “10% Cap”
 - Rates = cost of service principles emphasized
 - Certificate of Need process for new plant
 - New requirements for diversifying into specified areas (PA 295)
 - Required 10% of electric generation to come from specified renewable sources by 2015 (note this is an oversimplification)
 - Set annual requirements for “energy optimization” for both gas and electric utilities

Market Structures Generally

- “Fully Regulated” –customers purchase from single utility, which has an obligation to serve them.
 - Rates, long term planning, safety etc. are overseen by government (“regulated”)
- “Restructured” or “De-regulated” – customers may purchase the electricity or gas from any supplier, but a single utility will still be responsible for delivering it to their site via pipes or wires
 - “De-regulated” markets still involve regulation of the monopoly aspects, conformance with specific laws, and monitoring for market manipulation
 - Some “de-regulated” areas actually don’t allow individual customer choice (e.g. Chicago aggregation)

Historical Residential Rates in Michigan and US

(source: EIA)



Michigan's Market History

- Electric: We've tried it all – including the current hybrid structure that is unique in the nation
 - Fully regulated until 2000
 - Fully restructured (deregulated) until 2008
 - But required residential rate cuts were in place 2000-2005, so 3 years when prices not subject to legislative or MPSC regulation
 - At least 90% regulated, up to 10% can “shop” from 2008-present
 - But the UP had a unique exception allowing one territory to be approximately 85% “shoppers.”
- Natural gas is fully deregulated.

What System Lowers Rates?

- There are very good, honest reports arguing both that full regulation or restructuring lowers rates
- Scientifically, not possible to say for sure
 - States that restructured have had much higher prices historically on average; lower cost states didn't switch
 - Many states that restructured had rate caps or cuts for a while to smooth transition
 - The time period when most restructuring in effect coincided with lots of things that affect rates in hard to measure ways (hurricanes, Sept. 11 attacks, severe recession), so hard to say what "causes" rate change

Capacity Issue Interactions

- Ensuring enough “capacity” or supply
 - Will enough companies make hundreds of millions in an investment in a new plant that takes 30+ years to pay off without a guarantee of 30 years of revenues?
 - Will they want to keep running a plant that we only need for a few weeks a year?
 - Will we cede the power to fix any resulting problems to the feds if the answers are “no”?
- These questions need to be answered no matter what system (regulated, restructured, hybrid) is in place.

Cost of Service Principles

- Residential, Commercial and Industrial “Classes”
 - Rates are highest for residential, cheapest for industrial, and commercial in the middle
 - Usage is most stable and largest for industrial (their demand profile matches supply profile most closely)
 - Usage is least stable and smallest for residential users (when you are home vs. not; night vs. day)
- “De-skewing” was part of 2008 law, which was essentially a move away from having any class of user subsidize another class
- PA 169 of 2014 proceedings going on now to re-examine allocation to make sure no cross-subsidizing

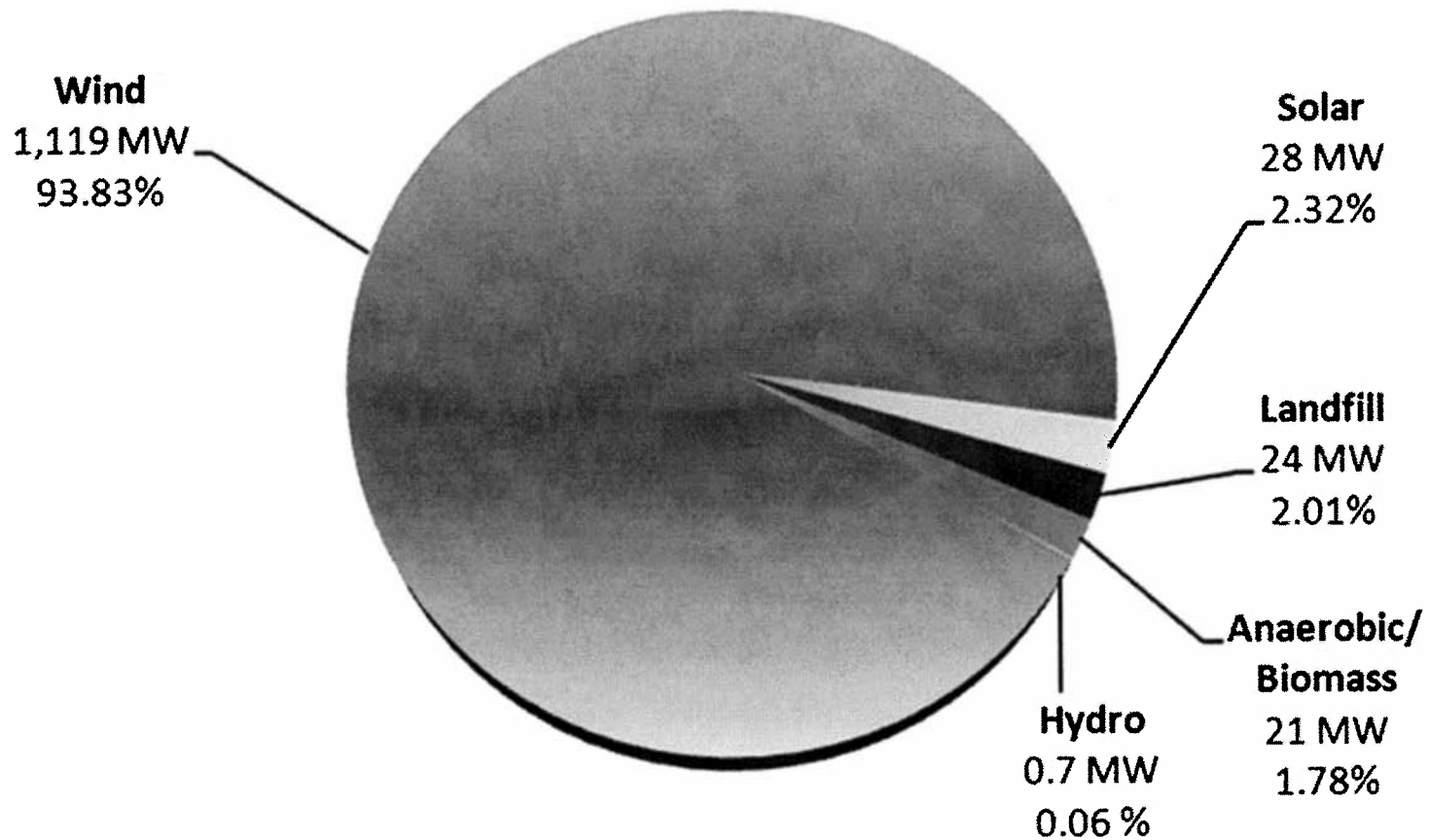
Certificate of Need

- NOT what they argue about in health policy
- When incumbent utilities want to built a new plant and have pre-approved expenditures, they can seek a “certificate of need”
 - Required to show why this is best option (file an Integrated Resource Plan)
 - Used twice – once for Indiana/Michigan’s Cook plant upgrade and once for Consumers Energy (which withdrew and chose to purchase a plant.

Renewable Energy

- 10% by 2015 “renewable energy standard” put in place
 - BUT we won’t actually have 10% of renewable energy in the pie charts in 2015, even though everyone will have complied and every utility was required to comply.
 - “Multipliers” – e.g. use of Michigan materials, labor, solar
 - In-territory mandate; court has criticized constitutionality
- Came in on time and under budget
 - Now no difference in cost for Consumers; much smaller surcharge than permitted by law in DTE

Renewables: What We Built



Energy Optimization

- Reducing energy waste (when costs more to use energy than the steps to avoid using it)
- Mandatory 1% reduction per year electricity; 0.75% gas, but cap on revenues that can be spent (2% of utility annual revenues)
- Michigan's utilities have met or exceeded and are expected to meet near-term EO targets.
- The EO programs in Michigan to date, have been cost-effective. (~2 cents/kWh which is less than 1/3 of the cost of new generation)

Why Incentivize

- Michigan uses 38% more energy (electricity + heating fuel) than national average (combined bills 5% above national average)
- Utilities make money selling electricity, and building facilities to supply it
- It is much cheaper and environmentally friendly for system (as well as user who upgrades) not to need to burn fuel, or build anything
- The best thing we can do for adaptability & reliability is avoid straining the system when we don't need to

Why All the Yoopers on EP?

- Nothing like an overnight hike in your electric bill of 20% to affect your requested committee assignment.
- Only major source of generation in UP, PIPP, slated to close due to enviro regs
- If PIPP didn't exist and no new generation built, would take about \$1B of transmission to replace it
 - Would need approximately \$200M even if PIPP stayed up for basic reliability needs, and to offset Escanaba plant closure
 - So approx. \$500M is a fair comparison

Term Sheets Announced

- Wisconsin Energy sells PIPP to UPPCO
- UPPCO agrees to run PIPP without SSR, because Cliffs (50% of energy demand of UP) agrees to buy from UPPCO until 2020
- In 2020, new plant built on Cliffs site (CHP unit) by Invenergy
- Objections to merger of Integrys and WEC dropped by AG, Gov, and MPSC staff, contingent upon deal going through