

Energy Efficiency Question 9: What have other jurisdictions' energy efficiency programs relied on: mandates, incentives, or both? What has the experience been with mandates and incentives?

Executive summary

1. Michigan uses both mandates and incentives to encourage the effective implementation of energy efficiency. Mandated savings targets began in 2009 and have increased each year till reaching the current level of 1.0% of total annual retail electricity sales and 0.75% of natural gas retail gas sales. In addition, investor-owned utilities are eligible to earn a performance incentive for exceeding mandated savings targets.
2. A common approach across other jurisdictions' energy efficiency programs is to establish savings targets through regulatory or legislative mandates with many mandates allowing for performance incentives for exceeding energy savings targets. Performance incentives help overcome the inherent negative financial disincentive utilities otherwise face by reducing energy sales through their energy efficiency programs.

1. Michigan uses both mandates and incentives to encourage the effective implementation of energy efficiency.

PA 295 mandates that utilities achieve annual savings of 1.0% of total annual retail electricity sales in megawatt hours and 0.75% of natural gas sales. The legislation also outlines how utilities can receive an economic incentive for implementing energy efficiency programs.¹

Utilities can request that energy-efficiency program costs be capitalized to earn a normal rate of return or expensed as operating and maintenance costs. Utilities are also eligible to earn a performance incentive for shareholders if the utilities are able to exceed the annual energy-savings targets established and approved by the MPSC. The total amount of the financial incentive shall not exceed the lesser of the following amounts:

- (a) 25% of the net cost reductions experienced by the provider's customers as a result of implementation of the energy optimization plan
- (b) 15% of the provider's actual energy-efficiency program expenditures for that year (PA 295, Section 75)

Historically, the amount of incentive earned by the eligible utilities has been determined by the achievement of energy savings over and above its target, Beginning in 2013, utilities will be able to earn incentives by reaching various threshold indicators of market

¹ Insert more detailed online citation for PA 295, Section 75

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progress, e.g., low-income savings achievement, percentage of multi-measure installations, increase in number of ENERGY STAR 3.0 Homes constructed. Performance incentives are still subject to the caps described above.

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In **Michigan**, the MPSC uses three attributes as the criteria for a properly designed performance incentive mechanism (PIM): 1) it should provide a utility with a proxy for the return on equity that the utility would receive if the energy efficiency expenditures were capitalized similar to supply side resources; 2) it should incent program performance by providing a bonus for exceeding targets; and 3) it should provide an incentive for optimizing the portfolio of programs.²

There are a number of other states with performance incentive mechanisms including **Minnesota** where the incentive increases as the percentage of savings of retail sales increases. There is no cap on the amount of incentive that may be earned. The incentive is set such that at savings of 1.5% of retail sales electric utilities will earn an incentive of \$0.09 per kWh saved, while gas utilities will earn between \$4.50 and \$6.50 per thousand cubic feet saved. The percentage of net benefits is awarded to each utility at different energy-savings levels that are set at the beginning of each year³.

² <http://efile.mpsc.state.mi.us/efile/docs/17138/0036.pdf>

³ <http://aceee.org/sector/state-policy/minnesota>; Minn. Stat. § 216B.241, subd. l(c) and Docket No. E,G-999/CI-08-13(3).