S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter, on the Commission's own motion, initiating a process to address demand response issues for regulated electric utilities.	))))	Case No. U-18369

At the September 15, 2017 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Sally A. Talberg, Chairman
Hon. Norman J. Saari, Commissioner
Hon. Rachael A. Eubanks, Commissioner

ORDER

History of Proceedings

In the February 28, 2017 order in Case No. U-17990, p. 42, concerning demand response (DR)[1] issues, the Commission observed that "traditional rate setting processes are not particularly conducive to dealing with changes in [DR] program design, spending, and timing. That is, the cost recovery approach through base rates is not sufficiently flexible to account for uncertainties that impact program spending and results." To address this matter, the Commission determined:

[1] The Federal Energy Regulatory Commission defines demand response as "Changes in electric usage by demand-side resources from their normal consumption patterns in response to changes in the price of electricity over time, or to incentive payments designed to induce lower electricity use at times of high wholesale market prices or when system reliability is jeopardized." In short, DR programs incentivize customers to shift electric consumption from times when demand is high (i.e., hot summer afternoons) to times when demand is lower (i.e., nights and weekends). Demand response can benefit all utility customers by deferring or displacing the need for additional generating resources. These programs may involve direct load control, for example, intermittent air conditioning, or may be behavioral programs such as time-of-use-rates.

> [T]he Commission, on its own motion in a separate docket, intends to initiate a proceeding to evaluate potential alternatives to the regulatory review and cost recovery approaches for DR. Among other considerations, the proceeding could examine the impact of new energy laws and whether the energy waste reduction program framework or DR practices in other jurisdictions could serve as a model. Therefore, the Commission will issue a separate order, in the second quarter of 2017, to provide additional guidance for this effort.

Id.

In an order issued on May 11, 2017 (May 11 order), the Commission opened this docket and directed the Commission Staff (Staff) to convene a workgroup dedicated to proposing a framework for the evaluation and cost recovery of DR investments. The Staff was further directed to meet with interested stakeholders and issue a recommendation no later than August 31, 2017. All stakeholders were also welcome to make proposals, recommendations, or comments to the Commission by the same date.

The Commission sought input on the following questions in order to gain a better understanding of the diverse views of a potential DR regulatory framework and to help guide the Staff in forming their discussion topics with the workgroup:

- In what regulatory proceeding should evaluation of DR programs take place and why? In general rate cases, energy waste reduction plans, power supply cost recovery (PSCR), separate proceedings, or elsewhere?

- In what regulatory proceeding should recovery of DR program costs take place and why? In general rate cases, energy waste reduction plans, PSCR, separate proceedings, or elsewhere?

- Should reconciliation of DR program costs be conducted in a similar fashion to renewable energy or energy waste reduction cost reconciliations? If so, in what regulatory proceeding should reconciliation of DR program costs take place and why? In general rate cases, energy waste reduction plans, separate proceedings, or elsewhere?

- Are there successful regulatory models in other jurisdictions regarding DR that would be appropriate for Michigan?

- What portions of Act 341 and Act 342 related to DR require the Commission's most immediate attention?

- What portions of Act 341 and Act 342 related to DR will have the most impact on Michigan utility customers?

- How should DR be considered in energy waste reduction plans as described in Subpart 2-C of 2008 PA 295 as amended by Act 342?

- What safeguards can be built into a DR framework to ensure appropriate tracking and accounting of benefits and costs relative to megawatt savings provided by energy waste reduction programs?

Initial recommendations on the DR discussion were filed by DTE Electric Company (DTE Electric), CPower, Constellation NewEnergy Inc. (Constellation), the Association of Businesses Advocating Tariff Equity (ABATE), Consumers Energy Company (Consumers), Michigan Energy Innovation Business Council (MEIBC), Michigan Electric and Gas Association (MEGA), and EnerNOC, Inc. (EnerNOC). After a series of stakeholder meetings, on August 24, 2017, the Staff submitted a proposed framework for DR program evaluation and cost recovery. On August 31, 2017, DTE Electric, Consumers, and Advanced Energy Management Alliance (AEMA) filed comments and recommendations concerning the Staff's proposal.

Staff Report

In response to the May 11 order, the Staff held four meetings with utilities, alternative energy suppliers (AESs), customer groups, and other energy advocates. The discussion at the meetings centered on the Staff's and others' framework recommendations, an analysis of the DR provisions in Acts 341 and 342, DR issues as they relate to large customers and AESs, and how DR may be considered in conjunction with EWR regulatory processes.

The Staff observed that DR is currently addressed in a variety of proceedings and filings, including rate cases and annual resource adequacy reports. However:

> Public Acts 341 and 342 [Act 341 and Act 342] of 2016, which went into effect on April 20, 2017, established a new process for examining the long-term energy

> outlook for Michigan. The new legislation requires utilities to create and file integrated resource plans (IRP) with the Commission for approval, and those plans are required to consider demand-side resources such as DR. Additionally, PA 342 contains an overhaul of laws regarding energy waste reduction (EWR), which includes certain provisions related to DR.

Staff Report, p. 1.

As a result of its discussions with the various stakeholders, the Staff developed three options for DR evaluation and cost recovery, with one option recommended for addressing DR issues on an ongoing basis. The options the Staff presented are: (1) a three-phase plan based on IRP; (2) integration of DR into the EWR process; and (3) a "business-as-usual" approach.

Under the business-as-usual method, DR would continue to be addressed primarily in general rate cases, with DR costs that are approved in the IRP included in rates as set forth in MCL 460.6t(17). Monthly and annual reporting on DR enrollment, costs, and benefits would continue as directed in Case Nos. U-17936 and U-18013 for the state's two largest utilities. The Staff noted, however, that there were significant shortcomings to this approach, including the absence of a means to evaluate DR between IRP proceedings and the lack of coordination between EWR and rate case proceedings.[2]

Under the EWR integration approach, DR benefit/cost and program design issues would be removed from rate cases and addressed as part of EWR plan and reconciliation proceedings, with DR cost recovery obtained through a DR surcharge. Certain aspects of DR programs, such as dynamic pricing or discounts associated with interruptible rates, would still be included in rate design in rate cases; however, other aspects of DR would be part of EWR cases. The Staff notes

[2] Although DR costs cannot be recovered through EWR surcharges, certain DR technologies, most notably programmable communicating thermostats, serve to reduce both overall energy consumption as well as consumption on-peak. Thus, there may be cost allocation questions between various programs and cost recovery mechanisms.

that the EWR integration approach is fairly straightforward applied to new programs, but the removal of legacy programs that are embedded in base utility rates could prove difficult.

The three-phase approach is a multi-step process where DR proposals, including program costs and benefits, are evaluated in the IRP. Once DR plans are approved as part of the IRP, the DR programs costs are considered approved and are included in rates in a utility's next general rate case. In between IRP proceedings, a provider may propose changes to DR programs or pilots, and these changes will be evaluated and approved in rate cases and must be included in the next IRP. The third phase involves a reconciliation of the DR program costs and customer participation rates (i.e., demand savings achieved) that will occur annually in a manner similar to that used in the provider's EWR reconciliation, with rates and participation reconciled against the levels approved in the IRP. The Staff indicated that it preferred the three-phase plan to the business as usual and EWR integration approaches because: (1) evaluating DR as part of IRP would remove that issue from rate case proceedings; (2) the ability to update DR amounts and costs between IRP proceedings provides necessary flexibility for programs that may scale up quickly or vary significantly from year to year; and (3) the reconciliation process will ensure that DR program costs and benefits align with IRPs, and a reconciliation protects both the utility and customers if costs deviate from the plan due to higher or lower customer participation.

In addition to its recommendations concerning the evaluation of DR programs and costs, the Staff also proposed that the Commission affirm that AESs may offer DR programs to their customers through a curtailment service provider or other third-party as long as the AES, as the load serving entity, bids the DR into the wholesale market. The Staff added that the Commission should also make clear that DR programs offered by AESs are not regulated by the Commission; however, the Commission will review these programs as part of the capacity demonstration

required under MCL 460.6w. Finally, the Staff recommended that, in evaluating the cost-effectiveness of DR as part of the IRP, providers should be directed to include any financial incentive or shared-savings in the cost of proposed DR programs.

Comments

DTE Electric and Consumers comment that they largely concur with the Staff's recommendation to use a three-phase method for DR evaluation and cost recovery. However, both utilities disagree with the need to reconcile previously-approved costs and energy savings resulting from implementation of DR. According to DTE Electric:

> A separate reconciliation proceeding only adds additional filing requirements on the Company and other parties when one of the stated goals of the Staff in the working group was to simplify the filing processes for Demand Response.
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> Furthermore, the tracker proposed by Staff could impact revenue requirements on an annual basis. These impacts have been traditionally addressed in the context of contested general rate cases and the Company proposes to continue with that practice. A tracker of this small magnitude would only complicate, not simplify, the process. The reconciliation process is further complicated by finding the right metric to reconcile against. Demand Response was proposed to be reconciled similarly to the EWR reconciliation process which has a spend and savings target per energy legislation. Demand Response programs are not required as part of existing energy legislation and therefore have no spend, savings or participation targets (nor should they as expanding DR resources may not always provide immediate benefit). The DR programs are designed by the Company based on assumptions such as load enrollment potential, market economics, technology costs, etc. The Company designs, proposes and implements DR programs when the economics to do so are beneficial to both the utility and the customer.

DTE Electric's final comments, pp. 3-4.

Similarly, Consumers contends:

> [I]t should be noted that there is a disconnect between DR target periods and test years used in general rate cases which further complicates any proposed reconciliation of DR costs. The overall DR portfolio costs and participation levels will be determined in an IRP. The IRP will identify these targets on either calendar year or Midcontinent Independent System Operator, Inc. ("MISO") Planning Year

> increments. These DR target periods will make it extremely difficult to conduct any type of reconciliation proceeding which attempts to reconcile DR portfolio costs and participation levels based on the test year of a general rate case when such a test year does not happen to align with a calendar year or a MISO Planning Year.

Nevertheless, if the Commission does determine that a reconciliation is necessary, Consumers suggests that:

> [The reconciliation] proceeding should be conducted on an annual basis, in a non-contested manner, and should be utilized only to report on actual spend for the previous calendar year. This type of proceeding would allow the Commission to effectively implement the authority granted in MCL 460.6t(17). Approval for a particular level of DR will have already been approved by the Commission in the IRP. Adjustments to the planned amount of DR, and corresponding costs, should be accomplished through general rate cases where deviations from planned spending can be addressed and approved.
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> In addition to the above, the Company believes that Staff's Option 1 should be clarified to ensure proper cost recovery and deferred regulatory accounting with return. Therefore, the Company proposes that any difference between actual DR spending and related rate recovery would follow deferred regulatory accounting with return. This would ensure that any over/(under) spending on the overall DR portfolio is fully tracked and recovered over time.

Consumers' final comments, p. 4.

AEMA also agrees with the Staff's recommended three-phase approach to addressing DR, noting that such an approach "allows utilities to make holistic forward planning decisions by considering DR programs alongside traditional supply-side options. This approach recognizes DR's role as a valuable and cost effective capacity resource to satisfying resource planning needs. At the same time, the rate cases afford utilities the flexibility to make changes to DR programs outside of the 5-year planning cycle in IRPs." AEMA's comments, p. 2. However, AEMA posits that it is insufficient to merely establish a framework for DR evaluation and cost recovery without also determining a method by which providers can earn a return on DR or share in the savings from implementing DR. AEMA points out:

> DR will not truly be on equal footing with generation, even if there is comparable consideration in the regulatory process. From a utility's perspective, they are worse off if they invest in a program for which they cannot earn a return than if they invest in a capital project where returns are guaranteed. Given a fiduciary duty to shareholders this may be an imprudent choice for the utility even if it is the best choice for their customers.

AEMA's comments, pp. 2-3. Accordingly, AEMA recommends that the Commission determine some means of ensuring a shared-savings or other incentive mechanism in order to place DR on an equal footing with supply-side resources.

Finally, AEMA concurs with the Staff's recommendations regarding AES offerings of DR through a curtailment service provider or other third party, provided that the AES is the entity that bids DR into the wholesale market. AEMA seeks clarification, however, on whether "an AES could use DR capacity from another AES's customers to meet their forward capacity demonstration, and whether that could be done through the use of a CSP, provided that the AES who contracts for the DR capacity ultimately bids the resource into the wholesale market." *Id.* p. 4.

Discussion

In light of the general consensus on this issue, the Commission adopts the Staff's three-phase approach as outlined in their framework recommendations, with some modification. Regarding the Staff's recommendation that "[a]ll investments and projects in an IRP, including investments in DR resources, will be included in future rate cases as pre-approved, recoverable costs, as long as the utility begins the projects three years after they were approved in the initial plan[,]"[3] the Commission finds that capital associated with DR resources approved in IRPs will be considered prudent and reasonable for recovery, but operations and maintenance (O&M) costs will undergo review and approval in the utility's general rate case.

[3] Staff Report, p. 2.

Reconciliations shall function as described in phase 3 of the Staff's proposal; however, actual capital spending in the examination period will be reconciled against the amount approved in the IRP and recovered in the rate case, while O&M spending will be reconciled against the amount both approved and recovered in the general rate case. These changes ensure that the utility is able to recover the fixed investment required to implement successful DR programs, while allowing the Commission more regular oversight into the ongoing operation of those successful programs. Because the reconciliations provide the necessary review of many new programs that may deviate significantly from the initial plans proposed in an IRP or rate case, the Commission rejects DTE Electric's and Consumers' recommendations to dispense with these proceedings. However, the Commission agrees with Consumers' suggestion that costs associated with DR should follow deferred regulatory accounting with return. To prevent double recovery of costs, deferred regulatory accounting for capital expenditures and O&M is not permitted for items that have been previously approved and already included in rates. A prudence review shall be completed prior to including any deferrals in rates.

Because utilities are not required to file IRPs until early 2019, and are unlikely to file them before the conclusion of the legislation implementation efforts underway by the Commission, an interim mechanism is necessary to bridge the gap between the current, rate case centered and the future, IRP-based regulatory paradigm. As such, the Commission finds that the reconciliation process described by the Staff and approved in this order is a reasonable transition between the present and future. Rather than reconcile capital and O&M costs approved in IRPs and rate cases, respectively, until an IRP is approved by the Commission, there shall be annual, stand-alone reconciliation cases as explained by the Staff, that match actual spending on DR programs with the

amounts approved in the previous general rate cases. This mechanism will apply to all ongoing and future rate case applications.

In addition, the Commission agrees with AEMA that a financial incentive for DR is reasonable and finds that providers and other interested parties may propose appropriate incentives as part of the DR reconciliation proceeding. By establishing incentives before IRP filings, the cost of the incentive will be known, and the parties may avoid litigation of this issue as part of the IRP process. Finally, the Commission affirms AEMA's interpretation concerning the use of curtailment service provider or other third-party by AESs. However, with respect to AEMA's request for clarification regarding the use by one AES of DR capacity of another AES, the Commission finds that this request is outside the scope of this proceeding and will not be addressed in this order.

THEREFORE, IT IS ORDERED that the Commission adopts the three-phase framework for addressing demand response resources as proposed by the Commission Staff and as modified by this order.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, under MCL 462.26. To comply with the Michigan Rules of Court's requirement to notify the Commission of an appeal, appellants shall send required notices to both the Commission's Executive Secretary and to the Commission's Legal Counsel. Electronic notifications should be sent to the Executive Secretary at mpscedockets@michigan.gov and to the Michigan Department of the Attorney General - Public Service Division at pungp1@michigan.gov. In lieu of electronic submissions, paper copies of such notifications may be sent to the Executive Secretary and the Attorney General - Public Service Division at 7109 W. Saginaw Hwy., Lansing, MI 48917.

MICHIGAN PUBLIC SERVICE COMMISSION

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Sally A. Talberg, Chairman

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Norman J. Saari, Commissioner

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Rachael A. Eubanks, Commissioner

By its action of September 15, 2017.

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Kavita Kale, Executive Secretary