Additional Question 8: *What are other states doing regarding rate structures for large volume users?*

Executive Summary

1. States and local governments offer a wide range of economic development incentives to attract new businesses and industries.

2. When deciding where to locate new or expanded operations, the price of energy is one of many factors considered by businesses, though other factors, such as labor costs, taxes, and access to markets, are practically always more important than electricity rates. Several states, including Michigan, have used economic development rates offered by regulated utilities to attract new load through existing or new customers.

3. States and utilities are using Economic Development tariffs to incent short-term increases in new load (through industry attraction or expansion), employment, and capital investment.

4. Economic recovery is also being incented through Brownfield Redevelopment, Urban Redevelopment, and Area Development tariffs.

5. Existing customers can be protected from economic development rates, although it can depend on the specific circumstances. To make economic development rates work without forcing existing customers to subsidize the discounted rates, the utility must bring in new revenue from new load and limit applicability of discounts to the utility's fixed costs that would otherwise be allocated to existing customers.

6. The benefits of the economic development rates can be maintained through a number of rate provisions.

7. Utilities should have the flexibility to determine whether and how to offer such rates with oversight by the MPSC.

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1. **States and local governments offer a wide range of economic development incentives to attract new businesses and industries.**

   Michigan and many states and their local governments have historically offered numerous types of economic development incentives to attract and retain particular companies or industries (bio-medical, film, energy). Incentives include tax credits, infrastructure improvements, special financing, job training, technical assistance, and other tools. Economic research and other analysis has shown that some of these incentives can be costly and/or ineffective in inducing business location or creating jobs, with concerns such as whether the incentives:[1]

   - Exceed the incremental tax revenue (or other economic benefit) associated with the new or expanded business operation
   - Are too high relative to the estimated or actual jobs produced
   - Produce jobs that would not otherwise have come to the state

[1] Tom Foley and Ben Zimmer, "Why Some State Incentives for Business Work—And Others Don't," Wall Street Journal Guest Editorial, February 8, 2013, citing Connecticut Policy Institute, Connecticut Job Creation - Separating Policy from Politics, January 5, 2012. See also, David Brunori, "Principles of Tax Policy and Targeted Tax Incentives," 29 State and Local Government Review 50 (1997); Dennis O. Grady, State Economic Development Incentives: Why Do States Compete? State & Local Government Review, Vol. 19, No. 3 (Autumn, 1987), pp. 86-94. See also, Barry M. Rubin and C. Kurt Zorn, Sensible State and Local Economic Development, Public Administration Review, Vol. 45, No. 2 (Mar. - Apr., 1985), pp. 333-339, available at: www.jstor.org/stable/976155.

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- Promote jobs that will remain viable and stay in-state after the incentives expire

Not all incentives have been problematic, and many states, including Michigan, continue to offer a variety of incentives, financing, and other tools to attract and retain businesses. Michigan has, however, shifted its economic development efforts to reduce emphasis on attracting out-of-state firms through tax abatements and other direct incentives. The state focuses more on "economic gardening," or building and growing businesses that are already in the state.[2] These and related strategies focus on attracting and developing talented and trained workers, making targeted investments that leverage existing assets, and strengthening the link between innovation and manufacturing to increase exports and attract investments.[3]

2. **When deciding where to locate new or expanded operations, the price of energy is one of many factors considered by businesses, though other factors, such as labor costs, taxes, and access to markets, are practically always more important than electricity rates. Several states, including Michigan, have used economic development rates offered by regulated utilities to attract new load through existing or new customers.**

State energy policy is also often crafted to benefit certain industries; for example, policies can promote particular fuels such as natural gas or coal, or incentives or subsidies can be given for large users such as manufacturing facilities. When deciding where to locate new or expanded operations, the price of energy is one of the factors considered by businesses that use large amounts of energy, such as metal smelting, refineries, and heavy manufacturing. A review of utilities in states throughout the Midwest and reports from utilities across the country show a consistent use of economic development rates to attract new or expanded business operations that are energy intensive.

Currently in Michigan, both Consumers Energy and DTE Electric have limited-term economic development rates, or tariff riders, which are designed to attract large new electric loads from existing or new customers. This is done using a sliding scale discount over a limited period of time. The discount is based on the marginal revenue the utility obtains from the new load. The marginal revenue refers to the amount collected in excess of what it collects to serve the additional load. This is similar to a tax abatement where a local or state government offers a credit to attract new business because it will generate tax revenue that otherwise would not exist without the new business.

Consumers Energy also is providing service under a General Service Large Industrial Economic Development Rate E-1. While this rate is closed to new customers, a current customer is receiving service under this rate through November 2015. This rate provided a bundled price for energy supply, which was essentially fixed over the 10-year life of the agreement under the tariff. This allowed the customer to more accurately predict its overall energy costs during this timeframe. But the price paid by other customers has fluctuated as fuel and purchase power costs have changed, and this has resulted in a shift of costs to other customers.

In Indiana, the major utilities have tariff provisions similar to the DTE and Consumers Energy tariffs expiring this year with discounts based on the marginal utility revenue. Indiana's discounts are generally defined with three basic purposes: economic development requiring a minimum increased load and increased employment; urban redevelopment by locating within an existing building which

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[2] Michigan Economic Development Corporation website, available at: www.michiganadvantage.org/Grow-Your-Business/.
[3] See Public Sector Consultants, Inc. and Brookings Institution, *Michigan's Urban and Metropolitan Strategy*, February 2012. Available at: www.pscinc.com/Publications/tabid/65/articleType/ArticleView/articleId/129/Michigans-Urban-and-Metropolitan-Strategy.aspx.

has been unoccupied; and in existing buildings in approved Brownfield redevelopment areas. The Indiana tariffs have a number of related restrictions to limit the availability and term of the discounts.

Alliant's Interstate Power and Light utility in Iowa offers an economic development rider that requires a cost benefit study for any discounts and approval by the Iowa Utilities Board. The discounted rate must as a minimum cover the energy costs and customer costs of serving the specific customer. In Wisconsin, Alliant's Wisconsin Power and Light utility offers an economic development tariff based on the customer receiving state or federal assistance for economic development or economic stimulus. This Wisconsin program is limited by an overall annual subscription limitation.

Minnesota utilities offer a different form of economic development rates. Both Northern States Power and Minnesota Power offer incentives for new load in specific areas. Like other utilities, the discounts are on the demand charges on a sliding scale over time. Demand charges are generally fixed expenses incurred by the utility that do not directly vary with the amount of electricity consumed. Thus, the customer gets a rate discount on this portion while paying standard rates for the actual electricity consumed. The programs are limited and targeted to loads the utilities can cover without significant new capital costs. For example, the utility does not have to build a new generating plant just to serve the new load.

Similar economic development tariffs can be seen on the East and West Coasts. In California, Pacific Gas and Electric is applying to the California Public Utility Commission for a targeted economic development rate that would provide rate discounts for up to five years. In 2011, Florida Power and Light followed the utility trend requesting approval of an economic development tariff to incent businesses to start up, expand, and relocate in its service territory. In New York, the Long Island Power Authority offers special rates for companies that significantly expand operations and/or relocate to certified Empire Zones.

3. **States and utilities are using Economic Development tariffs to incent short-term increases in new load (through industry attraction or expansion), employment, and capital investment.**

There are a number of consistent themes in the Economic Development tariffs being offered.

- First, many of the tariffs have a **limited availability**. In Michigan, both Consumers Energy and DTE Electric require enrollment by October 5, 2013, and American Electric Power's Indiana and Michigan utility had an economic development tariff that closed effective January 1, 2013. In Indiana, Duke Energy had tariff riders that expired December 31, 2012 and Southern Indiana Gas and Electric's tariff expires December 31, 2015. Wisconsin Power and Light's tariff rider is available until December 31, 2014 and limited to a maximum of a $5 million discount. Another tariff limits the availability to a limited amount of load.
- Second, many of the tariffs require a **minimum level of increased employment**. In Indiana, Duke's tariff requires a minimum increase of 25 Full Time Equivalents (FTEs) while Indiana & Michigan's tariff requires only 10 FTEs.
- The third theme is the requirement that the customer make a **minimum new capital investment** to qualify for the rate. In Ohio, Duke's tariff requires a minimum new capital investment of $1,000,000. In Indiana, Duke's tariff requires a minimum of $10,000,000 in new capital investment.
- The fourth theme is a requirement that the tariffs apply to **new load,** that is, an expansion of an existing business or a new business that results in additional electricity to be consumed.

Additional Question 8: *What are other states doing regarding rate structures for large volume users?*

4. **Economic recovery is also being incented through Brownfield Redevelopment, Urban Redevelopment, and Area Development tariffs.**

   States and utilities are also utilizing rate discounts to incent new load in targeted areas, including Brownfield sites, vacant industrial buildings, economic or area development zones of the states. These tariffs have many of the same requirements as the Economic Development tariffs along with additional qualifications on the location of the load.

5. **Existing customers can be protected from economic development rates, although it can depend on the specific circumstances. To make economic development rates work without forcing existing customers to subsidize the discounted rates, the utility must bring in new revenue from new load and limit applicability of discounts to the utility's fixed costs that would otherwise be allocated to existing customers.**

   With the exception of Consumers Energy's Rate E-1, no utility is offering fixed bundled rates for energy as part of their economic development tariffs.[4] The discounts are generally based on demand charges, which are for generally fixed expenses incurred by the utility that do not vary with the amount of energy consumed. In addition, the tariffs require that the load be a **new load** and not a load currently being served by the utility and in some cases not being served in the state. Thus, the customer cannot simply move its existing operations to another location. This is important because without the new load, the utility would not receive any new revenue. And while the rates for new load can be initially discounted, the utility can still collect new revenues to go toward its fixed and variable costs (assuming the tariff is properly designed and the costs to serve the customer do not significantly increase the utility's overall costs). By increasing the total electricity consumed on the utility's system, it allows the utility to spread costs across more units, thereby avoiding rate increases for other customers (assuming costs are held constant).

   A number of the Brownfield and Economic Development tariffs also limit the investment that the utility has to make to connect the customer.

   Other protection for existing customers from cost shifts occurs by requiring that the minimum rate be no less than the cost of service or 105% of the cost of service. The cost of service refers to the specifically identifiable costs the utility incurs to serve the customer. Additionally, some tariffs require a benefit/cost study or a filing of the tariff agreement with the public utility commission. The design and application of economic development rates can be fairly complicated and depend on specific circumstances of the utility and the customer.

6. **The benefits of the economic development rates can be maintained through a number of rate provisions.**

   A general concern with offering an incentive rate is that at the end of the rate term, the benefits obtained by offering the rate will go away (e.g., the new jobs and load will relocate to another area). The currently offered tariffs have a number of provisions to minimize that potential.

   - First, the tariffs generally offer a **decreasing discount** on the fixed cost over a 3–5-year term. A typical discount might be 30% the first year, 24% the second year decreasing until it is 6% in the fifth year. This provision also has the impact of reducing the rate shock for customers as they come off of the discount.

[4] The tariff has a bundled rate that is essentially fixed over the 10-year term. It applied to the total electricity consumed (kWh), without a separate demand charge.

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- Second, the discount is **limited to increased load**. If the load does not materialize or a minimum load is not maintained the discount is not received.
- Third, customers are **required to make long-term capital investments** in the location in order to qualify for the discounted rate.
- Finally, some tariffs include **claw back provisions** of the discounts if the load and employment are not maintained through the life of the contract.

7. **Utilities should have the flexibility to determine whether and how to offer such rates with oversight by the MPSC.**

   Economic development rates for electricity can be a tool to help states attract new business or promote expansions of existing businesses. The impacts of these rates may vary among individual utilities depending on their related cost structures and the details of the rate design. Therefore, it is important that any economic development rate be properly vetted with utilities having discretion to determine whether and how to offer such rates with oversight by the MPSC.