

**To: Karen Gould, Michigan Public Service Commission Staff, Energy Efficiency Section**

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**Date: April 9, 2010**

**Re: Comments on draft EO rules**

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The Natural Resources Defense Council and Environmental Law & Policy Center appreciate the opportunity to comment on the draft energy optimization rules and commends the staff on its work to develop this draft rule. These comments provide some high-level feedback on three particularly important issues: the calculation of avoided costs, the development of reasonable net-to-gross ratios for program evaluation, and verification of savings from self-directed programs. We look forward to providing more detailed comments and continued dialogue on these and other issues covered by these rules as we move forward in the rulemaking process.

### **1) Calculation of avoided costs**

The basis for the avoided cost calculation used in developing energy optimization programs is crucial for a several reasons. There are a number of electric and gas utilities in Michigan which are required to file energy optimization plans and to coordinate their program efforts. If each utility that develops an energy optimization program uses their own unique and markedly different approach to derive their system avoided costs, there could be significant inconsistencies. These differences could dramatically impact energy optimization program designs and service offerings to customers in a similar geographic region. This could introduce confusion, customer hassles, significantly different programs offered by the utilities and program and overall inefficiencies.

As drafted, Rule 39 requires that the provider simply provide a "full explanation" of how its avoided cost calculation was performed. They must also include the underlying assumptions in determining capacity and energy components. If the draft rule is adopted as written, there would be no consistency among utilities and over time as to how the avoided costs would be calculated; it would be solely up to each utilities' discretion and could be manipulated to satisfy their corporate interests. This is a problem and the Commission should establish a clear, consistent, transparent and comparable avoided cost methodology in conjunction with this rulemaking. If adopted in this rulemaking, each utility that submits energy optimization programs and plans would understand and adhere to a Commission approved methodology in developing and managing energy optimization programs.

Language similar to the following (which is now under consideration in another Midwestern state) should be developed in this rulemaking and adopted by the Commission:

1. The utility avoided demand cost shall include the capacity cost of generation, transmission and distribution facilities, adjusted to reflect reliability reserve margins and capacity losses on the transmission and distribution systems, or the corresponding market-based equivalents of those costs. The utility shall describe and document how it developed its avoided demand cost, and the capacity cost chosen shall be consistent throughout the plan.
2. The utility avoided energy cost shall include the fuel costs, emission allowance costs, and variable operation and maintenance costs of generation facilities, adjusted to reflect energy losses on the transmission and distribution systems, or the corresponding market-based equivalents of those costs. The utility shall describe and document how it developed its avoided energy cost, and the energy costs shall be consistent throughout the plan.
3. The avoided probable environmental costs include the effects of the probable environmental costs calculated on the utility avoided demand cost and the utility avoided energy cost. The utility shall describe and document how it developed its avoided probable environmental cost.

## **2) Verified gross and “net to gross” ratios**

The long-term success of this program depends upon the confidence of regulators, customers and all stakeholders that the claimed savings is actually being delivered. Good, credible verification and evaluation methodologies lead not only to increased public confidence in the results, but also guide the development of plan modifications necessary to improve program performance over time.

It strains credibility to the breaking point to assume that every measure planned is actually distributed, and that every measure distributed is actually installed. Yet, the draft rule suggests that in the first year reconciliation proceeding, the evaluators should assume the unverified gross savings were actually achieved. Verification of measure installation is a very basic part of any evaluation, and only verified gross savings should be claimed even in the first year of the program.

After a reasonable start-up period of one year, the collaborative should be charged with setting net-to-gross ratios that further refine the actual savings attributable to the programs. Net-to-gross ratios take into account "free riders" or program participants who would have invested in a given measure even without the utility program as well as "free drivers" and "spillover" (i.e., persons who implement efficiency measures due to the direct influences of the program but aren't counted as official "participants" ...e.g., don't claim a rebate), where such effects can plausibly be attributed to a program. A net to gross ratio is applied to verified gross program savings to determine the program's net impact.

Once a program evaluation has occurred and a net-to-gross ratio for a given program has been established, it is appropriate to use that ratio to establish deemed savings estimates for the program going forward.

For new programs for which there are no evaluation results to rely upon, results from similar programs in other states can be used until sufficient in-state evaluation results are available.

### **3) Verification of self-directed program savings**

PA 295 requires careful oversight by the Commission to ensure that the anticipated savings from self-directed programs actually occur. Specifically, the statute requires that measures be “implemented” and savings “achieved” prior to savings being attributed to the relevant provider’s energy optimization plans. *See* PA 295, Sec. 93(6). Customers are not exempt from EO charges until they “begin[] to *implement*” a self-directed plan at a site. *Id.* Sec. 93(7) (emphasis added). A fair verification process is important from a public interest perspective because both the utility and the customer benefit from a higher savings claim – even if such savings never actually occur.

Thus, the Commission has explicitly required staff to “assure that the third party contractor for the energy optimization credit program verifies the implementation and energy savings of self-directed projects before issuing energy optimization credits for these projects.” (*See* U-15805 Final Order at 31). Rule 46(h) addresses this objective by requiring an independent evaluation of self-directed program savings. This evaluation must include verification of whether or not customers have “actually implemented the measures indicated in their plans.” Rule 46(h)(iii).

Strong evaluation and verification provisions for self-directed savings must remain in the final rule in order to maintain public confidence and accountability in Michigan’s energy optimization programs. Although this necessarily will involve some additional work and expense, the rules allow utilities to charge self-directed customers a fee to cover such administrative burdens. This is fair because these costs are caused by the special treatment these customers receive under the statute.

Sec. 93(8) requires self-directed customers to file a report every two years, but also requires these customers to “promptly notify the provider if the customer fails to achieve incremental energy savings as set forth in its self-directed plan for a year that will be the first year covered by the next biannual report.” PA 295, Sec. 93(8). This “self-enforcement” approach does not provide sufficient protection of the public interest. Fortunately, the Commission is provided with broad discretion to establish different terms and conditions for service for self-directed customers. *See* PA 295 Sec. 93(3). The Commission should use this authority to require annual reporting of savings by self-directed customers in order to promote greater efficiency and accountability and facilitate a fair and accurate verification process.

Finally, the rules do not clearly spell out the process for someone other than the customer to initiate a process to terminate self-direct plans. This should be addressed in the next draft of the rules.