

Myths and Facts about Industrial Opt-Out Provisions

Even though industrial energy efficiency programs offer tremendous benefits, some states allow large customers to opt out of them. When large customers stop participating, both the utility and the customer suffer the consequences of using and paying for more energy than necessary. The lost opportunity and the consequences of passing industrial opt-out provisions into law are often misunderstood by both policymakers and large energy users. The following discussion outlines four common myths and facts that address these misconceptions. The facts may be particularly useful in states where good programs exist, yet arguments are still made in favor of industrial opt-outs. Bear in mind, however, that in states where utility programs are not effective, the first priority must be to improve them.

Myth 1. *Large energy users will invest in all cost-effective energy efficiency on their own as a matter of good business practice.*

FACTS

- While industrial firms have continued to become more energy efficient per unit of product output, most have many cost-effective energy savings opportunities that they have not captured.
- Large business customers report that their capital investments, including those in energy efficiency, must realize a very short (one- to two-year) payback requirement, which means that many cost-effective projects will not be initiated.
- Through incentives and rebates, utility programs address this “payback gap.” An industrial customer would not normally invest in an energy efficiency improvement project with a four-year payback, but with a utility program rebate to cover some of the costs, the four-year payback could be reduced to two years, meeting the customer’s short payback requirement.
- Companies do not invest in all cost-effective projects. They have limited capital, and decisions about which projects to fund are influenced by many variables including budget allocations, strategic priorities, and



market realities. In this environment, program incentives improve the competitiveness of an energy efficiency project as an investment option within an organization.

Myth 2. *Utility programs are not responsive to the needs of large industrial customers.*

FACTS

- Many utilities operate successful programs for industrial customers that consistently add value and contribute to utility program success. In a recent DOE report, four vastly different industrial companies gave testimonials demonstrating the business value they gained from participating in their utilities’ energy efficiency programs.¹
- In states where utility programs are not responsive, policymakers should require utilities and program administrators to fix broken program models by incorporating best practices to ensure programs effectively respond to the needs of the industrial customer class.

¹ US Department of Energy, Sustained Energy Savings Achieved through Successful Industrial Customer Interaction with Ratepayer Programs: Case Studies. (Washington, DC: 2015). www4.eere.energy.gov/seeaction/publication/sustained-energy-savings-achieved-through-successful-industrial-customer-interaction.

- In situations where traditional energy efficiency programs cannot meet the needs of particular customers (sometimes the largest and most energy-sophisticated firms), states may consider developing alternative options, such as self-direct energy efficiency programs that measure and verify energy savings.
- Some companies that exit utility programs end up unsatisfied and opt back in to regain the benefits of participation. In 2008, large customers in Michigan were given the choice to leave traditional efficiency programming and self-direct their energy efficiency funds. Over the next few years, more than one-third of the customers that originally opted out changed their minds and rejoined the utility programs in recognition of the benefits of full participation.

Myth 3. *Participation in efficiency programs creates a competitive disadvantage and may force companies to relocate to other states.*

FACTS

- Since energy efficiency program costs typically represent only about 2% of total electricity costs for a firm, and since electricity costs typically represent about 5% of a firm's cost of doing business, the existence of a surcharge for energy efficiency programs cannot realistically be considered a strong determinant of manufacturing competitiveness on a state-by-state basis.
- There are no empirical data that companies make decisions to relocate or go out of business based on the incremental cost of an energy efficiency program surcharge.
- Large customers are more significantly impacted by the prevailing rates utilities charge—which make up a more substantial portion of their bills—than they are by efficiency charges.
- Good efficiency programs can help states retain businesses. For example, Nissin Brake, an Ohio manufacturer of automotive parts for companies such as Honda and Harley Davidson, used energy efficiency to stabilize costs in otherwise unstable times. As the auto industry fluctuated in recent years, so did Nissin Brake's production demands. With help from AEP Ohio's Business Incentive program, the company cut costs and reduced annual energy consumption by 801,921 kWh. The utility incentive covered 30% of project costs and reduced the payback period from 2.8 years to 1.9 years.²

² AEP Ohio, Energy Efficiency Steadies Cash Flow for Auto Parts Maker. www.aepohio.com/global/utilities/lib/docs/save/business/programs/SuccessStories/Nissin_Brake_Case_Study.pdf.

Myth 4. *Costs will stay the same for small businesses and residential customers if large energy users are allowed to opt out of energy efficiency programs, so there is no harm in letting them do so.*

FACTS

- For virtually any utility system, large-customer energy efficiency is the cheapest energy resource available (typically 2 cents/kWh or less). If that resource is not captured, then the utility system will have to procure more expensive resources, which will result in higher costs than necessary for all customers. There is indeed “harm” to all customers if large customers are allowed to opt out and those energy efficiency resources are not captured.³
- There is also an important equity issue. Energy efficiency is an energy resource—just like transmission and distribution lines and power plants. No customer or group of customers would be able to refuse to pay for a new power plant. All customers pay, and all benefit. Similarly, all customers should pay for the energy efficiency resource. When some customers are allowed to opt out and not pay for an energy resource, all other customers have to pay more.
- The electricity saved directly displaces the need for more power plants or more transmission and distribution upgrades, saving money for all customers. Those who opt out gain the system benefits without paying for them, creating a free-rider fairness issue.

DEFINING OPT-OUT AND SELF-DIRECT

A true opt-out is different from a policy that allows large energy users to self-direct funds for energy efficiency. Opt-out provisions typically provide a full exemption from energy efficiency program surcharges and remove any requirements to achieve savings through energy efficiency. Self-direct policies typically allow customers to control some or all of how their energy efficiency fees are used and include some kind of accountability for energy efficiency savings. There are various approaches to self-direct programs, but the best examples are highly structured with substantial oversight. Well-structured self-direct programs achieve documented energy savings that are at least equivalent to what would have been saved through participation in traditional utility program offerings.

³ M. Molina, The Best Value for America's Energy Dollar: A National Review of the Cost of Utility Energy Efficiency Programs (Washington, DC: ACEEE, 2014). aceee.org/sites/default/files/publications/researchreports/u1402.pdf.