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2011 State Energy Bill Saves Large Natural Gas Users Millions in Energy Costs

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Energy costs are on a very short list of critical business climate issues for many Minnesota manufacturers that have real estate needs in Minnesota. Manufacturers that are large users of natural gas had a significant legislative victory this year. After many years of state energy policy decisions that did little to help manufacturers with their energy costs, the legislature took a major step to reduce energy costs for large natural gas users.

The 2011 omnibus energy bill gives large natural gas users an opportunity to petition for an exemption from paying Conservation Improvement Program ("CIP") charges on their natural gas and electricity use. That exemption has been available for years for large electricity users like mining companies, paper companies and refineries. If the exemption petitions filed with the Office of Energy Resources in the Minnesota Department of Commerce are granted, the new exemption will save manufacturers millions of dollars a year starting in January 2012.

The CIP program has existed for decades and is designed to require utilities to collect funds from energy users which the utilities then use to provide energy efficiency incentives to their customers. The 2011 legislature recognized that the program achieved no benefits when applied to large energy users who are driven by market forces to invest in energy efficiency. Taking money from them as an energy cost and returning

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vsome of it back as an incentive was not justified, particularly in a time when policymakers are looking for ways to increase manufacturing jobs.

The ethanol industry provides a perfect example of why the legislature's action is the right policy for Minnesota. As large consumers of energy, ethanol facilities are financially driven to implement energy conservation and efficiency improvements independent of the utility CIP programs. Minnesota-mandated CIP charges negatively affect ethanol facilities' competitive position in the ethanol marketplace. Other than corn costs, energy costs are the largest expense of producing ethanol. The combined impact of energy costs on total facility costs and the competitive and economic pressures facing the facility make energy conservation and efficiency a fundamental focus of ethanol facility operators.

Like almost all manufacturers, ethanol facilities face tremendous competitive and economic pressures. Ethanol industry economics are primarily driven by market prices for ethanol and the two key inputs to ethanol production—corn and energy. Unpredictable and volatile market forces impact each of those factors. In addition, tremendous growth in ethanol production capacity has created a very competitive marketplace for ethanol.

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Ethanol production capacity has been growing dramatically in recent years and, according to the United States Department of Agriculture, the U.S. is on track to surpass Brazil as the world's largest ethanol exporting country this year. As recently as 2008, the U.S. imported over one-half billion gallons of ethanol worth $1.25 billion to meet its fuel needs. By 2010, the U.S. produced 13.2 billion gallons, meeting U.S. demand for the first time becoming a net exporter producing $825 million in export revenues.

Increased demand spurred industry growth. Minnesota has been a leader in ethanol production. Minnesota ethanol production increased from 252 million gallons in 2001 to over 1.1 billion gallons in 2010. Minnesota used 239 million gallons of ethanol in 2010, a number that hasn't change significantly in 10 years. The vast majority of Minnesota-produced ethanol is now exported out of the state for use in other markets.

In competitive environment like that, a government-mandated CIP program is not needed to encourage a manufacturing facility to focus on productivity and cost control. Ethanol facilities are constantly assessing management practices and process changes that can reduce facility costs. Since energy use is the highest cost of producing ethanol after corn costs, facilities spend tremendous time and resources on identifying, evaluating and implementing projects to reduce energy use.

Minnesota manufacturers have historically enjoyed energy costs that provide a cost advantage over some competitors. That advantage has diminished in recent years. The Legislature and Governor deserve credit for creating a CIP exemption option for large natural gas users. For the sake of our manufacturing economy, let's hope they find more improvements in coming years.

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