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House Bill 4478 as enrolled
Second Analysis (7-31-87)

Sponsor: Rep. Ken Sikkema
House Committee: Public Utilities
Senate Committee: Energy

THE APPARENT PROBLEM:

Under Public Act 304 of 1982, the Public Service Commission (PSC) must review contracts between electric utilities and cogenerators or small power producers every year (for up to 35 years) during the period in which the project is operational. Since these reviews (called "cost reconciliation proceedings") also are "contested cases", the annual reviews allow legal challenges by interested parties and can result in the commission changing the rates set in the original supply and cost review.

Kent County decided to build a garbage disposal incinerator, using garbage as a fuel to generate 22 megawatts of electricity. In order to finance the project, the county negotiated a contract to sell excess electricity to Consumers Power Company. After the PSC approved the contract, a coalition of businesses challenged the rate decision at the annual hearing, asking the commission to specify in the rate statement that the Kent County rate could not serve as a precedent when Consumers Power converts its failed Midland nuclear power plant into a gas-fired co-generating facility. Kent County believes that this challenge to its approved contract with Consumers Power Company not only has nothing to do with the proposed Kent County facility, but that it jeopardizes the very completion of that facility. The county has asked for legislation that would forestall such challenges, which jeopardize the future of co-generation projects, by eliminating the annual review for certain co-generation and small power producing facilities.

THE CONTENT OF THE BILL:

The bill would amend the Public Service Commission (PSC) enabling act (as amended by Public Act 304 of 1982) so as effectively to prohibit annual legal challenges of contracts between utility companies and certain cogeneration or small power production facilities once the PSC had approved the initial contracts.

The Public Service Commission enabling act (Public Act 3 of 1939) allows the PSC (a) to review a utility's plans for securing electric power supplies, (b) to grant a power supply cost recovery clause in a utility rate schedule, and (c) to conduct an annual power supply cost reconciliation proceeding, that is, an annual review of a utility's costs versus what it charged customers. The act specifies those costs which may and may not be recovered by the utility. Under present law, if a utility contracts to buy power for periods of more than six months, the PSC may not take into consideration (must "disallow") any capacity charges beyond that six months in setting rates unless the utility has obtained prior approval from the commission.

The bill would exempt small power production facilities (plants generating fewer than 80 megawatts) or cogeneration facilities (power generating facilities owned jointly by non-utility companies and regulated utilities) that qualified under the federal Public Utilities Regulatory Policies Act (PURPA) from having to obtain such prior approval from the PSC in order to have capacity charges associated with power purchased for more than six months considered in their annual power supply cost reconciliation. If the PSC approved capacity charges in a contract between a qualifying facility and a utility company, it could not disallow these charges in the power supply cost reconciliation review for at least 17.5 years (or for the duration of the financing in the case of those facilities whose primary power source was a renewable resource such as garbage, wood, water, or wind). Even if a contract between a qualifying facility and a utility were later vacated or changed, the capacity costs in the original contract would continue to remain in force unless a court stay or suspension of the original contract had been obtained by a dissenting party within 30 days of the PSC order approving the contract (or, for orders issued after September 1, 1986, if the contract had not been challenged with 30 days of the effective date of the bill). Except for approvals granted before the effective date of the bill, initial hearings on capacity charges would have to be conducted as contested case hearings.

The commission would be able to decide on the scope and manner of the review of capacity charges for qualifying facilities, and every five years after the bill was enacted the standing legislative committees on public utilities would be required to review this amendment to the act.

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BACKGROUND INFORMATION:

Public Act 304 of 1982. In the wake of the rapidly escalating, unpredictable costs of fuel that followed the oil embargo in the early 1970s, the Michigan legislature in 1972 allowed regulated utilities to pass along increased fuel and power costs to their customers by increasing their rates without prior review by the Public Service Commission. This was done in the form of "adjustment" clauses which the PSC incorporated into the utilities' basic rate schedules. These clauses let utilities buy fuel from suppliers at whatever price was demanded and then pass on most or all of the increased costs to their customers in monthly charges over and above the base rates established by the PSC.

In 1981, Consumers Power Company predicted that winter heating bills would jump 50 percent when the contract signed several years earlier by one of its principal suppliers brought expensive imported liquified natural gas (LNG) from Algeria to Consumers' customers. Because of the "purchased gas adjustment" clause policy, this anticipated rate increase would not be subject to PSC review and approval or disapproval. Although the shipments of Algerian LNG were delayed, the Michigan Citizens' Lobby initiated a legislative petition drive to eliminate automatic fuel adjustment clauses. This became "Proposal D" on the 1982 fall ballot. In response to the urging of the utilities, the state Senate introduced a competing proposal, Senate Bill 72 ("Proposal H"), that also addressed the issue of automatic rate increases. Meanwhile, a legislative task

force had been working since 1978, with little progress, on developing a comprehensive set of utility regulation reforms. Faced with the prospect of two ballot issues designed to stop the automatic pass-through of rising energy costs, the legislature passed House Bill 5527 (which became Public Act 304 of 1982) to forestall the possible consequences of the passage of either or both of the ballot proposals.

Public Act 304 prohibited regulated utilities from using automatic adjustment clauses to recoup costs of purchased gas, fuel, or electricity. Instead, it provided for "gas cost recovery" (GCR) and "power supply cost recovery" (PSCR) clauses in utilities' rate schedules which require PSC review and approval. (The act also created a utility consumer participation fund and a utility consumer participations board to carry out statutory requirements.)

Under the act, in order to recover an increase in gas and power supply costs, an electric or gas utility must file a gas or electric cost recovery plan describing the utility's expected sources and quantity of gas and electric power and the changes in cost anticipated over a 12-month period. At the time of the filing of the plan, the utility also must submit a 5-year forecast of the gas and electric requirements of its customers, its anticipated sources of supply, and projections of cost.

Once the plan and forecast is filed, the PSC conducts a hearing ("proceeding") to evaluate the reasonableness and prudence of the plan and to establish recovery "factors" (the amount of additional charges the utility will be able to bill its customers over and above its base rates in order to "recover" increases in energy costs). This hearing is a "contested case", that is, a hearing at which the PSC staff, the Attorney General's Special Litigation Division, and others may participate through legal counsel. At this time, legal challenges may be raised to the proposed plan, forecast, or PSC determination of recovery factors.

Finally, the act requires the PSC to conduct an annual review (called a "cost reconciliation proceeding") of each cost recovery plan within three months of the end of the 12-month period covered by the plan. At this hearing, which also is a "contested case" (that is, allowing legal challenges), the PSC reviews the "reasonableness and prudence" of expenses charged to customers by the utility. If the PSC determines that the utility's "reasonable and prudent" actual expenses are less than what was charged to its customers, the utility will be required to refund these overcharges to its customers. Thus, for example, if the PSC finds that the utility bought energy from a supplier when cheaper sources were available elsewhere, it could adjust the utility's rates accordingly and require the utility to refund its customers the difference and lower its rates over the next 12-month period based on these cheaper sources of available energy.

The Public Utilities Regulatory Policies Act (PURPA). Congress enacted the Public Utilities Regulatory Policies Act in 1978 to bring about "increased conservation of electric energy, increased efficiency in the use of facilities and resources, and equitable retail rates for electric customers." (16 U.S.C. S 2601(1)) Under PURPA, a utility is required to buy excess electricity from co-generators at a price that it would have had to pay to generate the same electicity in its own modern coal-fired plant. State public utilities commissions are prohibited from discriminating among PURPA-qualified facilities when setting rates.

FISCAL IMPLICATIONS:

The House Fiscal Agency reports no fiscal implications to the state. (6-3-87)

ARGUMENTS:

For:

Without this bill, the future of all cogeneration projects — and the attendant economic benefits to the state — are in jeopardy.

Co-generation and small power plants are electric plants built and operated by municipalities and private industry. For these projects to be developed and financed, project owners need to be assured that once they have signed a contract to sell power and once that contract has been approved by the PSC, it will not be changed. In annual rate case hearings, however, various groups have threatened to challenge or begun challenging these contracts every year even though the PSC had previously approved them. These intervenors try to prohibit the utility from recovering from their ratepayers the amounts they pay under such contracts ("capacity charges" for the excess electricity produced by the cogenerators). If the utilities cannot recover the amounts they pay co-generators and small power producers, the utilities will attempt to recover the shortfall from the co-generator or small power producer by changing the price negotiated in the contract. For some small projects, a decrease in the negotiated contract price could bankrupt the company.

Co-generation and small power plants are good for Michigan's economy. They provide competitively priced energy at greater efficiency and lower cost than do traditional utility power plants. They do not put the risks of development, schedule delays, and operational problems on the ratepayer, and they also prevent "rate shock" by incrementally matching demand rather than overproducing to meet estimates of future demands. In addition, some plants use renewable resources, such as waste wood and hydroelectric power, which conserve depletable resources, keep fuel dollars in Michigan, and support the Michigan wood products industry. Those plants that use garbage, in waste-to-energy plants, also provide a partial solution to Michigan's solid waste problem.

The threat of constant challenges to the contracts between cogeneration facilities and utility companies complicates the financing of alternative energy projects in Michigan. If intervenors are allowed to continually challenge PSC-approved contracts between cogeneration facilities and utility companies, financing for alternative energy projects will be difficult, if not impossible, to get, and all of the benefits of these projects will be lost to the state and the people of Michigan.

Response: It is unrealistic to set a rate for 17.5 years at a time. Within this time period, new technologies allowing for more efficient and less expensive production of power could be developed. And if cheaper sources of power became available during this time, the capacity charges set at the initial hearing surely should be revised. In any case, the regulatory function of the PSC should be continued. In an open market, a consumer who buys the same or a similar product over a period of time continually compares the product with other producers' products and decides which product to buy at what price. In a regulated market, the consumer has little or no choice of whose product to buy at which price, so the regulatory agency must provide this price-oversight function. The bill would limit that consumer-advocacy role of the PSC.

Against:

The bill, in effect, would reinstate the automatic adjustment clause that the citizens of the state of Michigan so clearly and unequivocally rejected in their vote on the two ballot proposals in the fall of 1982 and that Public Act 304 of

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1982 was specifically designed to eliminate. The bill would break faith with the voters by automatically charging electric customers with capacity charges set forth in cogeneration contracts with utilities, so long as the charges had once been approved by the PSC and would take away for nearly two decades the customers' right to an annual hearing on the reasonableness and prudence of utility power supply expenses.

Response: The bill would not reinstate the automatic adjustment clause. In the first place, rates still would be set by the PSC in the initial contract approval, which would be conducted as a contested case hearing. Secondly, the bill would apply only to capacity charges for PSC-approved contracts between utilities and PURPA-qualified facilities. All the bill would do is assure cogeneration facility developers that capacity costs would be paid over the life of the contract and ensure that special interest groups could not hold economic growth in Michigan hostage to their crusade against Consumers' Midland plant.

Against:

It is difficult, if not impossible, to get a stay or suspension within 30 days. Most courts don't even begin to consider requests for rate case stays or suspensions until after 30 days, simply because of the preliminary paperwork necessary. By setting a 30-day deadline on obtaining a court-ordered stay or suspension of a rate order, the bill effectively eliminates any legal challenges to rate orders even if an initial hearing is held.

Response: Although it is true that most rate cases are not taken up within 30 days of filing, the courts are more likely to respond more quickly if a 30-day deadline is present. This occurred, for example, in the late 1970s with regard to the public utilities securities act, which has a similar 30-day limit.

Against:

The bill could have a disastrous financial impact on ratepayers, and thus of course on the state economy as a whole. The potential impact of cogeneration contracts on electric rates is extremely significant. The Tondu capacity rate will cost Consumers Power's customers $13-22 million per year in excess of the projected cost of purchasing power from other sources, and the contract will remain in effect for 35 years. The Kent County contract will cost Consumers Power ratepayers an extra $10 million or so per year. If the Midland Cogeneration Venture were to be approved at the Kent County rate, this 1300-megawatt facility would cost ratepayers an extra 25-32 percent over current electric rates. Under the bill, this stunning rate increase could be automatically imposed, without a hearing ever being held on the reasonableness and prudence of the Midland Cogeneration Venture capacity rate.

Response: In the first place, it is not the case that the costs of the failed Midland plant would necessarily be passed on to ratepayers, for the bill still allows an initial rate hearing, at which time concerned parties could express their positions. If, moreover, the PSC were to approve a rate for the Midland cogeneration facility that a particular party believed to be unreasonable, that rate could be legally challenged. In addition, however, the bill has a provision that allows the PSC to decide on the scope and manner of the review it holds on capacity charges for PURPA-qualified facilities, so the unique situation of the Midland plant could be addressed by the commission at the appropriate time.

Against:

To ensure that Midland does not "slip through" with this bill, the bill should be amended to specify that it applies only to facilities of a certain size. For example, the PSC has suggested that the bill apply to facilities generating no more than 80 megawatts, which would exempt the Midland facility.

Response: Such an amendment could be in violation of federal law, which prohibits state public utility commissions from descriminating among PURPA-qualified facilities when setting rates.