SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

House Bill 4478 (Substitute H-1 as reported without amendment)
Sponsor: Representative Ken Sikkema
House Committee: Public Utilities
Senate Committee: Energy

Date Completed: 6-22-87

RATIONALE

Public Act 304 of 1982 amended the Public Service Commission enabling Act to require the Public Service Commission (PSC) to 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 "power supply cost reconciliation proceedings") also are "contested cases", the annual reviews allow legal challenges by interested parties and can result in changes to the rates established in the original contract approval.

Kent County currently is building a garbage disposal incinerator, which will use 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 PSC 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 cogenerating facility. Kent County officials believe not only that this challenge to its approved contract with Consumers Power is irrelevant to the proposed Kent County facility, but that it jeopardizes the completion of that facility. Some people feel that legislation should be adopted to forestall such challenges, by eliminating the annual review of capacity charges for certain cogeneration and small power producing facilities.

CONTENT

The bill would amend Public Act 3 of 1939 to provide that if the Public Service Commission (PSC) approves the capacity charges of a contract between a qualifying facility (a cogenerator or less than 80 megawatt power plant) and a utility company, the PSC could not disallow capacity charges in its annual power supply cost reconciliation review. The contract would be considered valid, and capacity charges pursuant to the contract would be considered to be recoverable costs for rate-making purposes, even if the contract were later vacated, modified, or held invalid, unless the PSC order approving the contract were stayed or suspended by a court within 30 days of the date of the order, or within 30 days of the bill's effective date for orders issued after September 1, 1986.

Public Act 3 of 1939 allows the PSC to review a utility's plans for securing electric power supplies, grant a power supply cost recovery clause in a utility rate schedule, and conduct an annual power supply cost reconciliation proceeding (an annual review of a utility's costs versus what it has charged). The PSC determines in the proceeding those costs that can be included in cost recovery. The Act lists a number of allowable costs that can be included in cost recovery, and lists a number of costs that cannot be included. Among the costs that the PSC is required to disallow are capacity charges associated with power purchased for periods in excess of six months, unless the utility has obtained prior approval from the PSC.

The bill would require the standing committees of the Senate and the House that deal with public utilities to review the bill, five years after its effective date.

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BACKGROUND

Public Act 304 of 1982

In the wake of the rapidly escalating, unpredictable fuel costs following the oil embargo in the early 1970s, the 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 PSC. This was done in the form of "adjustment" clauses which the PSC incorporated into the utilities' basic rate schedules. These clauses permitted utilities to buy fuel from suppliers at demanded prices and then pass most or all of the increased costs on to customers in monthly charges beyond the base rates established by the PSC.

In 1981, Consumers Power predicted that winter heating bills would jump by 50% when a contract that had been signed several years earlier by one of its principal suppliers brought expensive imported liquified natural gas (LNG) from Algeria to Consumers' customers. This anticipated rate increase was not subject to PSC review and approval, however, because of the "purchased gas adjustment" clause policy. Although the shipments of Algerian LNG were delayed, the Michigan Citizens' Lobby initiated a 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 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 amended the PSC enabling Act to prohibit regulated utilities from using automatic adjustment clauses to recoup costs of purchased gas, fuel, or electricity.

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Instead, it provided for "gas cost recovery" and "power cost recovery" clauses in utilities' rate schedules which require PSC review and approval. (The Act also created a utility consumer participation fund and a utility consumer participation board to carry out statutory requirements.)

Under the Act, in order to recover an increase in gas and supply costs, an electric or gas utility must file a gas or electric cost recovery plan describing the utility's expected source and quantity of gas and electric power and the changes in cost anticipated over a 12-month period. At the time of filing the plan, the utility also must submit a five-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 are filed, the PSC conducts a hearing to evaluate the reasonableness and prudence of the plan and to establish recovery "factors" (the amount of additional charges for which the utility will be able to bill its customers over and above its base rates in order to "recover" increases in costs). This hearing must be conducted as a "contested case" at which the PSC staff, the Attorney General's Special Litigation Division, and others may participate through legal counsel, and 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 "power supply 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 must be conducted as a contested case, the PSC reviews the "reasonableness and prudence" of expenses charged to customers by the utility. Charges to customers are divided into several groups, including "capacity charges" (i.e., charges to customers for the costs of providing power) and "energy charges" (i.e., charges to customers for fuel costs). If the PSC determines that the utility's actual expenses are less than that amount charged to customers, the utility is required to refund those overcharges to its customers. Thus, for example, if the PSC found 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 it 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, when a utility buys excess electricity from a cogenerator, it is required to pay the price that it would have had to pay to generate the same electricity in its own plant (capacity costs). State public utilities commissions are prohibited from discriminating among PURPA-qualified facilities when setting rates.

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

ARGUMENTS

Supporting Argument

The future of all cogeneration projects — and the attendant economic benefits to the State — are in jeopardy. Cogeneration and small power plants often are built and operated by municipalities or small private industry. In order for these projects to be developed and financed, project owners wish 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 or have begun to challenge cogeneration contracts each year, even though the PSC previously had approved them. These interveners attempt to prohibit utilities from recovering from their ratepayers the amounts paid under such contracts (capacity charges for the excess electricity produced by the cogenerators). If the utilities cannot recover the capacity charges they pay to cogenerators and other small power producers, the utilities will attempt to recover the shortfall from the cogenerator 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.

Cogeneration facilities and small power plants are beneficial to Michigan's economy. They provide competitively priced energy at greater efficiency and lower costs 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 future demand estimates. 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 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 continual challenges of PSC-approved contracts between cogeneration facilities and utility companies are allowed, financing for alternative energy projects will be difficult, if not impossible, to obtain, and the benefits of these projects will be lost to the State and the people of Michigan.

Response: It is unrealistic to set a rate in the present time for a contract that could extend for 35 years (the period of time during which the PSC must annually review a contract between electric utilities and congenerators or small power producers). Within the lifespan of that contract, new technologies could be developed allowing for more efficient and less expensive production of power. If that were the case, then capacity charges certainly should be revised. Moreover, the regulatory function of the PSC should be continued. In an open market, a consumer who purchases the same or a similar product over a period of time, continually compares the product with other producers' similar products and decides which product to buy at which 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.

Opposing Argument

The bill, in effect, would reinstate the automatic adjustment clause that the citizens of Michigan rejected in their vote on the two ballot proposals in the fall of 1982 and that Public Act 304 of 1982 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, as long as the charges had once been approved by the PSC, whether or not a hearing had ever been held on the reasonableness of such charges.

The bill not only would eliminate the customers' right to an

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annual hearing on the reasonableness and prudence of utility power supply expenses, it would remove the right to any hearing on the reasonableness and prudence of capacity charges under cogeneration contracts.

Response: Rates would not be adjusted automatically, without PSC review, as under the automatic adjustment clause; rather, they would be set in the initial contract approval, for which the PSC could hold a hearing. Also, the bill would apply only to capacity charges for approved contracts with PURPA-qualified facilities, not to regulated utilities in general, and not to other types of charges. The bill simply would reassure cogeneration facility developers that capacity costs would be paid, under the initially approved contract, over the life of the contract; and that special interests couldn't hold their development projects hostage to crusades against Consumers Power's Midland plant.

Opposing Argument

Just because the law would allow an initial hearing would not thereby guarantee that such a hearing actually were held. The PSC has approved only four cogeneration contracts: Viking, Hillman, Kent County, and Tondu Energy Systems. No hearing of any kind was held with respect to three of those four contracts. The bill effectively would remove the protection to consumers of guaranteed public hearings that exists in present law.

Opposing Argument

It is difficult, if not impossible, to obtain 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 necessary preliminary paperwork. By setting a 30-day limit on obtaining a court-ordered stay or suspension of a cogeneration contract approval, the bill would eliminate any legal challenges to rate orders even if an initial hearing were 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 quickly if a 30-day statutory deadline is imposed. Neither legal challenges to nor PSC review of rate orders would be eliminated; the bill simply would prohibit disallowances of capacity charges for approved cogeneration contracts.

Opposing Argument

The bill could have a disastrous financial impact on ratepayers, and thus on the State economy as a whole. The potential impact of cogeneration contracts on electric rates is extremely significant. The Tondu capacity rate reportedly could cost Consumers Power's customers $13 million to $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 reportedly could 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 reportedly could cost ratepayers an extra 25%-32% 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: It is not true that the costs of the failed Midland plant necessarily would be passed on to ratepayers; the bill still would allow an initial rate hearing, at which time concerned parties could express their positions. Moreover, if the PSC were to approve a rate for the Midland cogeneration facility that a particular party believed to be unreasonable, the rate could be challenged legally. In addition, the bill includes a provision that would allow 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 PSC at the appropriate time.

Opposing Argument

To ensure that the Midland plant does not slip into the bill's provisions, the bill should be amended to specify that it applies only to facilities of a certain size. For example, it has been suggested that the bill be amended to apply to facilities generating no more than 80 megawatts, which would exclude the Midland facility and other large facilities.

Response: Such an amendment could be in violation of Federal law. Under PURPA, state public utilities commissions are prohibited from discriminating among PURPA-qualified facilities when setting rates.

Legislative Analyst: P. Affholter
Fiscal Analyst: L. Burghardt

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.