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BILL ANALYSIS

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Senate Bills 1331 through 1336 (as introduced 7-1-04)

Sponsor: Senator Bev Hammerstrom (S.B. 1331)

Senator Bruce Patterson (S.B. 1332 & 1334)

Senator Jud Gilbert, II (S.B. 1333)

Senator Dennis Olshove (S.B. 1335)

Senator Virg Bernero (S.B. 1336)

Committee: Technology and Energy

Date Completed: 8-4-04

CONTENT

The bills would amend the Customer Choice and Electricity Reliability Act. **Senate Bill 1331** would do the following:

- Allow customers purchasing electricity from an electric utility as a tariff service on the bill's effective date to continue to receive tariff service, elect to receive an alternative electric service, or receive default supply service.
- Set a deadline by which an alternative electric service customer could return to tariff service; and require a customer who returned to an electric utility but did not meet the deadline to do so under default supply service.
- Delete provisions related to the Public Service Commission's (PSC's) review and adjustment of stranded cost recovery charges and securitization charges.
- Require the PSC to ensure that rates for tariff services or retail open access services were established at a level that provided for full and complete recovery of all reasonable and prudent costs, including the costs of maintaining a minimum 15% reserve margin, and costs associated with a utility's compliance with decommissioning, environmental, energy efficiency, and securitization funding requirements.
- Provide that an electric utility required to offer retail open access service would be entitled to collect transition charges during the transition period; and provide that specific customers would have to pay transition charges.
- Allow an electric utility providing retail open access service to recover transition charges retroactive to 2002.
- Require an electric utility to file tariffs and existing service rule amendments that established the methodology for calculating transition charges within 30 days after the bill's effective date; and require the PSC to issue orders approving tariffs and service rules within 90 days after the bill's effective date.
- Require an electric utility to file tariffs that allowed it to collect transition charges from eligible customers that did not take retail open access service or alternative electric service.
- Allow an electric utility to add any PSC-approved surcharges to the bills of alternative electric service customers.
- Revise a provision requiring a utility to file an application with the PSC to unbundle its existing rate schedules.
- Delete a requirement that a utility provide standby generation service

for open access load until the rate caps are lifted.

- Allow a utility providing low income and energy efficiency funding to recover that funding from customers in its service area.
- Delete a requirement that the orders issued under the Act include the provision of reliable and lower cost competitive rates for all customers in this State.

Senate Bill 1332 would require the PSC, within 90 days after the bill's effective date, to establish electric supply reliability standards for all electric utilities and alternative electric suppliers, including standards to maintain a minimum 15% planning reserve margin over peak demand, and to meet the utility's or supplier's supply resource requirements through self-supply and contracts to purchase generation supply. The bill also would require the PSC to establish financial reliability standards for alternative suppliers.

Senate Bill 1333 would require the PSC to approve a low income and energy efficiency factor payable by every customer receiving a distribution service from a gas or electric utility, regardless of the identity of the customer's gas or electric generation supplier, and would limit the funding to 2% of each utility's commercial and industrial revenue.

Senate Bill 1334 would require each electric utility to file a tariff that would enable schools to purchase electric power and energy at a discounted rate; and provide that the PSC could not disallow recovery of these rates in a rate-making adjustment.

Senate Bill 1335 would include in the term "qualified costs" an electric utility's capital and operating and maintenance costs of complying with State and Federal mandates regarding emissions.

Senate Bill 1336 would allow an electric utility to apply to the PSC to recover its costs of complying with emissions mandates via an environmental compliance recovery surcharge, which

would be payable by every customer receiving a distribution service from the utility, regardless of the identity of the customer's electric generation supplier.

The bills are tie-barred to each other. They are described below in further detail.

Senate Bill 1331

Choice of Service

The bill would allow customers purchasing electricity from an electric utility as a tariff service on the bill's effective date to continue to receive tariff service, elect to receive an alternative electric service, or receive default supply service.

The bill also would allow customers purchasing an alternative electric service on the bill's effective date to return to tariff service when their existing agreement expired if the customer notified the electric utility by December 31, 2004, of the intent to return, and returned to tariff service by December 31, 2005. If the customer did not provide the required notice or return to tariff service by the specified dates, the customer would have to return to the electric utility service under default supply service.

The bill would delete a provision requiring that rates for retail customers who remain with or leave and later return to an incumbent electric utility to be determined in the same manner as rates were determined before rate caps were put in place, after the expiration of the rate cap period.

"Electric utility" means a person, partnership, corporation, association, or other legal entity whose transmission or distribution of electricity is regulated by the PSC. The term does not include a municipal utility.

The bill would define "tariff service" as services provided to customers by an electric utility as defined by its rates on file with the PSC; the term does not include alternative electric services or default supply service.

"Alternative electric service" would mean the provision of electric generation service to customers by an alternative electric supplier. Currently, "alternative electric supplier" means a person selling alternative electric

service to retail customers in this State. The term does not include a person who physically delivers electricity directly to customers, and an alternative electric supplier is not a public utility. The bill would retain this definition but refer to a person, other than an electric utility, selling alternative service to retail customers.

"Default supply service" would mean electric energy procured in the wholesale electric market (as described below).

Default Supply Service

The bill would require each electric utility, within 30 days of the bill's effective date, to file a tariff or tariffs that gave eligible customers the ability to receive default supply service. For the purposes of this provision, "default supply service" would mean electric energy procured in the wholesale market. The price of default supply service would have to include a utility's actual cost of obtaining the electric energy, retail open access tariff charges, and other applicable charges, including transition charges. The PSC would have to approve the tariff or tariffs within 90 days of the bill's effective date. A utility's only obligation would be to use reasonable efforts to procure energy for the provision of default supply service.

Reasonable & Prudent Cost Recovery

The bill would require the PSC, in any proceeding to establish rates and charges for tariff services or retail open access services, to ensure that rates for such services were established at a level that provided for full and complete recovery of all reasonable and prudent costs.

The PSC would have to include all of the following reasonable and prudent costs in establishing rates for tariff services:

- Generation-related costs, investments, and cost of capital necessary to serve the tariff customers' load, including the costs associated with the electric utility maintaining a minimum 15% reserve margin.
- Costs, investments, and costs of capital directly or indirectly associated with the provision of the tariff services, including transmission, distribution, and customer service.

- Costs associated with the electric utility's compliance with decommissioning, environmental, low income and energy efficiency, and securitization funding requirements.
- Any transition charge revenue the electric utility collected in establishing rates for tariff service.

The PSC would have to include both of the following reasonable and prudent costs in determining rates for retail open access services:

- Costs, investments, and cost of capital directly or indirectly associated with the provision of retail open access services, including transmission, distribution, and customer service.
- Costs associated with the electric utility's compliance with decommissioning, environmental, low income and energy efficiency, and securitization funding requirements.

In determining the rates, the Commission could not consider any other revenue, costs, investments, or costs of capital to the electric utility that were not associated with the provision of tariff service or retail open access service.

Stranded Cost Recovery & Securitization Charges

The Act requires that the PSC annually issue an order approving for each electric utility a true up adjustment to reconcile any overcollections or undercollections of the preceding 12 months to ensure the recovery of all amounts of net stranded costs, after a contested case proceeding. The PSC must review the utility's stranded cost recovery charges and securitization charges implemented for the preceding 12 months, and adjust the stranded cost recovery charge, by way of supplemental surcharges or credits, to allow the netting of stranded costs. The bill would delete these requirements, as well as various provisions related to the determination of net stranded costs and modifications to the securitization charge.

(Under the Act, the PSC was required to issue a "financing order" that authorized electric utilities to issue securitization bonds for the recovery of "qualified costs".

Qualified costs and stranded costs are described in **BACKGROUND**, below.)

Transition Charge

The bill provides that an electric utility that is required to offer retail open access service would be entitled to collect transition charges during the transition period. (The bill would define "retail open access service" as those services provided by the electric utility that were necessary for the transmission and distribution systems to function so that eligible customers located in the utility's service area could receive alternative electric services. Retail open access services would have to include standard metering.)

For purposes of this provision, "transition charge" would mean a charge or charges expressed in cents per kilowatt hour or as otherwise provided in the bill, calculated twice annually according to a formula described in the bill. "Transition period" would mean the period beginning on the bill's effective date and continuing until tariff rates for all classes of customers produced equal rates of return as determined by the PSC, or 120 months after the bill's effective date, whichever was longer.

Within 30 days after the bill's effective date, the electric utility would have to file all necessary tariffs and amendments to existing service rules that established the methodology for calculating transition charges to be paid by each customer or groups of customers receiving alternative electric service or default supply service. Within 90 days after the bill's effective date, the PSC would have to issue orders approving the tariffs and service rules, upon a finding that they conformed to the bill.

Customers receiving alternative electric service or default supply service, and eligible customers in the utility's service area that did not take retail open access services but that took electric power or energy from an alternative electric supplier or directly from a supplier other than the utility, would be required to pay the transition charge. Customers obtaining self-service power or energy or engaging in affiliate wheeling would not be required to pay a transition charge for that portion of the power or energy considered to be self-service power

or affiliate wheeling (as those terms are defined in the Act).

The bill would require an electric utility to file tariffs that allowed it to collect transition charges from eligible customers in its service area that did not take retail open access services but that electric power or energy from an alternative electric supplier or directly from a supplier of electricity other than the utility. The charges would have to be calculated for the period of time that the customer would be obligated to pay transition charges if it were taking retail open access services. The transition charges could not result in a modification to the securitization surcharge. The PSC could not adjust or changing securitization charges it authorized in a financing order under Section 10i of the Act as a result of its review and any action taken under the bill.

The electric utility's tariff and service rules would have to establish the methodology for calculating transition charges for each group of customers as defined by the electric utility. The utility's tariffs also could provide for the calculation of transition charges on a customer-specific basis for all customers with a maximum demand of 1,000 kilowatts or greater at a single location in the 12-month period immediately preceding the date of establishing alternative electric service.

Interim Transition Charge

An electric utility that provided retail open access service during 2002 through the bill's effective date would be entitled to recover transition charges for those years or partial years, and any accrued regulatory assets as of the bill's effective date, through an "interim transition charge". (That term would mean a charge to recover transition charges for all years from 2002 through the bill's effective date and any accrued regulatory asset associated with the implementation of retail open access.)

The interim transition charge would have to be calculated according to the transition charge calculation, and be recovered from all customers during the transition period.

PSC-Approved Surcharges

The bill provides that an electric utility would be entitled to add to the bills of all

customers receiving an alternative electric service any PSC-approved surcharges, including securitization charges, environmental compliance surcharges, low income and energy efficiency surcharges, and decommissioning surcharges.

Subsidy Elimination

The bill would require the PSC, upon its own motion or upon an electric utility's application, to initiate a proceeding to redesign the utility's rates to eliminate any and all subsidies in the cost of providing service to its various classes of customers, during the transition period. A motion or application would have to require the utility to file testimony and exhibits supporting its proposed rates for each customer class based on fully allocated costs of service. The proposed rates would have to be designed so that all customer classes produced equal rates of return. The PSC would have to require that the utility publish notice of the application within 30 days from the filing date. An order approved by the PSC to redesign rates would have to be issued within 180 days from the filing date.

Unbundled Rate Schedules

The Act required each electric utility, by June 5, 2001, to file an application with the PSC to unbundle its existing commercial and industrial rate schedules and separately identify and charge for their discrete services. Under the bill, within 90 days from its effective date, each electric utility would have to file an application with the PSC based on its current cost of service to unbundle its existing rate schedules and separately identify and charge for the discrete services.

The PSC would have to require that the utility publish notice of the application within 30 days after the filing date. The PSC would have to issue its order unbundling the rate schedules by December 31, 2005.

Standby Generation Service

The bill would delete a provision under which an electric utility is obligated, with PSC oversight, to provide standby generation service for open access load on a best efforts basis until December 31, 2001, or the date established under Section 10d(2), whichever is longer.

Under Section 10d(2), on and after December 31, 2003, rates for an electric utility with at least 1 million retail customers in this State as of May 1, 2000, may not be increased before December 31, 2013, or until the PSC determines that the utility meets a market test under the Act and has completed required transmission expansion, whichever is earlier. The rates for commercial or manufacturing customers of an electric utility with at least 1 million retail customers with annual peak demands of less than 15 kilowatts may not be increased before January 1, 2005. There may be no cost shifting from customers with capped rates to customers without capped rates as a result of this requirement. In no event may residential rates be increased before January 1, 2006 above the rates established under Section 10d(1).

Under Section 10d(1), the PSC was required to establish the residential rates for each electric utility with at least 1 million retail customers in this State as of May 1, 2000, that resulted in a 5% rate reduction from the rates that were authorized or in effect on May 1, 2000. The rates became effective on June 5, 2000, and remained in effect until December 31, 2003.

Low Income & Energy Efficiency Fund

The bill would allow a utility that is providing funding for the Low Income and Energy Efficiency Fund created under Section 10d(7) to recover that funding from all customers within its service area within any final order issued in a general rate proceeding order in an amount and for the remaining funding period the PSC originally established under that section.

(Under Section 10d(7), the PSC administers a Low Income and Energy Efficiency Fund to provide shut-off and other protection for low-income customers and to promote energy efficiency by all customer classes. If securitization savings exceed the amount needed to achieve a 5% rate reduction for all customers, then, for six years, 100% of the excess savings, up to 2% of the utility's commercial and industrial revenues, must be allocated to the Fund.)

School Aggregation

The bill specifies that a school district aggregating electricity for school properties

or an exclusive aggregator for public or private school properties would not be an electric utility or public utility for the purpose of that aggregation.

Senate Bill 1332

Reliability Standards

Within 90 days after the bill's effective date, the PSC would have to establish electric supply reliability standards applicable to all electric utilities and alternative electric suppliers that provided electric supply to retail customers in this State. The PSC would have to require each utility and alternative supplier to file annually an electric supply plan demonstrating that it was in compliance with the standards. The PSC annually would have to verify each plan's adequacy to assure that it met the minimum standards. The standards would have to be uniformly applied to electric utilities and alternative electric suppliers, and would have to include the following:

- That the utility or supplier maintain a minimum 15% planning reserve margin over and above its forecasted peak load demand.
- That the planning reserve margin requirement be for a minimum of one year.
- That the electric supply resources of the utility or supplier be required to satisfy deliverability standards established by the PSC to ensure that the supply resources were capable of being delivered to the load serving entity's retail customers without jeopardizing supply reliability.
- That the utility or supplier could use direct load control options as a means of satisfying the minimum planning reserve margin requirements to the extent that the direct load control options met applicable regional electric utility reserve standards.
- That the electric utility or alternative electric supplier have entered into all electric supply resource commitments before April 1 for that year's peak load period (the months of June, July, and August).

The standards also would have to include that each electric utility and alternative electric supplier meet its total electric supply resource requirements through self-supply

and contracts to purchase generation supply. Until the PSC determined that a proper electric capacity market existed in this State or region, electric supply resources would have to be tied to physical generating assets, whether through ownership or contracts. If the resources were tied to physical generating assets by contract, the contracted output of the assets would have to be solely dedicated to the load service entity and meet the deliverability standard described above.

Financial Reliability Standards

Currently, the PSC must order an applicant for licensure as an alternative electric supplier to post a bond or provide a letter or credit or other financial guarantee in a reasonable amount established by the PSC of at least \$40,000, if the PSC finds after an investigation and review that the bond requirement is in the public's best interest. The bill would delete this requirement.

Under the bill, the PSC would have to establish financial reliability standards applicable to all alternative electric suppliers that were licensed to provide electric service to customers in Michigan. The standards would have to require the supplier to demonstrate that it had sufficient financial resources for the services it sought to provide. An alternative electric supplier would have to demonstrate to the PSC that it had done both of the following:

- Completed an audited financial statement demonstrating that it had a net worth of at least \$5 million, or obtained a letter of credit or other equivalent credit instrument acceptable to the PSC of at least \$1 million or 20% of the amount of the supplier's revenue for the sale of electricity for the most recently completed fiscal year, whichever was greater.
- Complied with all other additional financial safeguards the PSC determined were necessary to protect electric retail customers in this State.

Senate Bill 1333

The bill would require the PSC, after notice and hearing, annually to approve a low income and energy efficiency factor that would be a nonbypassable surcharge payable by every customer receiving a

distribution service from a gas or electric utility, regardless of the identity of the customer's gas or electric generation supplier. The funding could not exceed an amount equal to 2% of each utility's commercial and industrial revenue.

The PSC would have to administer the distribution of the funds and direct that the funds received from the customers of a gas or electric utility be used only to provide energy and conservation assistance to low income and senior citizen customers living in the utility's service area.

The bill would define "gas utility" as a natural gas company subject to PSC jurisdiction under Public Act 9 of 1929.

Senate Bill 1334

The bill would require each electric utility, within 30 days of the bill's effective date, to file a tariff to provide schools receiving electric service at secondary voltage levels the ability to purchase electric power and energy from the utility at a rate 20% lower than the utility's otherwise applicable tariff in effect on the bill's effective date.

Schools receiving electric service at primary voltages and above would have to have the ability to purchase electric power and energy from the utility at a rate 10% lower than the utility's otherwise applicable tariff in effect on the bill's effective date.

The PSC would have to approve the tariff within 60 days of the filing date. The PSC could not adopt any rate-making adjustment that disallowed recovery of, or otherwise imputed the amount of revenue attributable to, the rates for electric service to schools.

Under the bill, "school" would mean buildings, facilities, playing fields, or property directly or indirectly used for school purposes for children in grades kindergarten through 12, when provided by a public or nonpublic school. The term would not include instruction provided in a private residence or proprietary trade, vocational, training, or occupational school.

Senate Bill 1335

Currently, the term "qualified costs" means an electric utility's regulatory assets as determined by the PSC, adjusted by the

applicable portion of related investment tax credits, plus any costs that the PSC determines that the utility would be unlikely to collect in a competitive market, including retail open access implementation costs, and the costs of a PSC-approved restructuring, buyout or buy-down of a power purchase contract, together with the costs of issuing, supporting, and servicing securitization bonds and any costs of retiring and refunding the electric utility's existing debt and equity securities in connection with the issuance of securitization bonds. Qualified costs include taxes related to the recovery of securitization charges. The bill would retain this definition, but include the utility's capital and operating and maintenance costs of complying with all Federal or State government laws, rules, regulations, and standards regarding emissions from its electrical power generating facilities.

Senate Bill 1336

The bill would allow an electric utility to apply to the PSC to recover its capital and operating and maintenance costs of complying with all laws, rules, regulations, and standards enacted or promulgated by the Federal or State government regarding emissions from its electrical power generating facilities in this State through an environmental compliance recovery surcharge. The PSC would have to require the utility to publish notice of the application within 30 days of the filing date.

The PSC would have to issue an order approving the surcharge if it determined that the costs allowed under the bill were reasonably and prudently incurred. In its order, the PSC would have to designate a period for recovery of the environmental compliance costs, including a reasonable return on the unamortized balance, over a period not to exceed the remaining economic life of the affected facility. The surcharge could never be less than zero.

A PSC order approving a surcharge would have to be issued within 180 days from the filing date. In its initial application, the utility would have to state the laws, rules, regulations, or standards of the Federal or State government that required the costs to be incurred, the costs that were incurred broken down by project, evidence concerning the reasonableness and prudence of its expenditures, and its

calculation of the environmental compliance surcharge.

The bill provides that the environmental compliance surcharge approved by the PSC would be a nonbypassable surcharge payable by every customer receiving a distribution service from the utility regardless of the identity of the customer's electric generation supplier.

MCL 460.10a et al. (S.B. 1331)
MCL 460.10q (S.B. 1332)
Proposed MCL 460.10dd (S.B. 1333)
Proposed MCL 460.10gg (S.B. 1334)
MCL 460.10h (S.B. 1335)
Proposed MCL 460.10ee (S.B. 1336)

BACKGROUND

In response to high electric rates in Michigan during the 1980s and 1990s, the Legislature enacted Public Acts 141 and 142 of 2000, the Customer Choice and Electricity Reliability Act, to open power generation to competition. (The transmission and distribution aspects of the electric industry remain under a regulated monopoly utility structure.)

Public Act 141 required the PSC to issue orders allowing utility customers to choose an alternative electric supplier, and required the orders to provide for full recovery of a utility's net stranded costs and implementation costs. Stranded costs are utility charges that were to be recovered over time through regulated rates that would not otherwise be collected from customers that switch to an alternative electric supplier. Implementation costs represent the expenses utilities incur to facilitate the implementation of the electric choice program. Utilities recover stranded costs and implementation costs by charging alternative electric supplier customers a transition charge.

Public Act 141 also required a 5% reduction in the residential rates that were in effect on May 1, 2000, for an electric utility with at least 1 million retail customers; froze those rates and the utility's other rates that were in effect on May 1, 2000, until 2004; and prohibited the utility's rates from increasing until December 31, 2013, or until the utility meets a market power test. Utilities also were required to unbundle their commercial and industrial rate schedules.

Under Public Act 141, electric utilities were required either to join a multistate transmission system organization or to divest their transmission assets. Utilities serving more than 100,000 retail customers had to file a joint plan to expand available transmission capability by at least 2,000 megawatts. Additionally, the PSC had to establish a code of conduct applicable to all utilities and alternative electric suppliers.

Public Act 142 required the PSC to issue a financing order authorizing an electric utility to issue securitization bonds in order to recover qualified costs (including regulatory assets plus stranded costs). The financing order must approve the creation of securitization charges and corresponding utility rate reductions.

Legislative Analyst: Julie Koval

FISCAL IMPACT

The bills would increase the administrative responsibilities for the Commission staff, particularly in the initial implementation period, due to the various deadlines that are established. The Commission is supported exclusively with restricted revenue so the bills would have no impact on the General Fund.

The energy and conservation assistance program for low income and senior citizens would be administered by the Public Service Commission and would require a surcharge on every customer receiving a distribution service from a gas or electric utility. This revenue then would be redistributed within the service area of the utility from which the surcharge was applied. Currently, there are nine investor-owned electric utilities, 12 electric cooperatives, and 12 natural gas companies that are regulated by the PSC. (It is not clear whether the requirement also would affect the 42 municipally owned electric utilities.) Each utility would be required to assess this surcharge on its customers, and the Commission would have to collect this revenue and redistribute it to all eligible customers within that service area. The Commission estimates that approximately \$140 million would be generated for this fund.

Based on the preliminary analysis of the bills, it appears their overall impact would be

to boost electricity rates from current levels in Michigan. This assessment is based on provisions that would create new transition costs, require higher reserve requirements for electric utility companies, create more costly restrictions on contracts for purchasing backup electricity to help meet reserve requirements, likely boost electricity tariffs in general due to a reduction in the Public Service Commission's oversight powers, and new securitization costs. In addition, some of these costs would be assessed on customers even if they chose to purchase electricity from an alternative energy supplier, which would undercut their potential savings on electricity and therefore make switching suppliers less financially beneficial. This would have a negative impact on competition in the marketplace, which by itself would tend to boost the cost of electricity. While some rate increases may be necessary and justifiable to keep the electric utility companies financially viable under existing law, particularly in light of the interim rate increase granted to Detroit Edison earlier this year, which will be finalized sometime this fall, it appears that the rates that would evolve under the bills would surpass those interim rate increases.

Michigan assesses its sales tax on electricity sales, so any increase in electricity prices would have an impact on sales tax collections. The sales tax rate on electricity is 4% for residential customers and 6% for all other customers. Reasonable estimates of how much overall spending on electricity would increase under the bills, how the increases would be distributed among the major customer groups (residential, commercial, and industrial), and when the increases would be realized over the next few years, is not possible at this time. To help illustrate the potential impact on sales tax collections, a \$100 million increase in spending on electricity would boost sales tax collections by an estimated \$4.2 million. Any increase in sales tax collections would be distributed as follows: 73% would go to the School Aid Fund, 24% would go for local government revenue sharing, and the remaining 3% would go to the General Fund.

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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.