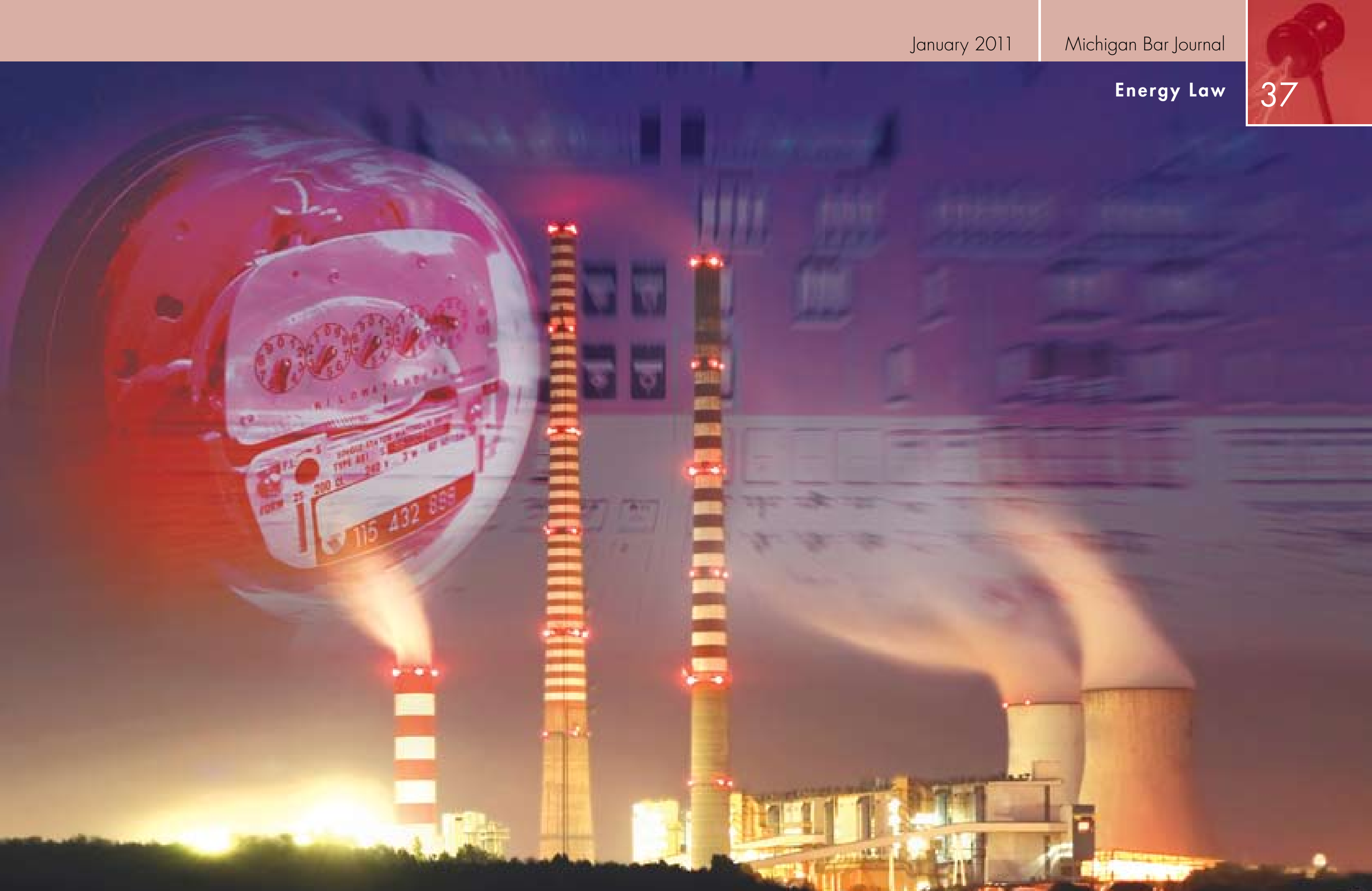

Changes in the Law Governing Public Utilities

By Lisa Babcock and Rodger Kershner

On October 6, 2008, Governor Granholm signed into law a bill that became Public Act 286 of 2008. Public Act 286 amends Public Act 3 of 1939, the sweeping law that created the Michigan Public Service Commission (MPSC) as the state's utility watchdog and the framework for the process of determining rates that utilities with state-given monopolies may charge their customers.

2008 PA 286: Game Changer or Tune-up?

PA 286 of 2008 passed the legislature as part of a package of bills that included the Clean, Renewable, and Efficient Energy Act, 2008 PA 295,[1] which obligated Michigan's utilities to include in the mix of electricity sold to utility customers at least 10 percent in the form of renewable energy.

PA 286 is a smorgasbord of changes to the pre-2008 utility laws. The law's proponents argue that the changes to the utility regulatory scheme are necessary to give Michigan's electric utility companies the financial strength and stability to attract capital to build new power plants and other utility facilities. Those facilities, supporters contend, are necessary to assure a reliable supply of energy at predictable prices for Michigan utility customers.

Opponents of PA 286 argued unsuccessfully that the act is a grab bag of gifts to utility shareholders that amount to a sea change in the relative positions of utility companies and their customers that, on the whole, creates an unfair advantage for utilities.

FAST FACTS

Michigan's electric utilities and cooperatives sold nearly $8.9 billion worth of electricity in 2009.

Michigan's electric usage by customers of all utilities and cooperatives dropped from 109 gigawatt hours in 2007 to 99 gigawatt hours in 2009.

On average, coal-fired power plants in Michigan are nearly 50 years old.

File-and-Use Rates

Under previous law, the rates that regulated utilities were permitted to charge their customers took effect only upon application by the utility company to the MPSC and a lengthy process of public notice, filings, review by MPSC staff and other parties, and hearings followed by deliberations among the commissioners. Increases were allowed if the applicant could demonstrate that the actual costs being incurred, including a reasonable return on invested capital, exceeded utility revenues under rates then in effect.

The 2008 act accelerated the process of increasing utility rates. Utilities can now use projections of future costs and revenues as the basis for rate increase applications. Utilities are still required to give notice to all interested parties in the area in which they hold the monopoly franchise and a full hearing must be held; the MPSC has 30 days to tell the utility if its application is complete. If the MPSC staff misses the deadline, the application is considered complete.[2]

The MPSC is required to allow a requested rate increase to take effect 180 days after it is filed regardless of whether the review process is complete unless good cause to delay implementation is shown. If subsequent proceedings cause the MPSC to conclude that the rate increase was in whole or in part unwarranted, rates may be reduced and refunds of the unwarranted portion, with interest, ordered.

If the rate review process is not completed within one year, the MPSC loses the authority to disapprove the increase, and the application is approved by operation of the new statute.[3]

Utility Merger Review

Section 6q of PA 286[4] creates in the MPSC the jurisdiction to approve or reject a proposal by any person to "acquire, control, or merge, directly or indirectly, in whole or in part, with a jurisdictional regulated utility" and to approve or reject a proposal by a regulated utility to "sell, assign, transfer, or encumber its assets to another person without first applying to and receiving the approval of the Commission."[5] A merger pre-approval process for public utilities is not rare among the states. An acquisition of a public utility, particularly a large publicly traded company, of which there are several doing business in Michigan, may affect interstate commerce and implicate federal jurisdiction. The question, therefore, is whether Section 6q can be enforced as written and, if it cannot, what purpose it serves. The language of Section 6q, if literally applied and enforced, would delay any proposed acquisition or merger for up to 180 days while its effect on the state of Michigan is considered by the MPSC.

Who benefits from the presence of Section 6q in PA 286? The answer varies depending on one's point of view. It can be argued that utility customers—Michigan's ratepayers—will benefit because the MPSC, having been given even colorable jurisdiction to prevent or delay an acquisition, now has a negotiating tool with which to protect the ratepayers from corporate raiders and extract for the benefit of ratepayers at least some of the synergistic advantages created by the acquisition or merger. It can also be argued that utility management benefits: that the imposition of a 120-day delay and the necessity of negotiating with the state over the fundamental terms of the transaction will discourage attempts to acquire Michigan utilities in the first place. Perhaps the answer is that both customers and management benefit. It is hard to see how utilities' shareholders benefit from Section 6q.

Certificates of Necessity

Section 6s of Act 286[6] partially introduces to Michigan utility jurisprudence a certificate as a prerequisite to the construction of major facilities by a utility. Many state and federal utility laws and regulators require utilities to obtain a certificate that proposed new facilities are needed and appropriate before construction may begin. Michigan's new law is unusual, if not unique, in one respect: whether a utility obtains a certificate before building or buying a major new facility is completely up to the utility.

New section MCL 460.6s provides that a utility may insulate itself from financial risk arising out of a hindsight conclusion that a major project was a bad idea or was badly executed. Under pre-2008 law, an electric utility in Michigan that wished to build a new power plant was free and, in fact, had no choice but to build the plant; once the plant was "used and useful," the utility had to petition the MPSC to allow it to include the cost and a return on investment in rates.[7] On occasion, major construction projects did not work out as originally envisioned. In that case, the utility would find that its customers objected to an increase in rates to pay for all or part of an ill-advised or ill-fated project on the ground

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that the utility's conduct was not prudent. Questions of prudence often involve highly subjective judgments and inquiries into questions about who knew what and when. Such questions are very difficult to resolve to the satisfaction of either side.

Section 6s, in a fashion, reverses the process by permitting, but not requiring, utilities to approach the Public Service Commission in advance of construction on major new projects to obtain the commission's blessing and assurance that, if and when the project is completed according to plan, the cost will be included in utility rates going forward. The justification offered for this new procedure should be no surprise. It is argued, without any real rebuttal, that the procedure reduces the risk to both shareholders and lenders of the utility and that the reduction in risk translates into a reduction in the cost of equity and debt capital, which in turn is reflected in a utility customer's rates.

Those who have taken exception to Section 6s argue that it not only revises the timing of the Public Utility Commission review of investments but also the review criteria. Under Section 6s, the commission is obliged to allow full recovery of a utility's investment if the commission issues a certificate subject only to certain limitations, which critics assert are not as stringent and do not offer the same protections of ratepayers as pre-existing law. It does appear that the act dispenses with the prior requirement that all expenditures be on used and useful facilities as a prerequisite to inclusion in rates,[8] and may permit full recovery of imprudent expenditures provided that the total cost of a project is within "the costs approved by the commission."[9]

Restoration of the Utility Monopoly

Perhaps the most controversial provision of PA 286 and the one that had the most immediate effect on utility customers is found in Section 10f. That provision largely restores the traditional utility companies' monopoly on retail sales of electricity.

PA 141 of 2000 provided, among other things, that utility companies would lose their traditional monopoly to make sales of electricity at retail within their authorized service territories. After 2000 PA 141, utility companies would retain only the monopoly on distribution of electricity through a system of wires, poles, and related equipment. Any person licensed by the MPSC was then authorized to sell electricity by transmitting that power through the lines owned by the local utility company and compensating that utility company for its investment in the distribution system and the expense of operating and maintaining the system.

In the months before the enactment of PA 286, Michigan's major utilities had argued that the loss of the retail monopoly on electricity sales deprived them of a valuable, necessary tool for long-range planning and financing large capital projects, most particularly electric-generating stations. Utilities argued that without the ability to predict with reasonable certainty what their electric sales would be in the future, it would be difficult for them to obtain investors and loan commitments to build multibillion-dollar projects. Therefore, the argument went, the traditional utilities' monopolies on retail sales of electricity would need to be restored.

Many utility customers vigorously resisted the remonopolization of retail electric sales, contending that a competitive market for electricity was, in fact, constraining and even reducing the cost of electricity. They argued that inexpensive electricity was needed for Michigan businesses to thrive and expand. The legislature apparently found the utilities' argument to be persuasive, but in an effort to address the concerns of large users of power, adopted a compromise. The compromise provides that electric utility companies in Michigan are subject to losing business to competition, but only to the maximum extent of 10 percent of their total sales.[10] The act provides that if customers representing more than 10 percent of the sales of either of the big electric utilities in Michigan choose to buy their electricity from a non-utility seller, the right to leave utility service and buy power elsewhere would be doled out on a roughly first-come, first-served basis.[11]

It was not generally believed at the time of the passage of PA 286 that the maximum 10 percent of the market allocated to non-utility competitors would soon be subscribed. But, possibly due in part to the relative ease for utility companies to raise rates provided by Section 6s of PA 286, the rates of large electric utility companies increased at a rather brisk pace during 2008–2010, to the point where the 10 percent allocation of competition for electric sales was quickly over-subscribed—suggesting that some customers paid the utilities more money for their power than they would have paid competing sellers, who are now essentially shut out of the market.

PA 286 received little note or comment in the press or among the public when it was enacted in 2008.

Deskewing

Industrial customers had long complained about being forced to subsidize residential rates. PA 286, section 10dd, ordered the MPSC to "deskew" the rates of electric utilities with at least one million customers. In doing so, the MPSC is required to shift costs among customers to better reflect the actual costs of generating and transmitting electricity to each class of utility customers—residential, commercial, and industrial. To ease the increase in costs to residential customers, rates for industrial and commercial customers would have to be deskewed in five years; the MPSC has until 2018—10 years from the effective date of the law—to phase in cost-based rates for residential customers.

Conclusion

PA 286 was conceived, debated, and enacted in a time when the need for electricity was growing at such a pace that many in government and industry were rightfully concerned about Michigan's capacity to meet the projected need. The legislation was signed on October 6, 2008, just three weeks after the bankruptcy of Lehman Brothers. The need for and adequacy of legislation designed to foster development and construction of new plants by utilities has yet to be put to the test. We will learn the wisdom and consequences of PA 286 when the state's economy is as robust as it was in the first part of this decade. ■

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Electricity Terms

Kinds of Electricity Providers

Incumbent Utility or Investor-Owned Utility (IOU): The company that has traditionally supplied electricity to the area, such as Detroit Edison or Consumers Energy. Incumbent utilities' rates are regulated by the Michigan Public Service Commission, which guarantees a return in equity, but the companies are governed by shareholders.

Municipal Utility or "Muni": A city-owned utility governed by a locally appointed board of directors. Lansing's Board of Water & Light is an example of a muni. Charlevoix, Petoskey, Traverse City, and many other cities are served by munis.

Cooperative Utility Provider: A utility governed by its members, a cooperative utility is the modern version of the 1930s rural electric association.

Alternative Energy Supplier (AES): A non-incumbent electricity provider not regulated by the MPSC, such as Integrys or Constellation. Like an IOU, it is owned by shareholders. Unlike an IOU, it is not guaranteed a return. "Alternative" in this case refers to an alternative to the traditional provider, not an alternative to fossil-fuel generation, although some AESs emphasize green generation.

Three Branches of the Business

Transmission: The big wires that transport large loads of electricity from the generation sites to distribution lines.

Distribution: The small lines that lead from transmission lines to individual buildings.

Generation: Where electricity is made, such as coal plants. Energy companies can choose to generate their own power or purchase power from another generator.

FOOTNOTES

1. MCL 460.1001, *et seq.*; see also Bzdok & Clift, *Michigan's Clean Energy Legislation: Charging Toward a New Energy Future,* 88 Mich B J 26 (October 2009).
2. MCL 460.6a(1).
3. MCL 460.6a(3).
4. MCL 460.6q.
5. MCL 460.6q(1).
6. MCL 460.6s.
7. See, e.g., Michigan Public Service Commission, Opinion and Order Case No. U-15768 (January 11, 2010), available at <http://www.dleg.state.mi.us/mpsc/orders/electric/2010/u-15768_01-11-2010.pdf>; see also Michigan Public Service Commission, Opinion and Order Case No. U-6006 (March 14, 1980), p 14, available at <http://www.dleg.state.mi.us/mpsc/orders/archive/pdfs/U-6006_03-14-1980.PDF> ("The rationale behind the 'used and useful' standard is to avoid allowing a utility to earn a return on property which is not being utilized toward the ultimate goal of providing service to utility customers."). All websites cited in this article were accessed December 12, 2010.
8. MCL 460.6s(12).
9. MCL 460.6s(9).
10. MCL 460.10(a)(1).
11. MCL 460.10a(1)(a) and 460.10a(1)(b).