



**House  
Legislative  
Analysis  
Section**

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**NUCLEAR PLANTS: RECOVERY OF  
SECURITY COSTS**

**Senate Bill 1499 (Substitute H-5)  
First Analysis (12-13-02)**

**Sponsor: Sen. Mat J. Dunaskiss  
House Committee: Energy and  
Technology  
Senate Committee: Technology and  
Energy**

***THE APPARENT PROBLEM:***

In 2000 the legislature passed the Customer Choice and Electricity Reliability Act, which required the Public Service Commission to issue orders establishing rates, terms, and conditions of service to allow retail electric utility customers to choose an alternative electric supplier. Among other things, the act instituted a rate reduction of five percent in the residential rates that were in effect on May 1, 2000 for an “electric utility with one million or more retail customers in the state” as of that date—i.e., Consumers’ Energy and Detroit Edison. The act requires those utilities to freeze those rates and their other electric retail rates until 2004. The act also prohibits those utilities from raising their rates (residential, commercial, or manufacturing) before December 31, 2013 or until the utility meets the act’s market power test and transmission expansion requirements, subject to certain qualifications. First, in no event could such a utility raise its residential rates before January 1, 2006. Second, the rates for commercial or manufacturing customers of an electric utility with 1,000,000 or more retail customers with annual peak demands of less than 15 kilowatts could not be increased before January 1, 2005.

Other electric utilities must justify their rates before the Public Service Commission, while alternative electric suppliers’ rates are basically unregulated. In short, the various companies who generate electricity and sell that electricity at retail are subject to different requirements when they want to change their rates. One significant reason why an electricity supplier might want to increase its rates is to recover an increase in the costs of doing business, especially when those costs are incurred as the result of governmental mandates. Under current law, alternative electric suppliers can raise their rates and let their customers be the judges of whether the increased prices are justified. Because smaller

electric utilities—i.e., utilities with less than one million retail customers in the state on May 1, 2000—are not subject to the act’s rate freeze and rate cap provisions, a smaller utility may apply to the PSC for a rate increase, explaining why it believes it would be appropriate to pass the increase in its costs along to its customers.

Larger utilities, which are subject to the act’s rate freeze and cap, argue that the act leaves them with severely restricted ability to recover costs incurred to enhance security measures needed in the post-September 11 world. Under current law, the larger utilities may seek recovery for certain “reasonable and prudent” costs associated with capital expenditures or incurred as a result of changes in taxes, laws, or other state or federal government actions during the period they are under the rate cap. However, the act defers the recovery period until after the rate cap period ends, and it is unclear whether the larger utilities could seek recovery for operating and management costs associated with protecting facilities against terrorism. Legislation has been introduced to permit any electric utility to apply to the PSC to recover post-9/11 security costs for an electric generating facility.

***THE CONTENT OF THE BILL:***

Senate Bill 1499 would amend the Customer Choice and Electricity Reliability Act to allow certain electric utilities to apply to the Public Service Commission (PSC) to recover security costs mandated by federal or state regulators after September 11, 2001 or determined to be necessary by the PSC to provide reasonable security from an “act of terrorism”, as defined in the bill. Recovery could only be sought for costs incurred before January 1, 2006. The bill would also:

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- specify application, notice, and hearing requirements for PSC approval of a "security recovery factor" (an unbundled charge to all retail customers except for customers of an alternative electric supplier);

- specify costs that the PSC could include in determining a security recovery factor; and

- provide for the confidentiality of certain utility records supplied to the PSC in the application process.

A more detailed description of the bill follows.

Enhanced security costs recovery. Under the bill, a "covered utility" could apply to the commission to recover "enhanced security costs" for an electric generating facility through a "security recovery factor". A "covered utility" would be defined as an "electric utility" subject either to the act's rate freeze and rate cap provisions, which apply to electric utilities that had one million or more retail customers in Michigan on May 1, 2000, or to the rate freeze provisions of specific PSC orders in case numbers U-11181-R and U-12204. (Those orders deal with Indiana Michigan Power Company and American Electric Power Company.) The act's rate cap and freeze requirements would not apply to rates or charges authorized by the PSC under the bill.

(The act uses the definition of "electric utility" in Public Act 30 of 1995—i.e., a person, partnership, corporation, association, or other legal entity whose *transmission or distribution* of electricity the PSC regulates, not including a municipal utility.)

"Enhanced security costs" would be defined as a covered utility's reasonable and prudent security costs of new and enhanced security measures incurred before January 1, 2006 for an electric generating facility that are required by federal or state regulatory security requirements issued after September 11, 2001 or determined to be necessary by the PSC to provide reasonable security from an "act of terrorism". The term would include increases in the cost of insurance that are attributable to an increased terror-related risk and the costs of maintaining or restoring electric service following an act of terrorism.

"Security recovery factor" would mean an unbundled charge for retail customers who are not customers of alternative electric suppliers to recover enhanced security costs approved by the PSC.

"Act of terrorism" would mean a willful and deliberate act that met the following conditions:

- the act would be a violent felony under the laws of this state, whether or not committed in the state;

- the person (committing the act) knew or had reason to know the act was dangerous to human life; and

- the act was intended to intimidate or coerce a civilian population or influence or affect the conduct of government or a unit of government through intimidation or coercion.

Application, notice, and hearing. Within 60 days of the bill's effective date, the PSC would have to issue an order prescribing the form for the filing of an application for a "security recovery factor". If the PSC or its designee determined that a filing was incomplete, it would have to notify the utility within ten days of the filing.

The PSC would have to require that a covered utility publish notice of an application for a security recovery factor within 30 days of filing a complete application. The initial PSC hearing would have to be held within 20 days of publication of the notice in newspapers of general circulation in the utility's service territory. The PSC could issue an order approving, rejecting, or modifying the security recovery factor. If the PSC issued an order approving a security recovery factor, the order would have to be issued within 120 days of the initial PSC hearing.

Determination of security recovery factor. In determining the security recovery factor for a covered utility, the PSC could include only costs that it determined were reasonable and prudent and that were jurisdictionally assigned to the utility's retail customers in Michigan. The costs included would have to be net of any proceeds that had been or would be received from another source, including any applicable insurance settlements received by the utility or any grants or other emergency relief from federal, state, or local governmental agencies for the purpose of defraying enhanced security costs. In its order, the PSC would have to designate a period for recovery of enhanced security costs, including a reasonable return on the unamortized balance, over a period of not more than five years. The security factor could not be less than zero.

Confidentiality of records. Records or other information supplied by a utility in an application for recovery of security costs that described security

measures, including emergency response plans, risk planning documents, threat assessments, domestic preparedness strategies, and other plans for responding to acts of terrorism, would not be subject to the Freedom of Information Act and would have to be treated as confidential by the PSC. The PSC would have to issue protective orders that were necessary to protect the information that it found to be to be confidential.

MCL 460.10d

### **FISCAL IMPLICATIONS:**

Fiscal information is not available.

### **ARGUMENTS:**

#### **For:**

On September 14, 2001 the Federal Energy Regulatory Commission (FERC) issued a press release assuring its regulated companies that the FERC would “approve applications proposing the recovery of prudently incurred costs necessary to further safeguard the nation’s energy systems and infrastructure made in response to the heightened state of alert the country” was experiencing in the wake of the September 11 terrorist attacks. Although the FERC has jurisdiction over wholesale rates for electricity and not over retail rates, the press release sets forth sound policy principles concerning the need for heightened security around the nation’s energy infrastructure: energy companies should beef up security measures in a timely and responsible fashion and regulators should do everything they can to ensure that energy companies recover the reasonable costs of doing so.

Because alternative electric suppliers may raise their rates as they choose and smaller utilities may already ask the PSC to approve a rate increase, the state’s larger utilities should be allowed to seek a rate increase as well. The state’s electric utilities--particularly those that own and operate nuclear power plants--insist that they have been enhancing security measures ever since September 11, 2001 and would continue to do even without the bill. Still, the thought that an electric utility might at some point decide that without any clear path to cost recovery it cannot afford to hire needed security guards or institute a more effective emergency plan is sobering enough that there should be no doubt as to the urgency of this legislation. Terrorist attacks like those of September 11 were simply not on anyone’s mind when the rate freeze and caps were placed on

the utilities, and the bill creates a very narrowly crafted exception, which would allow recovery only for reasonable and prudent security costs stemming directly from utilities’ wish to protect against the possibility of an attack on their generating facilities. The bill specifies that an approved security recovery factor would be an unbundled charge that would not be paid by customers of alternative electric suppliers, meaning that purchasers of electricity not generated by the utility would not have to pay for protecting the generating facilities of the utility.

#### **Response:**

No one disagrees that utilities, large and small, should be allowed to recover costs for increased security measures that the public has come to expect and the government has come to demand after September 11. Even with the required rate reduction and freeze, however, the state’s largest electric utilities—Detroit Edison and Consumers Energy—are earning rates in excess of their authorized rates of return. Their “take rates” are likely to increase even further due to a recent reduction in personal property tax rates approved by the State Tax Commission. The House Energy and Technology Committee had considered adding language to the bill that would permit the PSC to consider any cost savings, tax credits, or reductions in the cost of doing business when determining the security recovery factor. This would have allowed the PSC to consider the bigger picture—i.e., whether the costs that they were seeking to recover were taking them below their authorized rate of return or whether unanticipated savings in their cost of doing business offset, at least in part, the unanticipated costs of increased security requirements. Even that language may have been too weak, since it permitted the PSC to look at the bigger picture but did not *require* the PSC to consider such matters in making its determination. Language should be added to the bill to restrict any recovery of security costs to the recovery of costs that cause a utility to fall below its authorized rate of return.

Also, it is unclear whether the bill is really necessary. The Customer Choice and Electricity Reliability Act currently allows the larger utilities to recover certain costs at a later date. Perhaps language could be added to clarify or specify that enhanced security costs are among the costs eligible for deferred recovery under the act.

#### **Reply:**

Nothing in the bill would prohibit the Public Service Commission from looking at the “bigger picture” when making its determination to approve, reject or modify a security recovery factor. As for deferred recovery, if utilities need to spend now for

unanticipated costs, they should be able to seek immediate relief for these costs rather than having to wait for several years.

***POSITIONS:***

Energy Michigan supports the bill. (12-13-02)

The Michigan Manufacturers Association supports the bill. (12-13-02)

Consumers Energy supports the bill. (12-13-02)

The Association of Businesses Advocating Tariff Equity is neutral on the bill. (12-13-02)

Analyst: J. Caver

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.