

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536



Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1499 (as enrolled)
Sponsor: Senator Mat J. Dunaskiss
Senate Committee: Technology and Energy
House Committee: Energy and Technology

PUBLIC ACT 609 of 2002

Date Completed: 1-14-03

RATIONALE

The Customer Choice and Electricity Reliability Act was passed in 2000, mandating a rate reduction of 5% in the residential rates that were in effect on May 1, 2000, for an electric utility with 1 million or more retail customers in the State as of that date, and freezing those rates until 2004. Only the State's two largest electric suppliers, Consumers Energy and Detroit Edison, are subject to the rate reduction and freeze. Additionally, the Act prohibits each of these utilities from raising its residential, commercial, or manufacturing rates before December 31, 2013, or until it meets the Act's market power test, which limits the utility's commercial control of the generating capacity to serve the relevant market.

Other electric utilities, which are not subject to the rate freeze, can change their rates by making a case before the Michigan Public Service Commission (PSC). One reason a utility might want to raise its rates is that the State or Federal government can impose new regulations on it, resulting in an increased cost of doing business. Utilities with more than 1 million customers, however, do not have flexibility in adjusting rates to cover the costs of government mandates, including enhanced security measures imposed after the terrorist attacks of September 11, 2001. It was suggested that such a utility should be permitted to apply to the PSC for permission to raise its rates to cover the cost of increased security.

CONTENT

The bill amended the Customer Choice and Electricity Reliability Act to excuse from the Act's rate reduction and rate freeze provisions covered utilities'

recovery of increased costs to enhance security against acts of terrorism.

Under the bill, a covered utility may recover enhanced security costs for an electric generating facility through a security recovery factor, after it applies to the Public Service Commission and the PSC issues its approval. (The bill defines "security recovery factor" as an unbundled charge for all retail customers, except for customers of alternative electric suppliers, to recover enhanced security costs that have been approved by the PSC. "Covered utility" means an electric utility subject to the rate freeze and rate cap provisions of the Act, or the rate freeze provisions of certain PSC orders.) The PSC must require the covered utility to publish notice of the application in newspapers of general circulation in the service territory of the covered utility within 30 days from the date the application is filed. The PSC must hold an initial hearing within 20 days of the date the notice is published, after which it may issue an order approving, rejecting, or modifying the security recovery factor. If the PSC approves a security recovery factor, it must issue the approval within 120 days of the initial hearing.

In determining the security recovery factor, the PSC may include only costs that it determines are reasonable and prudent, and that are jurisdictionally assigned to retail customers of the covered utility in this State. The costs included must be net of any proceeds that have been or will be received from another source, including any applicable insurance settlements received by the covered utility or any grants or other emergency relief from Federal, State, or local governmental agencies for the purpose of defraying

enhanced security costs. The PSC must designate a period for recovery of the enhanced security costs not to exceed five years. The security recovery factor may not be less than zero.

The bill requires the PSC, within 60 days of the bill's effective date, to prescribe the form for filing an application for a security recovery factor. The PSC must notify an applicant within 10 days of filing if the filing is incomplete. Further, the bill specifies that information provided by the covered utility in an application that describes security measures (including emergency response plans, risk planning documents, threat assessments, domestic preparedness strategies, and other plans for responding to acts of terrorism) is not subject to the Freedom of Information Act. The PSC must treat such information as confidential, and issue orders to protect the information as necessary.

Under the bill, "act of terrorism" is defined as a willful and deliberate act that is all of the following:

- An act that would be a violent felony under the laws of this State, whether or not committed in this State.
- An act that the person knows or has reason to know is dangerous to human life.
- An act that is 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.

"Enhanced security costs" means reasonable and prudent costs of new and enhanced security measures incurred before January 1, 2006, for an electric generating facility by a covered utility 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 and prudent security from terrorist attacks. Enhanced security costs include, but are not limited to, increased insurance costs and the costs of maintaining or restoring electric service as the result of an act of terrorism.

MCL 460.10d

BACKGROUND

Following the attacks of September 11, 2001, many governmental and other entities have examined the vulnerabilities of essential infrastructures. These infrastructures include the electricity sector, as industry players and the Federal government realize that terrorists could significantly interfere with, or halt, the daily operations of the country by cutting off the supply of electricity, or could use the facilities themselves to cause physical harm to civilians. The Electric Power Research Institute (a nonprofit energy research consortium) identified several ways terrorists could use electric generating facilities in an attack against Americans:

- Attacks upon the power system (a single substation or transmission tower, for example, or a multipronged attack), in which the electricity infrastructure itself is the primary target.
- Attacks by the power system, in which a terrorist uses a facility itself to harm the public, such as by using a power plant cooling tower to disperse chemical or biological agents.
- Attacks through the power system (including lines, pipes, underground cables, tunnels, and sewers), which would target the entire civil infrastructure.

State and local governments also have been examining infrastructure vulnerabilities and taking steps to close gaps in security. In January 2002, Governor John Engler issued an executive directive redesignating the Michigan Anti-Terrorism Task Force, which had been created in 1996 in response to the Oklahoma City and World Trade Center bombings, as the Michigan Homeland Security Task Force. The Emergency Management Division of the Michigan State Police occupies a principal position on the Task Force, which also includes representatives from the Michigan National Guard; the State Departments of Environmental Quality, Agriculture, Natural Resources, and Community Health; the U.S. Department of Defense; the U.S. Environmental Protection Agency; the U.S. Public Health Service; the Federal Bureau of Investigation; and various local agencies. The Task Force is made up of four committees: Indication and Warning; Response; Health; and Critical Infrastructure Protection, on which PSC personnel serve. The Energy

Subcommittee of the Critical Infrastructure Protection Committee examines the security of all systems that produce and distribute energy—petroleum products, natural gas, and electricity.

The electricity industry has been involved in similar efforts over the past 20 years, working with Federal governmental agencies to identify and reduce vulnerabilities in the electricity power grid, both physical and cyber, and maintain public confidence in the industry. The North American Electric Reliability Council (NERC) claims that the electricity industry now occupies a unique position on the frontlines of homeland security, since many of this society's core activities rely on a stable supply of electricity.

The Council's Critical Infrastructure Protection Advisory Group worked in conjunction with the U.S. Department of Energy's Federal Energy Regulatory Commission (FERC) to issue in May 2002 a set of guidelines for the electricity sector in preparing for acts of terrorism and increasing cybersecurity. The Council defines "critical facility" as any facility or combination of facilities that, if severely damaged, would: have a significant impact on the ability to serve large quantities of customers for an extended period of time; have a detrimental impact on reliability or operability of the energy grid; and would cause significant risk to national security, national economic security, or public health and safety. The guidelines deal with the following topics:

- Vulnerability and risk assessment: identifying critical facilities, their vulnerabilities, and appropriate countermeasures.
- Threat response: developing plans for enhanced security.
- Emergency management: preparing companies to respond to a spectrum of threats, both physical and cyber.
- Continuity of business practices: reducing the likelihood of prolonged interruptions and enhancing prompt resumption of operations after interruptions occur.
- Communications: the effectiveness of threat response, emergency management, and business continuity practices.
- Physical/cyber security: mitigating the impact of threats through deterrence, prevention, detection, limitation, and corrective action.

- Employment screening: mitigating "insider" threats.
- Protection of sensitive information: production, storage, transmission, and disposal of both physical and electronic information.

On September 14, 2001, FERC issued a press release to assure utilities that it 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" caused by the terrorist attacks. One month later, the National Association of Regulatory Utility Commissioners (NARUC) adopted two resolutions reiterating FERC's statement in support of energy emergency preparedness and allowing utilities to recover costs incurred in implementing new security measures. Under the resolutions, "States should approve appropriate applications by electric and gas companies subject to their jurisdiction to recover prudently incurred costs necessary to further safeguard the reliability and security of our energy supply and delivery infrastructure", and "State Commissions are also encouraged to inquire what security-related steps jurisdictional utilities have taken, to coordinate with local or appropriate law enforcement agencies or with an information clearinghouse such as the State's emergency management agency, and to identify and/or establish procedures for timely recovery of prudently incurred security related costs". According to NARUC, because the costs associated with these security enhancements are uncertain, state governments should make a strong commitment to support critical utilities.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

It is for the types of activities described by NERC that the major electricity providers in Michigan wish to raise rates. Smaller utilities already may do so by making a case before the PSC. The larger utilities should be able to do the same, especially when all utility companies, regardless of size, now must increase security. Many electric utilities report that they began working on security

improvements even before the government response and will continue to do so without being reimbursed, as long as they are financially able. The State cannot afford, however, to take the risk that a utility might not have the funds to beef up protective measures sufficiently. The covered utilities' rate reduction and freeze were instituted before the September 11 attacks and, as circumstances change, so must regulations. The bill creates a very restrained ability for electric suppliers to raise rates; it allows them to recover necessary costs but does not create an opportunity for overcharging customers.

While electricity providers have been taking steps to increase security since September 11, a lot more can be done to prepare for a terrorist attack. The interdependencies between the electricity sector and other critical infrastructures are complex; local telecommunications, oil and natural gas providers, and local and State government emergency service providers all depend on a continued supply of electricity. Even a brief loss of power can have a profound impact on the economy, especially with the dramatic increase in e-commerce in recent years. This dependence makes the electric system an attractive target for another terrorist attack. In the war on terror, the government frequently turns to private corporations, which own 85% of the nation's critical infrastructures. Electricity providers, especially the largest ones, need additional funding to take on the new responsibility of national defense.

Opposing Argument

Businesses already are experiencing hard times and struggling to compete in a global economy. According to a representative from the Association of Businesses Advocating Tariff Equity (ABATE), this bill will result in an 8- to 11-cent per unit increase, exacerbating economic hardship for Michigan businesses. Even with the mandatory rate reductions, freezes, and caps, Detroit Edison and Consumers Energy are charging rates beyond their authorized rate of return. Further, both companies are expected to receive sizeable refunds as a result of a recent readjustment of the property tax tables. It seems logical that when a utility must pay more to do business, customers' rates should go up. Conversely, when a utility experiences a drop in the cost of doing business, customers should see that

difference on their monthly bills. It is not fair to require consumers to pay for increased costs when they do not get to share in the company's economically prosperous times. Detroit Edison and Consumers Energy should use the property tax refund to upgrade their security measures instead of passing the cost on to consumers.

Response: Utilities should not have to use their tax refunds to make necessary improvements in security, especially if the improvements are government-mandated. Taking these crucial steps will enhance the safety of entire communities and minimize the disruption of a terrorist attack on the economy and people's daily lives.

Legislative Analyst: Julie Koval

FISCAL IMPACT

To the extent that a State agency or local government is a customer of the affected utilities, utility costs might increase.

Fiscal Analyst: Maria Tyszkiewicz

A0102\1499ea

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.