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BILL ANALYSIS

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Senate Bill 612 (as passed by the Senate)
Sponsor: Senator Laura Toy
Committee: Technology and Energy

Date Completed: 10-30-03

RATIONALE

The Customer Choice and Electricity Reliability Act was enacted in 2000 to restructure Michigan's electricity industry. Among other things, the Act required the Michigan Public Service Commission (PSC) to establish a code of conduct applicable to all electric utilities, including measures to prevent cross-subsidization, information sharing, and preferential treatment between a utility's regulated and unregulated services. (According to the code of conduct, a service is "regulated" if the PSC has the authority to set the price for the service.) Since the code was created, there have been questions as to whether Consumers Energy's Appliance Service Plan (ASP) program complies with the code of conduct. Some also have expressed concerns about the company's use of inserts in monthly bills to promote the program. The PSC has ordered Consumers Energy to complete the full functional separation of the ASP program and its regulated activities, and discontinue the use of monthly promotional inserts, by December 31, 2003, or discontinue the program. (The PSC's orders to Consumers Energy related to the code of conduct are described under **BACKGROUND**.)

The ASP is a voluntary repair program for large home appliances, for which Consumers Energy charges its customers a fee on their monthly utility bills. Approximately 175,000 Consumers Energy customers, about 6.7% of the company's total customer pool, currently are enrolled in the program. According to the company, more than half of the ASP customers are over the age of 55, and about half have an annual household income of less than $40,000. Some people believe that the ASP program provides a valuable service and that the company should be able to continue offering it to its customers, under certain circumstances.

CONTENT

The bill would amend the Customer Choice and Electricity Reliability Act to make an exception to electric utilities' code of conduct for a utility's repair and servicing program, if the utility had less than 30% of the market share for the repair and servicing of heating and cooling systems or other appliances within the utility's service area.

The bill would require the Public Service Commission to ensure that the regulated rates of a regulated utility did not subsidize programs offered by the utility for the repair and servicing of heating and cooling systems or other appliances. The bill specifies that, for purposes of its provisions, a subsidy would not exist if the revenues of the repair and servicing program exceeded the incremental costs of the program and the program revenues were credited to utility customers in general rate cases.

The bill would prohibit a regulated utility from promoting its repair and servicing program through the use of utility bill inserts or other promotional materials included in customer utility bills.

MCL 460.10a

BACKGROUND

Under the Customer Choice and Electricity Reliability Act, the PSC was required to establish a code of conduct, applicable to all electric utilities and alternative electric suppliers, to promote fair competition. On December 4, 2000, the PSC adopted a code that contains, but is not limited to, the following "separation" provisions:

-- An electric utility may not offer unregulated services or products except through one or more affiliates or through other entities within the corporate structure, such as divisions.

-- An electric utility's regulated services may not subsidize, directly or indirectly, the unregulated business of its affiliates or other separate entities within the corporate structure.
-- An electric utility must maintain its books and records separately from those of its affiliates or other entities within its corporate structure.
-- An electric utility and its affiliates or other entities within the corporate structure may not share facilities, equipment, or operating employees, but may share computer hardware and software with documented protection to prevent discriminatory access to competitively sensitive information.
-- An electric utility's operating employees and the operating employees of its affiliates must function independently of each other and maintain separate offices.
-- An electric utility may not finance or co-sign loans for affiliates.
-- An electric utility and its affiliates or other entities within the corporate structure offering both regulated and unregulated services or products in Michigan may not engage in joint advertising, marketing, or other promotional activities related to the provision of regulated and unregulated services, nor may they jointly sell regulated and unregulated services.

All electric utilities were required to file a code of conduct compliance plan within 90 days of the PSC's order. (In January 2001, the PSC extended the filing deadline in response to requests from the industry to examine and clarify how the code of conduct would affect utilities' appliance repair programs. Under the new deadline, electric utilities had up to 60 days after the Commission's final order on rehearing, reconsideration, and clarification to file their compliance plans.)

Consumers Energy received a temporary waiver, until April 3, 2003, of the requirement to separate its Appliance Service Plan, through which the company provides repair service for heating and cooling (HVAC) systems and major appliances. In December 2002, Consumers Energy sought an extension of the waiver through April 3, 2004. The PSC granted the extension, but only until December 31, 2003, at which time Consumers must either have terminated its ASP program or have completed the full functional separation of the program from its regulated activities. The Commission granted the extension on the condition that the company stop including promotional material for the program with customers' bills and that the program bear the full cost of promotional activities through use of separate mailings by December 31, 2003.

At the time it granted the extension, the PSC also cited Consumers Energy for violating the code of conduct by jointly advertising unregulated programs with regulated programs, and ordered the company immediately to discontinue promoting the ASP program with inserts and bills provided through ratepayer funds. Consumers Energy appealed the PSC's orders to the Michigan Court of Appeals, which heard oral arguments on September 4, 2003, and has not yet handed down a decision.

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

Consumers Energy's ASP provides a valuable service for its customers, particularly senior citizens, the physically disabled, and low-income people. Customers are satisfied with the program because it is associated with a name they know and trust. If the company is forced to terminate the program, it will mean the end of a reliable, essential service during the coldest time of the year.

The ASP program provides cost efficiency to the regulated side of Consumers Energy's activities because it helps hold down natural gas costs. The company would have to duplicate its business infrastructure to continue operating the program as a completely separate entity, thereby eliminating the revenue and efficiency benefits that ratepayers currently enjoy.

The bill would allow the utility to continue offering the ASP program while promoting fair competition. It would require the PSC to ensure that utility customers were not subsidizing the program, and would prohibit the company from including promotional material for the program in its monthly bills. Furthermore, if the ASP program were to capture more than 30% of the appliance service and repair market, Consumers Energy would have to comply with the code's separation requirements.

Supporting Argument

The ASP program is a benefit to many small businesses. In 2002, the program paid $6.9 million to its network of 152 independent contractors who performed approximately half of Consumers' ASP work. Additionally, the program provides employment to many utility workers during seasonal non-peak times. The PSC requires additional staff in case of an emergency, and the ASP program provides a revenue-generating activity that makes sustaining this adequate workforce economical.

Response: The ASP program takes utility workers away from work they should be performing, so that it sometimes takes several days for them to respond to utility service calls that should be attended to immediately.

Opposing Argument

Consumers Energy is not being forced to terminate the ASP program; it must simply change how the program operates so that it is competing on a level playing field with other HVAC businesses. The code of conduct was formulated to ensure fair competition among service providers. The bill would grant an exception for one company and allow it to finance its unregulated activities with regulated funds. If Consumers wants to offer the ASP program to its customers, it should do so under the rules that apply to independent businesses. Unlike entrepreneurs who invest in a business, Consumers was able to break into the HVAC business without the element of risk. The company can use employees it already has and does not need to invest in vehicles or other necessary equipment, or pay other start-up costs that people in the private sector pay when starting from scratch. Consumers has a monopolistic advantage over small and independent businesses, and it is impossible for them to compete against an entity that can switch between regulated and unregulated activities at will.

Consumers claims its ASP program generates a 41% profit, in stark contrast to the 3% profit that most HVAC businesses make for similar services. If the program truly is so successful, it easily should be able to stand on its own; Consumers would find a way to continue operating the program under the code of conduct.

It is questionable, however, whether the program actually generates a 41% profit because of the incremental cost accounting practices the company uses. This method makes determining the true cost nearly impossible. If Consumers used fully allocated cost accounting, it probably would show that the ASP program lost money and was being subsidized by utility ratepayers. The PSC found that the program was so intertwined with the utility's regulated activities that a true accounting was impossible without a separation.

Response: Neither the PSC nor the courts have found evidence of cross-subsidization in Consumers Energy's ASP program. The program generated $13.7 million in ratepayer benefits in 2002 because the PSC offsets revenues that exceed the program's cost against the operating costs on which Consumers' natural gas rates are based. These facts do not support the conclusion that the company unfairly is leveraging its regulated activities or that it is eliminating competition and choice. There are more than 3,000 businesses in Michigan that provide HVAC services despite the fact that Consumers Energy has offered the ASP program for 15 years. Consumers Energy currently has about 19.1% of the market, well below the 30% ceiling the bill would establish.

Opposing Argument

Consumers Energy has an advantage over independent HVAC businesses because it can draw from its extensive database of utility customers to target for ASP program advertising.

Response: Consumers has discontinued the practice of including promotional inserts or printing program advertising on monthly bills.

Opposing Argument

Consumers Energy is attempting to usurp both the legislative and judicial processes by promoting this bill. The company was involved in the negotiations over the 2000 Act and had substantial input in crafting the code of conduct. Nevertheless, the company has since challenged many aspects of the Act in the courts and now is advocating for a legislative remedy before the Court of Appeals hands down its decision. The PSC did exactly what it was required to do: develop a code of conduct prohibiting the very activities in which Consumers wants to continue to engage.

Response: The code of conduct applies to unregulated services related to electric customer choice. Consumers Energy appealed the PSC's order to the Court of Appeals because the code is ambiguous in how it applies to services that are not related to choice.

Legislative Analyst: Julie Koval

FISCAL IMPACT

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

Fiscal Analyst: Maria Tyszkiewicz

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