

Chapter 7 – The Challenge of Restructuring

With a stroke of the pen, President George H. W. Bush set in motion the restructuring of the electric utility industry. At an October 24, 1992 ceremony on an oil rig near Maurice, Louisiana, the president signed the Energy Policy Act of 1992, H.R. 776.¹ The 1,300-page bill, the last major piece of legislation enacted during the Bush presidency, ushered in one of the most tumultuous periods in the utility industry's long history.

During the next decade, Michigan and dozens of other states would consider electric utility deregulation bills. MPPA, and the public power community nationwide in general, would spend huge amounts of time in the mid- and late 1990s ensuring that state-sponsored utility deregulation schemes worked to the advantage of public power's ratepayers.

H.R. 776 was in line with what MPPA and the public power community had been trying to accomplish since the late 1970s. The bill essentially called for the breakup of high-voltage transmission monopolies exercised by the nation's investor-owned utilities. The Energy Policy Act of 1992 included provisions granting third parties the right to request transmission service through the Federal Energy Regulatory Commission (FERC).

FERC was given the authority to issue an order requiring a transmitting utility to provide service in return for fair compensation. FERC also could require the transmitting utility to base its pricing on "legitimate and verifiable costs." Any refusal of service had to be supported by a timely explanation of the transmitting utility's actions. Finally, the legislation restricted FERC from issuing transmission orders that would unreasonably impair a system's reliability.²

The "transmission access" guaranteed by H.R. 776 was what MPPA had been fighting for since 1978. Although the bill promised to "increase competition in the way electricity is generated and sold," MPPA and the public power community were skeptical, mainly because large industrial customers had been the major supporters of the legislation.

MPPA's Dave Naberhuis summed up the public power community's skepticism. "I am fearful for the electric industry," Naberhuis said, "because I think the big push for deregulation was by the large industrial customers who thought that they could get cheaper prices. Their idea was perhaps cheaper prices and all other things staying the same, but often times when you get cheaper prices, you get less reliable products."³

The Theory and Practice of Deregulation



The idea behind electric utility deregulation and open markets was that competition in the electric marketplace should lead to lower electricity prices.

Perspectives on an Industry in Change

In early July 1999, MPPA General Manager Gary Zimmerman addressed the summer meeting of the Michigan Electric Power Conference at the Crystal Mountain Resort in northern Michigan. It was exactly 11 months before Michigan's first electric utility restructuring legislation would be enacted into law.

Zimmerman told the group that Michigan's 41 municipal electric utilities served 281,311 ultimate customers. Zimmerman added that "15 of those utilities are strictly distribution utilities. Lansing Board of Water & Light is the largest municipal electric utility within the state with 93,903 customers, while Daggett is the smallest with 140 customers. Municipals, excluding the two largest and the three smallest, serve on average 5,127 customers. Twenty-four of these 41 utilities were established over 100 years ago. Our municipals' residential rates are on average 20 percent lower, while commercial rates are 14 percent lower than the average private utility."¹

Zimmerman reported that 13 of those 41 utilities had banded together in a joint action agency to control their energy destiny. Bay City, Charlevoix, Chelsea, Grand Haven, Harbor Springs, Hart, Holland, Lansing, Lowell, Petoskey, Portland, Traverse City and Zeeland had the foresight 20 years before to fight for

a n d establish the Michigan Public Power Agency. All but Grand Haven, Lansing and Zeeland were participants in Campbell Unit No. 3, MPPA's original project. Only Grand Haven and Harbor Springs did not participate in MPPA's Belle River project. Charlevoix, Grand Haven, Harbor Springs, Lansing, Lowell, Petoskey, Traverse City and Zeeland formed the membership of MPPA's innovative power pool project.

Zimmerman noted that MPPA's members had formed the joint action agency in the first place because "munis are inherently frugal. That's quite logical since the customers and the governing body are one and the same. After all, it's their money."² He added that public power's innate frugality contributed to MPPA members' ability to provide low-cost power to consumers. "Public power systems' general and administrative expenses average 38 percent less," Zimmerman said. "Decisions on major capital improvements are prudently thought out. As a result, no Michigan municipal electric system bought into a nuclear plant."³

As Zimmerman surveyed the utility landscape in Michigan at the dawn of the new millennium, he saw an industry in change. The state's investor-owned utilities were selling generating assets and joining regional transmission organizations (RTOs) that would manage high-voltage transmission grids. Smaller IOUs, especially those located in the Upper Peninsula, were being acquired by larger private utilities from out of state. Utility holding

In 1996, California's Legislature enacted into law a bill that would effectively implement retail electric competition in the state beginning in early 1998. It was the nation's first experiment with significant electric utility deregulation, and it proved to be an object lesson to the rest of North America.

Computer software problems delayed start-up until March 31, 1998. After that date, customers of the state's three major investor-owned utilities (IOUs) – Pacific Gas & Electric (PG&E), Southern California Edison (SCE), and San Diego Gas & Electric (SDG&E) – had the choice of staying with their existing utility or selecting a new energy provider. Customers who elected to stay with their original IOU were rewarded with an immediate 10 percent rate decrease that could not be lifted until 2002.

The enabling legislation also created the California Power Exchange, a non-profit public benefit corporation charged with operating a "spot market" for buying and selling electricity. The state's three investor-owned utilities were required to sell all the power they generated to the Power Exchange. Municipal utilities, independent power producers and utilities located outside California had the option to sell to the Power Exchange or sell directly to a customer.

Coupled with the creation of the California Independent Service Operator (ISO), which operated the California high-voltage transmission grid, deregulation was supposed to be well on its way to becoming reality by the summer of 2000.

Instead, two years into full-scale electric utility deregulation, energy service providers were scurrying for cover in a vastly changed energy environment. After a long, hot summer of double-digit rate hikes and rolling brownouts across the Golden State in 2000, Californians were wondering if the state's experiment with deregulation was all that good an idea. And utility regulators and consumer groups around the nation were closely monitoring the situation in California.

Dealing With MISO



The California experience was no surprise to Dan Cooper and his engineering staff at MPPA. From the time the MPPA power pool went operational in 1992 until 2000, Cooper and the staff were kept busy dealing with transmission issues emanating from the Energy Policy Act of 1992. General Manager Gary Zimmerman, and the lobbyists and attorneys who worked jointly from MPPA and MMEA, labored unceasingly in trying to shape utility deregulation legislation in Michigan.

In 1996, FERC issued Orders 888 and 889, which required transmission owners to create an open-access same-time information system (OASIS). In effect, the OASIS requirement created uniform terms and pro-forma tariffs for users. FERC also ordered transmission owners to unbundle basic transmission functions from wholesale merchant functions, making the grid more transparent for users.⁴

FERC followed up its first two orders with Order 2000 in December 1999. Order 2000 required transmission owners to form regional transmission organizations (RTOs) that would be independent whatever their profit status. The newly-formed RTOs would have a regional configuration, operational authority over the grid, and the responsibility to ensure short-term reliability of the network.

The Midwest Independent Systems Operator (MISO) in Carmel, Indiana began operation on December 15, 2001 and received federal approval to operate as the nation's first RTO four days later. At its formation in 1999, MISO operated in portions of 14 states from Ohio to the Dakotas.

Its members boasted a service territory covering more than 1 million square miles and generated more than 87,000 megawatts of electric power. MISO oversaw 100,000 miles of high-voltage transmission lines. MISO completed the acquisition of the assets of the Minneapolis-based Mid-Continent Area Power Pool late in 2000. By 2001, MISO was in the process of merging with the Southwest Power Pool, giving it broad functional control over the interconnected transmission grid in all or parts of 20 states and two Canadian provinces.

"The MISO is just the local instance of what is a national phenomenon of FERC trying to basically restructure the electric industry in this country," Cooper explained. "FERC's first move was to open up the transmission system, a process that started in 1996 with what is called Order 888. That was designed to make it possible for anyone to use the transmission system. FERC has been less than successful with that, and there have been a whole series of orders and attempts to achieve transmission access. Order 888 was the first one, and Order 2000 was the second. By 2002, FERC was at the point of mandating the formation of RTOs. The goal on all of these was to ensure that the transmission owners didn't have the ability to game the system or to favor their own resources or their own transactions over others."⁵

Gary Zimmerman explained that when MISO finally did begin commercial operation, there was an issue concerning private use of MPPA's tax status. "Membership put our tax-exempt status at risk at that time," Zimmerman said, "and so we chose not to join as a charter member. By 2003, we were pursuing and had an understanding with MISO about how we would be handled if we would become members."⁶

Michigan Restructures



While Cooper and MPPA's engineering staff concerned themselves with integrating MPPA and its power pool into the new grid structure operated by MISO, Gary Zimmerman and the Agency's lobbyists and attorneys were occupied with utility restructuring initiatives in the Michigan Legislature. As California embarked upon its experiment with utility restructuring in 1995 and 1996, Michigan adopted a more cautious, wait-and-see attitude. Still, there was pressure to reduce energy costs in the Wolverine State by increasing competition.

In late 1995, the Michigan Jobs Commission issued a short report entitled "A Framework for Electric and Gas Utility Reform."⁷ In the report, the commission recommended that large industrial customers be allowed to deal directly with energy generators and wheel electric power over the Michigan transmission grid. Governor John Engler endorsed the report, sending it to the Michigan Public Service Commission (PSC) with a strong insistence that the PSC "use this document as guiding principles in its continued effort to promote competition within reasonably established time frames."⁸

In the spring of 1996, the Michigan PSC requested retail wheeling plans from the state's two biggest electric utilities, Consumers Power and Detroit Edison.⁹ That summer, FERC rejected a Consumers Power plan that would have increased transmission charges for MPPA power pool members up to 30 times what they had been paying. "We couldn't be happier," Zimmerman told *Public Power Magazine*. "We don't think the order could have been any better."¹⁰

companies were diversifying at a rapid rate, buying or starting businesses that specialized in every-thing from real estate to home security systems to automobile auctions.

Zimmerman predicted that all of the trends would continue. He also noted that "munis are not interested in expanding their distribution beyond our current service areas. We do wish to continue buying and selling in the wholesale markets."⁴

Zimmerman pointed out that MPPA members and other Michigan public power communities were an island of stability in a sea of utility change. "In the future," he said, "municipal electric utilities will be there, at home in our communities where we belong – providing reliable, low-cost electric energy, responsive and concentrated service, local representative control with direct citizen input, serving as the ultimate aggregator, and an expert resource for the citizens of our communities."⁵

Endnotes

1. Gary Zimmerman, "Executive Vice President's Message: Perspectives on an Industry in Change," MMEA Currents, August 1999, p.3
2. *ibid.*, p.3
3. *Ibid.*, p.3
4. *Ibid.*, p.5
5. *Ibid.*, p.5

Meanwhile, Michigan's Legislature began to address the topic of retail wheeling and competition. In the fall of 1996, joint hearings of the House Public Utilities and Senate Technology and Energy Committees explored the issue for the first time.¹¹ Late in the year, the Michigan PSC unleashed a storm of protest when it released a 47-page report on electric utility restructuring in Michigan. The report included recommendations for an immediate customer choice program, called "Direct Access." It also called for the creation of rate reduction bonds and the creation of performance-based rates for transmission and distribution services.¹²

The most controversial recommendation in the report involved the establishment of a methodology for determining stranded costs. Also called transition costs, the expense was one the investor-owned utilities dreaded facing. In essence, stranded costs were those assets that would have a much lower market value if the utility who owned them was forced to give up its monopoly status. Utility economists estimated that a provision for stranded costs in any Michigan restructuring effort would be worth as much as \$4 billion to Consumers Power and Detroit Edison, both of whom enthusiastically supported the Michigan PSC report.¹³

Michigan Attorney General Frank Kelley's acid comment about stranded costs summed up the opposition to the report. "Christmas has come early for Consumers Power and Detroit Edison at the expense of ratepayers," Kelley said.¹⁴

'Royally Mess Up An Excellent System Now'



During 1997, the Michigan PSC pushed ahead with the recommendations incorporated in the restructuring report, instituting Direct Access in June on a narrow 2-1 vote. The restructuring order required state-regulated electric utilities to allow 2.5 percent of their load to choose other power suppliers through 2002.¹⁵ Michigan's municipal electric systems, which were regulated by their local communities and not by the PSC, were exempt from compliance with the commission's order.

Gary Zimmerman, in his capacity as MMEA's executive vice president, had definite views on utility restructuring. In June 1997, he testified before the Joint Committee hearings in the Michigan Legislature. First of all, Zimmerman told legislators, Michigan's municipal utilities already provided electric power competition in the state. Municipal utility rates were an average 12 percent lower overall than those of the private utilities, he said, and a whopping 24 percent lower on average for residential customers.¹⁶

"MMEA believes it is possible for there to be structural changes that would lead to the development of competitive markets for power supply," Zimmerman concluded. "In the process of change, it is also possible to royally mess up what is an excellent system now."¹⁷

In July 1997, MMEA joined a coalition of industry, environmental and consumer groups to propose draft legislation that would restructure Michigan's electric utility industry. Called the Michigan Electric Industry Restructuring Act, the bill would have phased in customer choice over three years, capped electric rates during the transition period, addressed the issue of market power, provided for the reasonable recovery of stranded utility costs, established an ISO to control statewide transmission facilities, established a utility standard of conduct, and protected the right of municipal utilities to continue to be locally controlled.¹⁸

Consumers Energy, the renamed holding company for Consumers Power, and Detroit Edison in the meantime were promoting an ambitious plan under which the two utilities would receive as much as \$15 billion in bonds backed by the State of Michigan to compensate them for potential stranded costs.¹⁹ Zimmerman noted that “with deregulation of generation, the utilities no longer have an obligation to serve, but with stranded cost the customers have an obligation to pay whether they receive service or not. This smells like a fish that has been in the sun for a couple of days.”²⁰

The battle over electric utility restructuring continued unabated in the Michigan Legislature for the next two-and-a-half years. Most of the deadlock revolved around the private utilities’ insistence on financial guarantees so that they could recover what they expected to be significant stranded costs. The private utilities also continued to be opposed to opening up their high-voltage transmission grids to third-party providers.

In the summer of 1999, the Michigan Supreme Court issued a blockbuster ruling that set back restructuring in the state for more than a year. The June 1999 ruling stated that the Michigan PSC lacked the statutory authority to “order a utility to transmit a third-party provider’s electricity through its system to a customer.”²¹

The Importance of Local Control



Fighting over legislation continued throughout 1999 and into the spring of 2000. Finally, in May 2000, Governor John Engler acted to break the deadlock. Concerned about the erosion of reserve margins in the state and worried that Michigan could face blackouts during the summer of 2000, Engler announced his electric utility restructuring plan and asked the Legislature to move quickly.

One month later, Engler signed PA 141, the Customer Choice and Electric Reliability Act of 2000. It was a compromise version of legislation that had been debated and argued for years, but it did give Michigan’s utility customers the ability to choose an alternate supplier by 2002.²²

Zimmerman and his staff had lobbied long and hard on behalf of MMEA, MPPA and the Michigan public power community. Their efforts at preserving local control had been eminently successful. PA 141 included provisions that kept local control intact for the governing bodies of municipal electric utilities and protected municipal utilities against predatory pricing by the investor-owned utilities. The law also gave municipal utilities the option of competing in the new restructured marketplace, and allowed governing bodies of municipal utilities to recover standard costs if their customers chose alternate suppliers.²³

Public power’s successful battle to maintain local control in Michigan’s restructuring legislation kept consumers in MPPA communities insulated from the upheavals in the electric utility marketplace. By the time Engler signed the Customer Choice and Electric Reliability Act of 2000, utility restructuring was exhibiting its potential to “royally mess up an excellent system.”

The summer of 2000 was a disaster for California’s deregulated utility market as hot, dry weather strained the high-voltage transmission network in the Golden State to the breaking point. Voltage reductions and, in some cases, outright power blackouts affected millions of California electric customers. Blackouts were followed by skyrocketing rates. Electric bills for some San Diego and San Francisco electric customers doubled and tripled in three months’ time.

1. “Historic Energy Bill Signed by President Bush,” *MMEA Currents*, November 1992, p.1
2. *Ibid.*, p.1
3. Dave Naberhuis Interview, p.15
4. Steve Garwood and Douglas Logan, “Grid Business 101,” *Electrical World*, Second Quarter 2002, p.16
5. Dan Cooper Interview, p.11
6. Gary Zimmerman Interview, p.23
7. “Engler to PSC: Reduce Energy Costs,” *MMEA Currents*, February 1996, p.1
8. *Ibid.*, p.1
9. “MPSC Requests Retail Wheeling Plans,” *MMEA Currents*, June 1996, p.1
10. “FERC Says No to CPCo Transmission Plan,” *MMEA Currents*, August 1996, p.1
11. Senator Bill Schuette, “Retail Wheeling: Powering Competition, New Jobs in Michigan,” *MMEA Currents*, August 1996, p.3
12. “MPSC Staff Releases Restructuring ‘Report’; Hearings Scheduled,” *MMEA Currents*, January 1997, p.1
13. *Ibid.*, p.1
14. *Ibid.*, p.1
15. “MPSC Orders Direct Access,” *MMEA Currents*, July 1997, p.1
16. Gary Zimmerman, “Executive Vice President’s Comments – Joint Committee Hearings,” *MMEA Currents*, July 1997, p.4
17. *Ibid.*, p.4
18. “Coalition Introduces Legislation,” *MMEA Currents*, August 1997, p.1
19. “Coalition Opposes ‘Securi-Tax,’” *MMEA Currents*, September 1997, p.1

20. Gary Zimmerman, "Executive Vice President's Report – Stranded Cost and Securitization," *MMEA Currents*, September 1997, pp.4-5

21. Jim Weeks, "Special Report: The History of Electric Restructuring in Michigan," *MMEA Currents*, August 2000, pp.2-3

22. "Governor Signs Restructuring Bills Into Law; Local Control Intact for Munis," *MMEA Currents*, June/July 2000, pp.1-3

23. *Ibid.*, p.2

24. Rebecca Smith, "Utilities May Have Bottomed Out," *The Wall Street Journal*, October 23, 2003, p.A8

25. David R. Walters, "Executive Report," Michigan Public Power Agency, 2000 Annual Report, n.p.

Things got so bad in early August that San Diego County officials urged ratepayers to revolt by simply paying the same amount that they paid for electricity in the same month of 1999. Merchant power marketers booked obscene profits for deregulated electricity, sparking calls in the California Legislature for a return to electric utility regulation.

The restructuring of generating assets resulted in a nationwide building boom for new power plants. Between 1999 and 2002, merchant power firms built more than 200,000 megawatts of new capacity, creating a glut of energy which quickly depressed the price of power nationwide.²⁴ The biggest casualty of the precipitous drop in prices was Enron, the diversified energy marketer, which imploded before filing bankruptcy in December 2001.

Through all the upheaval and chaos, MPPA and the communities it served continued to provide the best electrical service at the lowest cost possible. "MPPA is proud of this heritage," wrote David R. Walters, the chairman of MPPA's executive committee, in the spring of 2001. "Municipal systems working together through Joint Action have provided the cornerstone of a structure and synergy from which to move forward with zeal toward that continuing quest. This quest remains a work in progress."²⁵