

FISCAL AWARENESS SERVICE



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A LETTER OF POLITICAL AND SOCIAL COMMENTARY

November 12, 1984

#19

MEMO TO: Clients and Interested Parties

SUBJECT: MICHIGAN'S ENERGY FUTURE

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Gerry

Energy may become the number one public policy issue of 1985. Nuclear power is under siege in the United States. Since 1972 work has been halted on some 100 nuclear plants throughout the country. It seems clear that here in Michigan the Midland nuclear plant will never be completed. But the debate about Midland as well as the larger issues of planning, financing, and regulating electrical power production and use continues and promises to remain acrimonious unless it is redirected. We are concerned that what should be a discussion of the substantive issues of needs, safety, alternatives, regulation, and costs has become a shortsighted and unrewarding political scuffle. The issues are complex, but the public has been presented with numerous oversimplifications and distortions. There is too much fighting about who pays for mistakes of the past and not enough discussion about providing for Michigan's energy future.

Abundant energy has long been fundamental to the economic prowess of the Western world. Yet energy prices have more than quadrupled since the 1972 Arab oil embargo. The energy sources and distribution systems with which we are most familiar are not necessarily those which will best serve us in today's changing economy. Nuclear energy may be a dead-end street. High transmission costs and the heavy financial requirements of new plant construction mean that large central electric power plants may no longer automatically yield adequate economies of scale. Consequently, planners and policymakers are being forced to consider the advantages of more decentralized systems and the potential contributions of cogeneration, conservation, and other energy alternatives. If the parties to Michigan's energy debate look to the future, they can see that they have a common interest -- the creation of a flexible, reliable, and low-cost electrical power system that can support the state's present and future economy. Unfortunately, the more immediate political advantages of assigning blame for purported errors of judgment and of playing to public fear, anger, and self-interest have obscured this common interest.

Michigan's two largest public utilities, Consumers Power Company and Detroit Edison Company, serve approximately 90 percent of the state's electricity consumers. The two companies also possess about the same proportion of the state's total electrical generating capacity. Both Consumers Power and Detroit Edison have reserve capacity, needed to meet surge

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demand or to compensate for equipment failure, well above the 15-25 percent levels usually recommended by industry experts. Completion of Consumers Power's Midland project (two units) would have further increased Michigan's already substantial reserve capacity. According to what Consumers Power calls its first definitive estimate, the Midland project was originally projected to cost about \$349 million. By 1984, nine years after the completion date originally announced, the estimated cost of completing just one of the two Midland units had ballooned to more than \$4 billion. The estimated cost of completing both units had grown to more than \$6 billion. Dow Chemical Company sought to withdraw from its contract to buy steam from the Midland I unit, in 1983, on the grounds that Consumers Power had misrepresented costs and construction time. That matter is currently under suit. Negotiations with the Public Service Commission staff, the Michigan Citizens Lobby, the Attorney General, and ABATE (an association of Consumers' industrial customers) concerning a plan to save the situation foundered on the question of acceptable rate increases. Consumers Power finally halted construction at Midland on July 16, 1984. Favorable changes of opinion and public perception could still move this nuclear effort forward in the future.

Without the Midland units, Michigan still has more than adequate electrical power for the present. However, the Midland debacle has created an adversarial atmosphere. Consumers Power's August 1984 request to the Public Service Commission for a \$7 billion rate increase over the next 15 years to defray losses on the Midland project immediately drew heavy fire. The Michigan Citizens Lobby has initiated a petition drive for a referendum on a constitutional amendment to restrict a utility's ability to charge customers for construction of plants that are not used or that are judged to be unneeded or less cost effective than available alternatives. On September 11, the Michigan House of Representatives appointed committees to study Consumers Power Company and to examine the role of the Public Service Commission in utility regulation. On October 2, State Attorney General Frank Kelley accused the chairman of the Public Service Commission of improper communication with Consumers Power. Kelley announced that he would seek to bar the chairman from participating in the decision on Midland cost recovery.

The utility has been conducting a public relations campaign in which it asks the question "Will there be power for the future?" and reassures its customers that there will be. But critics feel that the campaign contributes to polarizing the debate by also asking the question "Will there be power for next week?" -- a question that may raise unnecessary fears.

Some argue that Consumers Power should bear all of the responsibility and financial losses for the Midland fiasco. It is unlikely that such a punitive approach would leave customers' pocketbooks untouched. Even if Consumers Power's losses did not drive it into bankruptcy court, its standing in credit markets would be severely damaged and its cost of borrowing would increase. That added cost would be reflected in higher utility rates. A loss of all its Midland investment would likely lead the company to bankruptcy court. It is difficult to predict the effects of bankruptcy on Consumers' customers. Several parties to August's failed utility rate negotiations held then that customers would be better off shouldering a limited rate increase than risking the uncertainties of a Consumers Power bankruptcy.

Consumers Power's long-run financial future is, of course, bound to the question of future energy needs and sources. However one may feel about Midland and the justice or mercy due to Consumers Power, there are substantive issues that must be addressed, and they should be addressed as objectively as possible. A case in point is the question of forecasting the rate of growth of electricity use in Michigan, estimates for which vary. Public Service Commission staff forecasts of the rates of growth for both total energy use and peak load from 1990 to the year 2000 are lower than either Consumers Power's or Detroit Edison's forecasts. These disagreements are attributable to differences in forecasters' methods and assumptions. For example, Consumers Power's forecasts use national data at some points where the Public Service Commission staff uses state and local data. A recent study by the Energy Administration in the Michigan Department of Commerce found fault with both the Public Service Commission staff and the utility company forecasts, finding the former too low and the latter too high. The Energy Administration also asserted that neither the Public Service Commission staff forecasts nor the utility company forecasts have taken adequate account of price-elasticity -- the effects of rising prices on growth in electricity use.

Differences in methods and assumptions are legitimate subjects of discussion, but in the present highly charged atmosphere, the motives as well as the methods of the forecasters are a matter of dispute. For example, those who have suggested that the utility company forecasts are too high have been attacked as pessimists resigned to a low rate of economic growth in Michigan. It is suggested that their lack of faith in Michigan's economic future will lead to an electrical power shortage that will itself stunt Michigan's growth. Such accusations ignore the fact that manufacturers are continually seeking ways to increase production without parallel increases in energy use or the possibility that a rush to build new generating capacity could result in utility rate hikes that discourage industrial growth and encourage industrial flight.

No matter what the rate of growth of electrical power use, just when Michigan will need additional supplies of power depends on what steps are taken in the near future. Rising energy costs have given all users of electrical power a dollars-and-cents incentive to reduce energy use. Utility companies nationwide find that large centralized generating plants no longer provide the economies of scale they once did and that smaller plants not only entail smaller capital costs but are more reliable and allow for finer adjustments of generating capacity to demand. We are clearly in a period of transition, and we need to consider dispassionately alternative means of meeting electrical power needs and controlling the growth of electricity use. What are the costs of power purchased from Canada, Ohio, and Indiana? Will national acid rain legislation eliminate the price advantage of Indiana and Ohio electricity now produced with high-sulfur coal? What is the potential for electricity production from cogeneration? How does the cost of refurbishing existing generating plants compare with the cost of building new plants? What returns can we expect from additional investments in conservation?

In the recent report on "Michigan's Future Electricity Needs," the Energy Administration recommended that the utility companies and the Public Service Commission staff work together to resolve the differences in their post-1990 load growth forecasts; that the Department of Commerce cooperate with the utility companies, customer groups, and legislative staff in assessing

the options for meeting Michigan's future electric power needs; and that the companies, the Public Service Commission staff, and the Energy Administration work together to study the potential for load management, conservation, and cogeneration.

These are steps in the right direction. For the sake of Michigan's future the Governor and the Legislature should promote a cooperative approach, formulate clear goals for our electrical power policy, and establish a more productive relationship with the utility companies.

We suffered greatly in the past recession. We now have an opportunity to prepare for a challenging and vital future. As the philosopher George Santayana pointed out, "Those who cannot remember the past are condemned to repeat it." That should be sufficient caution for those who have lived through the recent past.

We have prepared these comments for a small and special constituency. We hope you will find them interesting and helpful.

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POSTSCRIPT: During rate hearings late last week state regulators and critics of Consumers Power proposed alternatives through which the utility might raise needed funds without raising rates; for example, eliminating all remaining stockholder dividends, selling or leasing power plants, and/or selling its entire natural gas business. The company rejects such alternatives as stopgap measures which would further erode Consumers' standing with investors. Proponents, however, argue that rate increases should be a last, not first, resort. In related developments, a Canadian bank and several U.S. banks have alleged that Consumers defaulted on loans totaling nearly \$175 million. The company denied that the missed payments constitute default and is meeting with these banks to resolve the dispute.