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SFA BILL ANALYSIS

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Senate Bill 1340 (Substitute S-2 as reported)
Sponsor: Senator Mat J. Dunaskiss
Committee: Technology and Energy

CONTENT

The bill would amend the Public Service Commission (PSC) enabling Act to:

-- Establish a schedule for retail electricity customers to have the option of choosing an alternative supplier by January 1, 2002.
-- Provide for the deregulation of retail rates, beginning January 1, 2003, if a market power test were met.
-- Freeze the rates that were in effect on November 1, 1998, for electric utilities serving more than 1 million customers, through 2002.
-- Require the PSC to establish transition charges (payable by customers choosing an alternative supplier) and implementation charges (payable by all retail customers), based upon stranded costs.
-- Provide that stranded costs would be subject to an annual true-up, which would include consideration of a mitigation factor.
-- Require an electric utility to provide stand-by service, based on three proposed options, for customers choosing an alternative provider.
-- Establish shut-off protection for eligible low-income and senior citizen customers.
-- Require an electric utility to join an independent system operator or divest its interest in its transmission facilities to an independent transmission owner.
-- Require the PSC to: adopt reliability standards; establish a code of conduct regarding information-sharing, antiswitching procedures, minimum standards for information dissemination; and require utilities to carry out educational programs.
-- Exempt municipally owned utilities from the bill, except as otherwise provided by law.

Proposed MCL 460.560-460.524 Legislative Analyst: S. Lowe

FISCAL IMPACT

The major State and local government taxes paid by producers and consumers of electricity include the sales tax, single business tax, State education property tax, local school property taxes, and local government property taxes. The amount of revenue generated from these taxes depends basically on the price of electricity, the amount of electricity consumed, and the profits earned by the electric companies. As these factors change, the amount of tax revenue also changes. While deregulation of the electric industry in Michigan could potentially generate significant reductions in these tax revenues, it is estimated the provisions in Senate Bill 1340 (S-2) would not have a significant impact on tax revenues. The estimated fiscal impacts on each of these taxes are summarized below.

Sales Tax - The sales tax on electricity is assessed at a rate of 4% on residential use of electricity and 6% for all other uses. Sales tax revenues could be potentially affected in several ways by deregulation.

1) Stranded Cost Charges - Theoretically, deregulation is intended to lower prices by increasing competition. The greater the decline in prices, the greater sales tax revenues would decline; however, some of this direct loss in revenue would be made up by increased consumption of electricity in reaction to the lower price. Under the bill, however, it is uncertain how much new competition would actually be generated because of the new stranded cost charges that

would be assessed prior to January 1, 2008. All retail electric customers would be assessed implementation charges, and in addition, customers that left the regulated system to be able to choose their electric company would be assessed transition charges. These new stranded cost charges would most likely offset most, if not all, of the potential reduction in prices that would be generated under deregulation. As a result, it is estimated that sales tax revenue would not decline due to increased competition under the bill, and in fact could actual increase slightly because the regulated rates would be increased due to the implementation charges.

2) Rate Freeze - Under the bill, regulated electric rates would be frozen until January 1, 2003, at their November 1, 1998, levels. As a result, this freeze would eliminate rate decreases totaling about $230 million that have already been scheduled by the Public Service Commission. Therefore, this bill would actually result in higher electric rates than would occur under the current regulated system even before factoring in the new stranded cost charges. This increase in rates would result in an estimated $8 million increase in sales tax revenue on a full fiscal year basis.

3) Nexus and Unbundling - Because competition is not expected to increase much under the bill, it is estimated that sales tax revenues would not be reduced significantly due to two potential factors relating to nexus and unbundling.

Single Business Tax - One of the potentially largest impacts on single business tax revenue under deregulation would be the issue of nexus described above. As more of Michigan's electric customers purchased electricity from out-of-state electric companies, these businesses would not be liable for the single business tax as long as they had no nexus in Michigan. This is not expected to be a big problem under the bill. In addition, the amount of single business tax paid by the electric companies also would be affected by changes in their profits, total compensation paid to employees, and investment in new plants and equipment, but it is difficult to figure out how these factors would net out under the bill.

Property Taxes - The value of any electric generating facility is related to the profits generated from selling the electricity produced by the facility. If electric rates decline, some current electric generating facilities would likely be shut down because they would no longer be profitable, and the property taxes paid by these plants would be reduced significantly. Under the bill, it is estimated that these potential reductions in State and local property taxes would be minimized because no significant reduction in rates is expected.

Changes in the revenue generated from the sales, single business, and State education property taxes would affect different components of the overall State government budget. Changes in sales tax revenue would primarily have an impact on the School Aid Fund, local government revenue sharing, and the General Purpose portion of the General Fund. Changes in single business tax revenue would only directly affect the General Fund/General Purpose budget. Changes in the revenue generated by the State education property tax would have an impact on the School Aid Fund. Reductions in local school property taxes would potentially require increased State payments from the School Aid Fund. Changes in local government property taxes would directly affect the local governments, and also could potentially affect the distribution of State revenue sharing payments.

The bill would have no fiscal impact on the Public Service Commission.

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