

# MICHIGAN'S ELECTRIC RESTRUCTURING IS A SUCCESS

## EXECUTIVE SUMMARY

Recent commentaries have questioned the success and future sustainability of electric restructuring in Michigan.<sup>1</sup> This report looks at the past performance of electric restructuring and the prospects for continued success.

### The Goals of Restructuring

Michigan's electric restructuring legislation consisted of two laws: PA 141 and 142 which were designed to address the needs of customers, utilities and non-utility competitive generators who wished to build generating plants in Michigan.<sup>2</sup>

#### PA 141

Under PA 141, the residential customers of Consumers Energy and Detroit Edison received a 5% rate reduction, and their rates were frozen from June 2000 through December 31, 2005. Business customer rates were reduced 5% on the Edison system. All Consumers and Edison industrial rates were frozen through December 31, 2003 and commercial customer rates were frozen through December 31, 2004. Finally, all classes of customers were promised access to competitive electric service from licensed Alternate Electric Suppliers ("AES"). PA 141 was intended to assure non-utility generating companies that there would be a competitive market to purchase their output if they built the new power plants that were needed in Michigan.<sup>2</sup>

#### PA 142

Consumers Energy and Detroit Edison claimed that expensive nuclear power plants made their rates uncompetitive and that they needed to be protected from loss of revenue or stranded costs under competition until they had time to adjust to the new PA 141 competitive framework. The

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<sup>1</sup> Electricity Restructuring in Michigan, Public Sector Consultants, 11/30/06 and Michigan's 21st Century Electric Plan, J. Peter Lark 1/31/07.

<sup>2</sup> Electric Industry Restructuring in Michigan, Suzanne Lowe, Senate Fiscal Agency, July/August 2002.

PA 142 securitization law allowed Edison and Consumers to refinance their high cost nuclear power plants at low customer backed interest rates, an advantage not possessed by their unregulated competitors. Also, under PA 141, retail customers switching to Electric Choice were made liable for stranded costs to protect the utilities from unrecovered power plant investment due to competition.

### Electric Restructuring Is Working

#### Customer Benefits

All classes of customers have been big winners under PA 141 and 142. Five percent rate reductions were implemented for all Detroit Edison customers while rates were frozen from 2000 through 2005 for residential customers, through 2004 for commercial customers and through 2003 for industrial customers. Consumers Energy residential customers got 5% rate reductions and frozen rates through 2005. Residential rate reductions totaled \$110 million per year.

Since June 2000, all Edison and Consumers retail customers have been able to purchase power from non-utilities when the price was advantageous. There have been times when the unregulated market offered significant savings and the record clearly shows that as much as 20% of Detroit Edison load and 11% of Consumers load took advantage of these savings particularly during 2004 through 2005<sup>3</sup>. It is estimated that the Choice program has saved participating customers an average of 15% or almost \$500 million since 2000. See Attachment A. When Hurricane Katrina production interruptions and regulatory orders forced up unregulated prices in 2005 and 2006, many customers chose to go back to regulated prices and Choice participation dropped as low as 6%<sup>4</sup>. These customers avoided the rate shocks which have created economic and business climate problems in other states. The customer load that stayed on Choice helped regulated utilities reduce expensive power purchases by over \$1 billion since 2000 thereby minimizing utility cost increases. See Attachment A.

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<sup>3</sup> See 2004 and 2005 MPSC Reports - Status of Electric Competition

<sup>4</sup> MPSC 2006 Report: Status of Electric Competition, p. 5.

Now, in 2007, deregulated energy markets are trending down, utility rates have increased to reflect post-Katrina increases and customers are once again taking advantage of the opportunity to switch to Electric Choice and save money<sup>4</sup>. In fact as of this writing, the majority of Detroit Edison and Consumers Energy customer classes can break even or save money by switching to Choice service. Under PA 141 and 142, Michigan customers have had the best of all worlds: a choice between regulated and unregulated energy service. (See Chart on p. 8.)

### Utility Benefits

Utilities have also fared well under restructuring. Detroit Edison and Consumers Energy refinanced their Fermi and Palisades nuclear plants with low interest, customer backed securitization bonds. In Edison's case, securitization financing produced a net reduction in Fermi costs of over \$270 million per year or about 10% for a typical business customer.<sup>5</sup> This low cost financing made Edison and Consumers more competitive with non-utility power sources. PA 142 also forces AES customers to pay Palisades and Fermi securitization bond costs thus imposing a significant handicap on competition which helped utilities compete to retain customer load. This utility marketplace advantage was increased by MPSC awards of over \$63 million of stranded costs to Consumers and \$64 million to Detroit Edison under PA 141 which forced customers leaving utility service to make significant contributions to the cost of bundled utility service.<sup>6</sup> These stranded cost payments helped keep utility rates lower than would otherwise have been the case and ensured cost recovery for generating plant while protecting the utilities from some of the adverse financial impacts of competition.

### Non-Utility Generation Benefits

PA 141 also stimulated significant non-utility power plant construction and investment in Michigan. Over 4,000 MW of generating plant was built by non-utilities in Michigan subsequent

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<sup>5</sup> Report by DTE (Michael Van Haerents) to MPSC, February 19, 2004, Docket U-12478.

<sup>6</sup> MPSC Cases U-13720 and U-13780 -- Consumers; U-13808 and U-13808-R--Detroit Edison.

to passage of PA 141.<sup>7</sup> If it is assumed that the cost of this generation was between \$400 and \$500 per kW, the investment exceeds \$2 billion. Since this generating plant investment was made by non-utilities, the cost was not added to utility rates and Michigan electric users did not pay the cost of this generation when the power was unneeded or not economically attractive. Because they were not responsible for \$2 billion of investment, the customers of Consumers and Edison potentially avoided annual rate increases of \$360-400 million while benefiting from the availability of generating capacity that clearly constituted a margin between power adequacy and blackouts during recent years.<sup>8</sup> These non-utility generating companies continue standing ready to supply Michigan's energy needs.

If PA 141 Is Weakened Utilities Would Keep Subsidies  
But Customers Would Lose Competition and  
New Power Plant Investment Would Be Discouraged

Some groups seem to be suggesting that it is time to revise the fundamental bargain inherent in PA 141 and 142. It is suggested that PA 141 must be revised to protect electric utilities from competition by "deskewing" rates or removing alleged subsidies to residential customers which are paid by traditional utility customers but not Electric Choice customers. Critics of PA 141 also claim the current mandate that utilities stand ready to serve customers returning from Choice service, forces utilities to maintain uneconomic reserve levels and may prevent financing of new power plants due to revenue uncertainties. These critics suggest that restricting the right of customers to exercise Choice would provide load certainty. Finally, critics express concern regarding the impact of natural gas prices on deregulated service which they fear may end attractiveness of competition due to price volatility or long range increases.<sup>1</sup> Id.

Each of these criticisms or concerns is addressed in detail below. However, the criticisms should be viewed in an overall context rather than in isolation. Taken as a whole, PA 141 and 142 have

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<sup>7</sup> MPSC Capacity Need Forum Report, January 3, 2006, p. 23.

<sup>8</sup> \$2 billion x 18 - 20% FCR = \$360-400 million per year ÷ 90 million MWh output of Consumers and Detroit Edison = .4-.5 ¢ /kWh

given customers and generating competitors as well as utilities exactly what they bargained for in 2000.

Recent market price reductions offer most Consumers and Edison customers the opportunity to save money on Electric Choice. (See Chart on p. 8). Many of these customers avoided deregulated market increases in 2005 and 2006 by using regulated service when it was economic to do so. After all, the programs under PA 141 are called Electric Choice and that name implies the ability to choose between two sources of energy: deregulated and regulated. Any significant curtailment or reduction in the customer's right to choose by preventing or greatly hampering migration of customers from Choice to retail and back again would effectively destroy the competitive framework. Retail service would no longer be a choice for electric customers in Michigan. The right to return to utility service is being paid for by Choice customers who are forced to continue paying for financing costs of utility nuclear power plants through 2015 even after these customers leave utility service. Utilities must not be allowed to eliminate the burdens of Choice while still receiving the benefits of customer backed low cost financing not enjoyed by their competitors and enforced contribution to nuclear plant costs by Choice customers.

Competitive generators have invested billions of dollars building generating facilities in Michigan.<sup>7</sup> Revisions to PA 141 which weaken or destroy Choice will significantly reduce the value of the generating investments which were made in reliance of the open market promised by PA 141. Breach of the PA 141 "contract" would be both unfair and unwise. It would be unfair because an estimated \$2 billion of investment has been encouraged based upon a promise of open markets. It would be unwise because retraction or abrogation of the fundamental "contract" implied in PA 141 would surely discourage new, non-utility investment in needed generating plants designed to serve the Michigan market.

### Conclusion

The Electric Choice program has saved customers almost \$500 million and reduced utility costs by billions of dollars. See Attachment A. Without these reductions, Michigan business costs would have been higher by hundreds of millions of dollars. Michigan would have been a less attractive place for employers to locate or remain.

At a time when Michigan is challenged to create the most competitive possible economic environment, proposals to revise or repeal PA 141 would deprive commercial and industrial customers of needed utility rate reductions that can be delivered at no cost to other customers or to Michigan's government.

# ***Michigan's Electric Restructuring Is A Success***

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**2007**

**Prepared by  
Customer Choice Coalition**

I. Electric Restructuring Continues To Benefit All Consumers and Detroit Edison Customers.

A. Choice Is Producing Savings

Contrary to fears expressed in the Public Sector Consultants Report, the Choice market is increasingly attractive in 2007 and can produce savings for many classes of Detroit Edison and Consumers customers.

Does Choice Offer Lower Electric Rates In 2007? \*

LF=Load Factor\*\*\*

	Residential**	Small Commercial	Large Commercial	Small Industrial	Medium Industrial	Large Industrial
DTE	D1	D3	D4	D6 Primary	D6 Subtransmission	D6 Transmission
	Break Even	No	Yes	LF<50% = Yes LF>50% = No	LF<50% = Yes LF>50% = No	LF<50% = Yes LF>50% = No
CE	A1	B	C	D Primary	D Subtransmission	D Transmission
	Break Even	Yes	Yes	LF<50% = Yes LF>50% = No	Yes	Yes

\* Rates and market price in effect as of 1/22/07 are used.

\*\* Market rate of power is competitive with utility rate for first time. The PA 141 rate freeze of residential utility rates below market and Katrina related market increases have made residential Choice uneconomical until 2007 and service is not being offered. It is hoped that changed economics and the resulting opportunities will bring residential suppliers into the Michigan market.

\*\*\* Load Factor refers to the portion of theoretical maximum that electricity is used, e.g. a 100% Load Factor customer uses its maximum amount seven days a week, 24 hours a day. Factories or pumping stations might come close. A 50% Load Factor customer might be a shopping mall or apartment complex with maximum use in evenings or weekends.

The Choice program represents an opportunity for many of Michigan's residences and businesses to save money. It is estimated that Michigan customers have saved almost \$500 million since 2000 using the Electric Choice program. Attachment A. Equally important, the Choice program is an economic development tool which can lower the cost of doing business in Michigan at no cost to the State of Michigan or local governments.

Can Michigan truly afford to deny market rate Electric Choice service to businesses when many other surrounding states make that opportunity available?

B. PA 141 and 142 have provided savings to retail customers not using Electric Choice service.

#### PA 141 Savings For Edison and Consumers Customers

All residential customers of Detroit Edison and Consumers received a 5% rate reduction for the period starting 2000 and their rates were frozen through the end of 2005. PA 141 § 10d. Commercial and industrial customers on the Detroit Edison system received a 5% reduction through February 2004. For Edison and Consumers, rates were frozen from 2000 through the end of 2004 for commercial customers and through 2003 for industrial customers. Id.

#### Utility Securitization Savings

Under PA 142 both Edison and Consumers were able to lower utility rates by converting nuclear power plant financing from utility finance rates above 9% to debt financing backed by State law that lowered interest rates below 6%. The savings produced a double benefit for customers and utilities. Flow through of the savings to customer rates produced a \$270 million rate reduction in the case of Edison or almost 10% for an industrial customer.<sup>3</sup> At the same time, these lowered rates resulting from customer backed financing made Edison and Consumers more competitive with alternate suppliers who do not have access to government financing.

Finally, Choice customers were required to pay securitization and nuclear decommissioning charges on utility nuclear power plants even though these customers

did not receive service from these plants.<sup>9</sup> This contribution produced additional rate reductions for retail customers which were supplemented by Choice payment of over \$60 million in stranded costs on both the Consumers and Detroit Edison system.<sup>4</sup> Id. Collectively the securitization financing, mandatory Choice contribution to these securitization costs and stranded costs significantly lowered retail customer rates and made utilities much more competitive with market prices than would have been the case without these subsidies.

C. The Choice program reduced utility power supply costs during 2005 and 2006.

Both Detroit Edison and Consumers Energy purchase more than 15% of their peak power requirements on the unregulated, competitive market<sup>10</sup>. Hurricane Katrina and related events caused large increases in the cost of generating fuels and wholesale market rate electric power. Because many of their customers had left retail service for Choice, Detroit Edison and Consumers were able to purchase significantly less expensive power than would have been the case without the Choice program. See Attachment A. Edison in fact, has taken the position that elimination of Choice migration would have increased power purchases and produced related rate increases of over .5 ¢ /kWh or about 5-7% of a customer's total bill.<sup>11</sup> Also, excess power was sold at a profit and offset loss of revenue to pay for fixed power plant costs. [U-14275-R].

D. PA 141 encouraged construction of non-utility generating plants which have been a critical reliability margin in Michigan and avoided utility rate increases.

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<sup>9</sup> See MCL 460.10k.

<sup>10</sup> See Consumers and DTE 2007 five year plans for power supply. U-15001 (Ex. A-15) and U-15002 (Ex. A-3) respectively.

<sup>11</sup> See DTE Matrix, Case U-14275.

Over 4,000 MW of non-utility generating plants were built during the period 2000 through 2004 largely in response to the State's new competitive framework. This is equal to more than 20% of Michigan's total power supply<sup>12</sup> If it is assumed these plants cost \$400-500 per kW of capacity, total construction costs would have exceeded \$2 billion. There is no doubt that this additional capacity was the margin between power adequacy and shortage in Michigan during the past few years. If utilities had built this capacity the required cost recovery would range from \$360 million to \$400 million per year assuming finance and plant cost recovery at 18-20% per year.<sup>6</sup> This cost would have produced rate increases in the 4-8% range for Consumers and Edison customers.<sup>6</sup> However, these costs were borne by non-regulated generators even when the power plants were not fully used or profitable.

## **II. Calls for An End To Electric Choice Are Based on Two Myths: Competition Has Been Subsidized and Michigan's PA 141 Framework Hampers Construction of New Power Plants.**

Critics of PA 141 claim that competition is made possible by retail customer subsidies and that the right of customers to move back and forth between utility service and competitive service, i.e. exercising choice, prevents utilities from financing new power plants.<sup>1</sup> An examination of the facts proves these contentions are incorrect.

A. Choice customers typically pay stranded cost subsidies to utilities that equal or exceed any "skewing" subsidies which help Choice compete with utilities.

If "skewing" hurts the competitive position of utilities, the Choice program is hurt equally by uneconomic stranded cost subsidies to utilities. Consider the following facts:

1. Choice customers pay stranded costs which are a contribution to retail rates when utilities can't recover costs due to competition. Through 2006, Edison

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<sup>12</sup> MPSC Staff Capacity Need Forum Report, January 3, 2006, p. 23.

Choice customers paid \$64 million of stranded costs to Detroit Edison which were used to lower retail rates. The Commission is currently requiring Consumers Choice customers to pay \$63 million for Consumers Energy stranded costs <sup>4</sup>

2. Choice customers on the Edison and Consumers system pay the securitized stranded cost financing and nuclear decommissioning costs for the Palisades and Fermi nuclear plants even though Choice customers do not use electricity from those plants. For an Edison Choice business customer, securitization and nuclear decommissioning charges equal about 10% of the total cost of energy for no benefit whatsoever.

3. PA 142 provided Edison and Consumers with guaranteed, subsidized financing amounting to \$468 million for the Consumers Palisades nuclear power plant and \$1.77 billion for Edison's Fermi nuclear plant. Securitization has proven a huge competitive advantage for Detroit Edison because it lowered Edison's net annual Fermi costs by over \$270 million per year or about 8-10% of a business customer's energy costs. Choice competitors of Edison do not have access to low cost customer backed financing for their power plants. Securitization represents a huge subsidy to Edison and Consumers that is not enjoyed by Choice customers.

In fact, the magnitude of Choice subsidies to utilities often exceeds any alleged "skewing" subsidy built into retail rates for the benefit of residential customers. The chart below uses typical Detroit Edison retail rates to compare the subsidies paid to support retail service by Choice customers with the subsidies paid by retail business customers to lower residential rates. It can be seen that in the case of many commercial and industrial customers, the Choice subsidy to utility customers is greater than the retail rate subsidy.

DTE SUBSIDIES

PA 141 & 142 Subsidies to DTE

	Residential Rate D1	Small Commercial D3	Large Commercial D4	Primary D6
1) Fermi 2 Securitization And Nuclear Decommissioning Costs Paid By Choice Customers	.62 ¢/kWh	.62 ¢/kWh	.62 ¢/kWh	.62 ¢/kWh
2) Stranded Cost	0	0	0	0
3) PA 142 Low Interest Financing on Fermi Plant*	>.5 ¢ /kWh	.5 ¢ /kWh	.5 ¢ /kWh	.5 ¢ /kWh
Total PA 141 & 142 Subsidies to Retail Customers	1.12 ¢ /kWh	1.12 ¢ /kWh	1.12 ¢ /kWh	1.12 ¢ /kWh

PA 141 Advantages To Choice Customers

	Residential Rate D1	Small Commercial D3	Large Commercial D4	Primary D6
1) Rate Skewing (Residential Subsidy Paid By Retail and Not Paid By Choice)***	0**	1.08 ¢ /kWh	1.73 ¢ /kWh	.96 ¢/ kWh

\* Over \$270 million annual securitization savings ÷ over 50 million MWh of sales = .54 ¢ /kWh. See DTE U-14278 Report on Securitization Savings, 2/19/04. Sales from U-15002, Exhibit A-1.

\*\* Rates are same for Choice and retail residential.

\*\*\* DTE Rate Sheets, D1, D3, D4, D6 (assumes 65% load factor)

Legislators and policy makers should take careful note of these facts in their deliberations. Any program to eliminate or reduce "skewing" subsidies should also reduce the often greater subsidies paid by Choice customers to utilities.

B. PA 141 encouraged construction of needed generation.

Electric Restructuring Has Stimulated Not Prevented Power Plant Investment

An analysis of the legislative history of PA 141 and 142 reveals that the need to encourage or stimulate power plant construction as a driving force behind the legislation.<sup>2</sup> The theory behind restructuring was clear: unless open free markets were assured, non utility developers would not build needed power plants in Michigan. After passage of PA 141 and 142 the competitive industry responded by installing more than 4,000 MW of generating capacity in reliance on the State's commitment to provide a free market for the output of that generation.<sup>5</sup> Equally important, the legislative analysis of PA 141 noted that regulated utilities were unwilling to provide needed capacity before restructuring of PA 141.<sup>2</sup> If the right of customers to choose competitive service is repealed or weakened, the only proven source of new capacity over the last 15 years; non-utility generators will be discouraged and likely have little incentive for future investment in Michigan.

Utility Claims That Uncertainty Created By The Electric Choice Program Has Prevented Power Plant Construction Are Simply Not True

Recent reports have claimed that the Electric Choice program has created uncertainty regarding the amount of electric utility load. These reports further claim that this uncertainty prevents financing of new base load power plants<sup>1</sup>. The actions of Detroit Edison and Consumers Energy do not support this claim. Detroit Edison has projected an investment of over \$1 billion in its Monroe power plant alone to comply with Clean Air Act requirements. (Detroit Free Press, February 19, 2007.) Moreover, Edison projects steady capital expenditures of almost \$900 million per year through 2011 in its generating fleet<sup>13</sup>. Compare these massive expenditures with an estimated cost for a new 500 MW base load unit of less than \$1 billion.

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<sup>13</sup> DTE presentation to financial analysts.

## Michigan's Utilities Do Not Maintain Excess Capacity To Serve Changing Utility Load

Critics have claimed that the obligation to serve returning Choice customers requires Michigan utilities to maintain excess capacity to serve load that may not return.<sup>1</sup> This is not true.

Both Consumers and Detroit Edison currently purchase more than 15% of their energy requirements on the short term and long term deregulated markets.<sup>8</sup> When customers leave utility service for Choice, purchases are reduced and excess utility power is sold into the competitive and MISO markets. The proceeds are used to reduce retail rates. For example, during 2005 and 2006 Edison sold hundred of millions of dollars worth of power producing significant revenue to offset increased costs. See Cases U-14274-R, U-14275-R. But, when Choice customers return to utility service excess power is not available for sale and is used to serve returning customers. Often utility generated power to serve customers must be supplemented by purchases on the MISO long term or short term markets. In the current dynamic electric markets, utilities are not forced to maintain uneconomic reserve levels merely in the fear that Choice customers may return to the system. Rather, utilities rely on market sources of power to meet these needs or sell excess power, not unused excess generating capacity. A review of utility capacity plans confirms that excess capacity is not maintained to serve returning customers.<sup>8</sup>

### Choice Customers Are Not Free To Move Back And Forth Between Regulated Or Deregulated Services

The Public Service Commission has been charged with the responsibility for developing tariff terms which strike a reasonable balance between the right of customers to choose suppliers (retail or Choice) and the need of utility for some advance notice of returning customers for planning purposes. The resulting Commission orders have imposed significant burdens on Choice customers who wish to return to utility service. Returning Choice customers must give at least 60 days advance notice at any time of the year and, in some cases, six months' notice if they wish to return during or just prior to a peak

summer month. Customers who leave utility service for Choice must stay on Choice service at least two years before returning. Also, any Choice customer who returns to utility service must pay market rates unless they will commit to remain on utility service for at least one full year. This one year commitment would certainly give the utility the opportunity to buy long term power supplies to cover the needs of returning customers at a predictable rate.<sup>14</sup>

Choice customers are paying for these return to service privileges. Under PA 141 and 142, utilities were shielded from competition with billions of dollars of below market customer backed securitization financing which made them more competitive. Choice customers must pay the cost of the Fermi and Palisades securitization bonds through 2015 and were made responsible for stranded costs if the utilities suffered financially because of competition.

Proposals to eliminate or greatly restrict Choice customer return to utility service would prevent most utility customers from using Choice service. Preventing or restricting return to utility service would give the utilities all of the benefits of PA 142 and none of the burdens. Financing and Choice subsidies to retail service while allowing the utilities to escape all competition because the abolition or reduction of return to service privileges would destroy the Choice program but leave utilities with customer backed financing.

The Public Service Commission should continue rulings which strike a balance between the rights for which all customers have paid to choose between retail and competitive service on the one hand and the burdens which Choice imposes on utilities. However, a complete elimination or significant reduction of return to service rights is simply another way of saying that Michigan's electric users should be deprived of the Choice program while continuing to pay utility securitized stranded costs for the Fermi and Palisades nuclear plants.

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<sup>14</sup> Cite DTE tariff EC2. See 5.3, CE tariff Sec. F2.5.

## Steps Can Be Taken To Encourage Power Plant Construction

Recent proposals by the utilities suggest that the best way to encourage construction of generating capacity is to eliminate competitors of the utilities by providing financing incentives or customer guarantees that are useful only to regulated companies. These proposals are nothing more than an attempt to avoid the consequences of poor performance and cost overruns which make a power supply uncompetitive in the marketplace.

In the long term, competitive mechanisms offer a far better solution to the problem of power supply than approaches which attempt to augment power supply through restriction of competition and use of customer guarantees or subsidies that are not available to all suppliers.

Needed power resources or resource deficiencies are best addressed through an all source competitive bid process which encourages all types of resources, including demand side, renewable and traditional fossil fuel plants, to compete for the right to supply identified requirements. Utilities should be required to issue all source RFPs for needed capacity. If a set of resources can be obtained at prices which are at or below projected market levels, the owner of these resources has a good opportunity to use or sell the output at a compensatory rate. For customers who must pay electric bills this competitive approach is far more desirable than a system that preordains a certain type of resource to be built by only one supplier (a utility) with any price overruns or underperformance paid by customers rather than the power supplier.

If utility revenue uncertainty is truly preventing power plant construction, there are other ways to address this issue. For example, regulators can adopt mechanisms which automatically adjust utility rates and revenue for the ebb and flow of competition. This

type of mechanism can create a more predictable revenue flow in the Choice environment which should enhance the ability to finance large new generating projects<sup>15</sup>.

The MISO regional market is another answer to the problem of serving returning Choice customers although it is a solution which imposes cost discipline. With the advent of the MISO regional markets, power suppliers can sell literally all of their excess output at a market rate. The problem, of course, is whether the costs of electric production will be fully compensated at the prevailing market rate. In this market environment, an overpriced or inefficient generating plant becomes a liability for its owner because the output may not be sold at a rate that pays costs of production.

### **III. Restructuring Can Produce Competitive Residential Service.**

It is premature to state that PA 141 cannot foster competitive residential service. PA 141 and 142 delivered electric service to residential customers that was below market price from June 2000 through the end of 2005. During that timeframe, residential rates were priced about 5% below the year 2000 true cost of service and the rates were frozen so they could not increase with prevailing cost trends. It is no wonder that residential customers had no interest in switching to market rate Choice power when they were receiving a below cost supply of power.

Also, no mechanism was provided to aggregate residential customers into large groups that produced economics of scale.

In 2006, the residential price freeze expired but Hurricane Katrina related cost increases made Choice service uncompetitive with regulated retail service, which had not yet increased in price due to regulatory lag.

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<sup>15</sup> See MPSC 2006 Report on Status of Competition, p. 12-13.

In 2007, Choice market rates are declining and reflecting more typical pre-Katrina cost trends. Also, regulated rates have finally risen to reflect Katrina related cost increases. With these two countervailing trends, Choice market rates have a good chance of competing successfully with regulated market rates.

One problem remains: Residential Choice customers must pay the same distribution costs to their utility as are paid by retail customers. However, the residential Choice customer gets far less service for the distribution charge paid. The Choice residential competitive service provider must charge for the utility's administrative cost for billing, collection and bad debts. Moreover, the retail customer's distribution charge includes all these services and costs of bad debt related to utility generation service. In other words, the Choice customer pays twice for distribution service: once to their alternate supplier and once to the regulated utility.

If this duplication of costs can be eliminated, residential Choice customers can effectively use the regulated company to bill, collect and cover bad debts and residential competitive service has a reasonable chance to be competitive with utility service in the current energy market. This approach has proven effective with natural gas service in Michigan and should be adopted for Choice electric residential service.

#### **IV. Let's Keep The Proven Benefits Of Electric Choice.**

Michigan's approach to electric restructuring saved customers about \$500 million, reduced utility power and fuel purchases by over \$1 billion and will continue to benefit customers with savings if they switch to competition, the ability to return to retail service when savings are not available, and continuing reduced costs from securitization.

The availability of electric supply at market rates case be a significant advantage in Michigan's effort to attract and retain jobs.

Finally, restructuring produced about \$2 billion of non-utility generating plant which was constructed exclusively at the risk of non-utilities. The availability of this generation has

prevented blackouts in Michigan and saved Michigan electric customers millions of dollars because non-utility plant costs were not included in base rates. If the rules of the game are changed to eliminate or reduce competitive markets, we will be sending a signal to private investors that Michigan does not want their new power plants.