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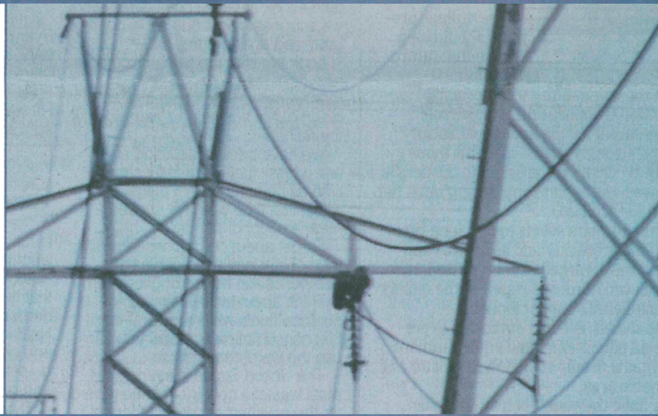
POWER STRUGGLE

Restore electricity competition for Michigan



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The Michigan House and Senate have approved legislation to limit competition in the supply of electricity.

The bills reverse reforms that had reduced the high energy costs that long plagued Michigan. Resurrecting the monopolies of DTE Energy and Consumers Power Co. will tax the budgets of Michigan families and the businesses that employ them.

Differences between each chamber's bills must be reconciled before the legislation goes to Gov. Jennifer Granholm for her consideration. Thus, voters still have an opportunity to voice opposition to a policy that represents special-interest politics at its worst.

The legislation would, if enacted, prohibit competition in electricity supply for 90 percent of the market. In essence, the bills would outlaw free enterprise with respect to the generation of power. In so doing, lawmakers would be undermining energy reliability by centralizing energy sources and driving away new suppliers.

Proponents argue that the "incumbent" utilities need a guaranteed market share to finance new power plants. Yet, other electric companies have managed to finance new facilities in Michigan and in competitive markets nationwide without protection from the state.

It is also worth noting that there was no bailout of monopolists in the deregulation of other industries, such as rail, aviation, trucking and telecommunications.

In the late 1990s, Michigan's high energy costs and aging infrastructure prompted the Michigan Legislature to restructure the electricity industry. Two principle goals guided the Legislature: 1) to encourage investment in new, more efficient generating capacity and 2) to introduce competition in energy supply as a means of controlling electricity rates.

The new law "unbundled" the three elements of electricity service — generation, transmission and distribution. It also established a schedule by which competitive suppliers could market electricity to residential, commercial and industrial customers. (As a practical matter, power suppliers cannot direct the electricity they produce to specific customers. But the total volume of power they add to the transmission grid represents the load specified by their customer contracts.)

P.A. 141 and P.A. 142 were passed in 2000, but because of phase-in provisions in the legislation, significant competition among electricity providers did not really begin until 2002.

Executives and lobbyists for Detroit Edison and Consumers Energy successfully argued that the incumbent utilities should be compensated for their costs in transitioning to competitive markets. They asserted that competition would pit them against newer, more nimble and efficient competitors unburdened by the costs of less efficient equipment and more expensive overhead.

They also claimed that competition would shrink their customer base and deprive them of revenue needed to pay the debt costs of the infrastructure necessary to provide mandated services such as maintaining excess generating capacity necessary to serve all customers during periods of peak demand, as well as a range of programs to assist low-income customers. They secured in Public Act 142 of 2000 a substantial stream of revenue to recover these "stranded" costs.

The two utilities were granted state loan guarantees totaling $2.2 billion with which to refinance their debt through the sale of securities. In so doing, the incumbents received a huge infusion of cash to offset future — hypothetical — losses.

To ensure repayment, lawmakers imposed a surcharge on all electricity customers in the DTE and CMS Energy service territories, including those who would opt for a competing supplier.

Given this payoff, there's no justification for the utilities to now claim that a loss of market share is crippling their finances. Indeed, the stock of DTE outperformed the utility average during the years of peak competition.

Michigan's limited experiment with competition in energy supply did produce cost savings and service improvements for both commercial and industrial firms, while also attracting investment to the state.

In Detroit Edison's service territory between 2001 and 2004, competitors increased the number of customers they served at a whopping rate of 104 percent annually, amassing a 69-percent annual gain in megawatts served. In 2004, these "nonincumbents" peaked at 17,241 customers, representing 2,378 megawatts of load.

Similarly, in Consumers Energy service territory between 2001 and 2004, competitors increased their customer base at a clip of 65 percent annually, producing a 60-percent annual gain in megawatts served. In 2004, they reached 1,473 customers, representing 926 megawatts of load.

The results were impressive: During that period, average industrial rates in the state dropped by about 3 percent at the same time that the average industrial rates in the United States as a whole increased by around 13 percent.

Meanwhile, commercial rates dropped by about 4 percent in Michigan, even as the average commercial rates in the country as a whole increased by around 10 percent.

In fact, Michigan's total electricity prices across all sectors dropped by about 2 percent, while the nation's total electricity prices rose by about 12 percent.

The residential market was not a natural niche for these suppliers: They were seeking to establish themselves in the marketplace, and they focused first on attracting higher-vol-

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ume customers, such as schools, retail stores and manufacturing plants. Not surprisingly, then, few residences switched to alternative suppliers.

Regardless, all Michigan residents benefited either directly or indirectly from the lower electricity prices spurred by competition, and this competition brought Michigan's business rates closer to those of surrounding states, thereby ameliorating a competitive disadvantage.

As a variety of experts predicted, the stranded-cost scheme and various regulatory mandates ultimately undermined competition. For example, the state loan guarantees provided the incumbent utilities with a marked competitive advantage over prospective competitors in both better access to capital and lower debt costs. Moreover, the surcharge imposed on competitors' customers narrowed the price differences between new, more efficient electricity suppliers and the incumbents.

Simply put, customers of competing suppliers were effectively subsidizing the former monopolies.

Stranded-cost recovery also undermined the rate discipline that partial deregulation had stimulated. The average price of electricity for industrial customers in Michigan jumped 23.0 percent between 2004 and 2006 (the last full year for which data are available), while industrial rates rose 17.3 percent for the nation as a whole. The state's commercial rates fared slightly better, rising 12.4 percent, compared to 15.8 percent for the nation as a whole, but overall, Michigan's electricity prices rose 17.3 percent, compared to a national increase of 17.0 percent.

Thus, after 2004, the state's electricity rates were no longer rising less than the national average; instead, they were rising at about the same rate as the national average.

Similarly, Michigan's electrical rates improved and then lost ground compared to electricity prices in the surrounding four Midwest states (Illinois, Indiana, Ohio and Wisconsin). Although Michigan's prices were high compared to the four-state average from 2000 to 2006, they declined relative to that average from 2000 to 2004. This decline ended after 2004, however, with Michigan trending up again at a faster rate than the four-state average.

Energy policy is critically important to Michigan households and businesses. Lawmakers and voters alike would do well to recognize that a vibrant energy market requires less government involvement — not more. Consumers would be better served if the governor and Legislature eliminated the burdensome service and capacity mandates on the utilities and left them to compete freely with other producers.

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