Energy Michigan: Electric Choice Cap and Restructured States

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1999-2007 Electricity Restructuring

- States who move to retail electricity markets did so by artificially capping or reducing default prices for customers who didn't switch.
- By 2007 these caps were set to be removed and the deferrals caused by the rate reductions were ready to be paid.
- In addition, volatility in natural gas along with emission concerns of coal created the perfect storm for customer "price spikes".

2008 National Perspective on Electric Choice

- Concerns over increasing wholesale electricity costs had MI, OH, IL and MD reviewing a need to return to regulated regime and "control prices" competition became the scapegoat.
- A study by the Northbridge Group "Embrace Electric Competition or It's Déjà Vu All Over Again" from Oct. 2008 reminded everyone of what happened under the old regulated structures:

1. First and foremost, future electricity costs and prices are inherently uncertain. Because future load levels and fuel prices are unknown – as are changes in technology and environmental requirements – investments in long-lived generation assets are inherently risky.
   - We can centrally plan these decisions, and impose the risks on retail customers, but we should not be surprised when things turn out badly for customers, particularly when we evaluate projects over 30 year time horizons and the risks are not borne by investors.
2. Decision-making under regulation performs particularly poorly in times of uncertainty. … many of the difficulties in the electric industry arose from the fact that the administrative, command-and-control approach to resource allocation under regulation was too inflexible and too slow to respond to external stresses and changing market conditions.
3. Inherent incentive problems …. Much of the excess of planned baseload capacity at the start of the 1970s energy crises and the failure to trim that excess sufficiently in response to changing conditions can be attributed to improper incentives for regulated utilities.

Question 2: What approaches to retail electric market structure have been tried in Michigan and in other states and jurisdictions?

2008/2010 Legislation To Mitigate Rate Increases

- Only MI put a cap on competition. Other states recognized the role of competition in putting pressure on utility pricing and options for customers:
- OH – S.B. 221 policy of the state to promote competition in addition to new rate plan authority.
- IL – creation of a power authority to take the procurement function away from utilities. Policy of the state to promote competition.
- MD – after unanimously voting down a bill to re-regulate Governor O'Malley conceded that the utility commission was in the best place to determine need and prices.
- CA - 2009: Senate Bill (SB) 695 was signed into law which called for a limited Direct Access market to begin to be phased in by April 11, 2010 for all non-residential customers.

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Other States Approach To Competition Post 2008

- Connecticut – current budget bill would auction customers to retail suppliers for a fee. Going forward all customers must choose a supplier or remain with the supplier who purchased them.
- Texas – utilities are wires only. Customers must choose a supplier to receive service. All customers have smart metering which allows for new products.
- Illinois – default service is procured for the utilities by the Illinois Power Authority and independent state agency. Only small commercial and residential customers have default service. All other customers are on hourly pricing if they do not choose a supplier they do not have purchased default service.
- Pennsylvania – utilities must bid out their default service through wholesale procurements. All customers have the opportunity to switch suppliers. Smart meters have been a game changer for customers ability to pick new products.
- Ohio – utilities individually file plans to design default service every 3 years. All customers have statutory right to choose a supplier. Ohio is currently investigating its processes for retail choice to open the market further in case # 12-3151-EL-COI

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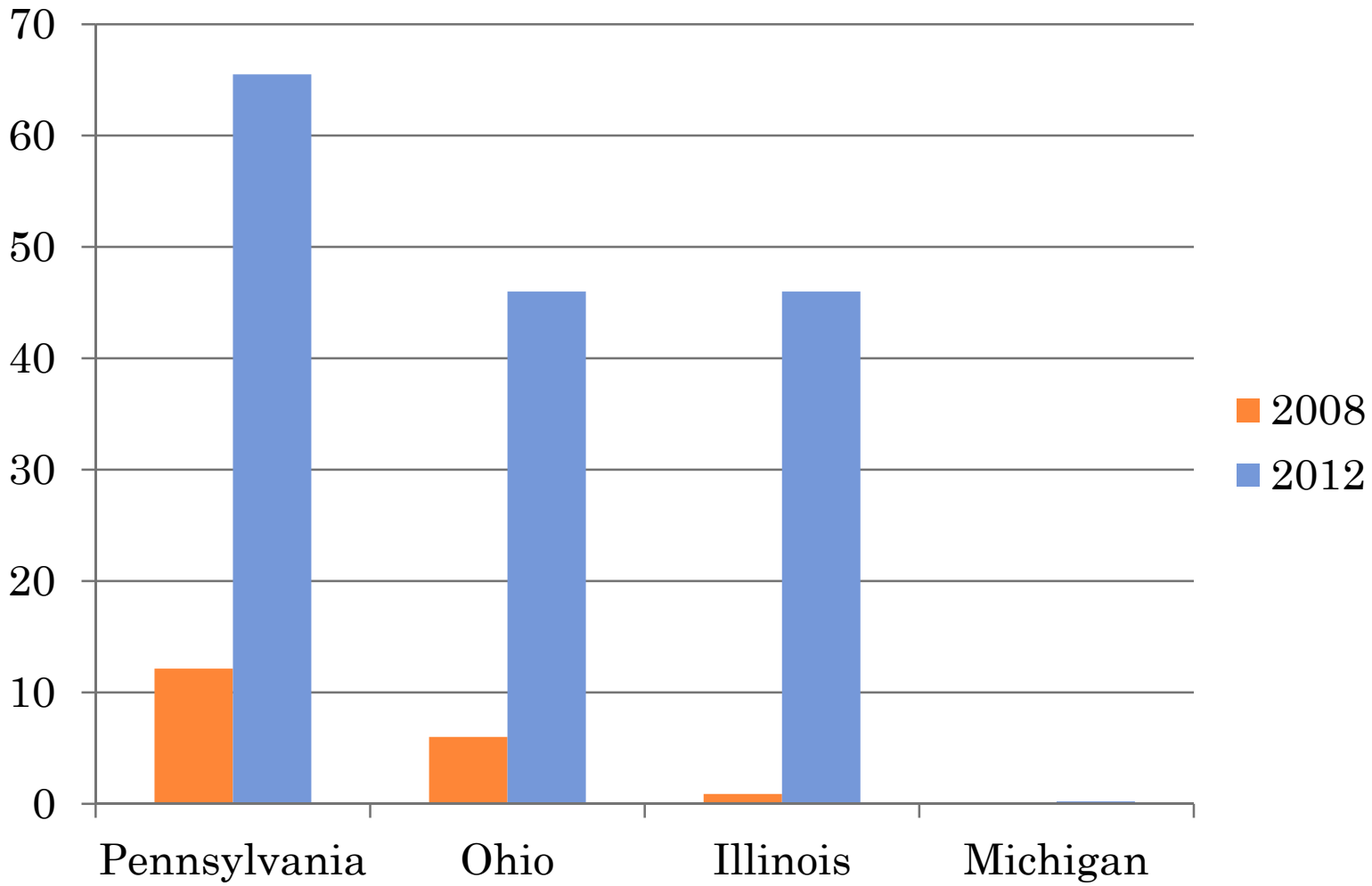
CAPS ON CHOICE VS. COMPETITIVE DECLARATIONS

- Michigan and California are the only states with caps on switching.
- California in 2009 SB 695
  - The amount of commercial load available to switch over a 4-year period is outlined below. The amount of load able to switch each year is approximately: Phase 1 – 35%, Phase 2 – 35%, Phase 3 – 20% and Phase 4 – 10%.
  - Communities can self aggregate and switch all residents over to a supplier.
- No other restructured states have caps on the amount of switching regardless of customer class.
  - Illinois has declared all but the smallest commercial customers competitive meaning they must choose a supplier.
  - Texas declared all classes of customers competitive.
  - Connecticut has proposed in recent budget to declare all classes competitive and auction them to suppliers.

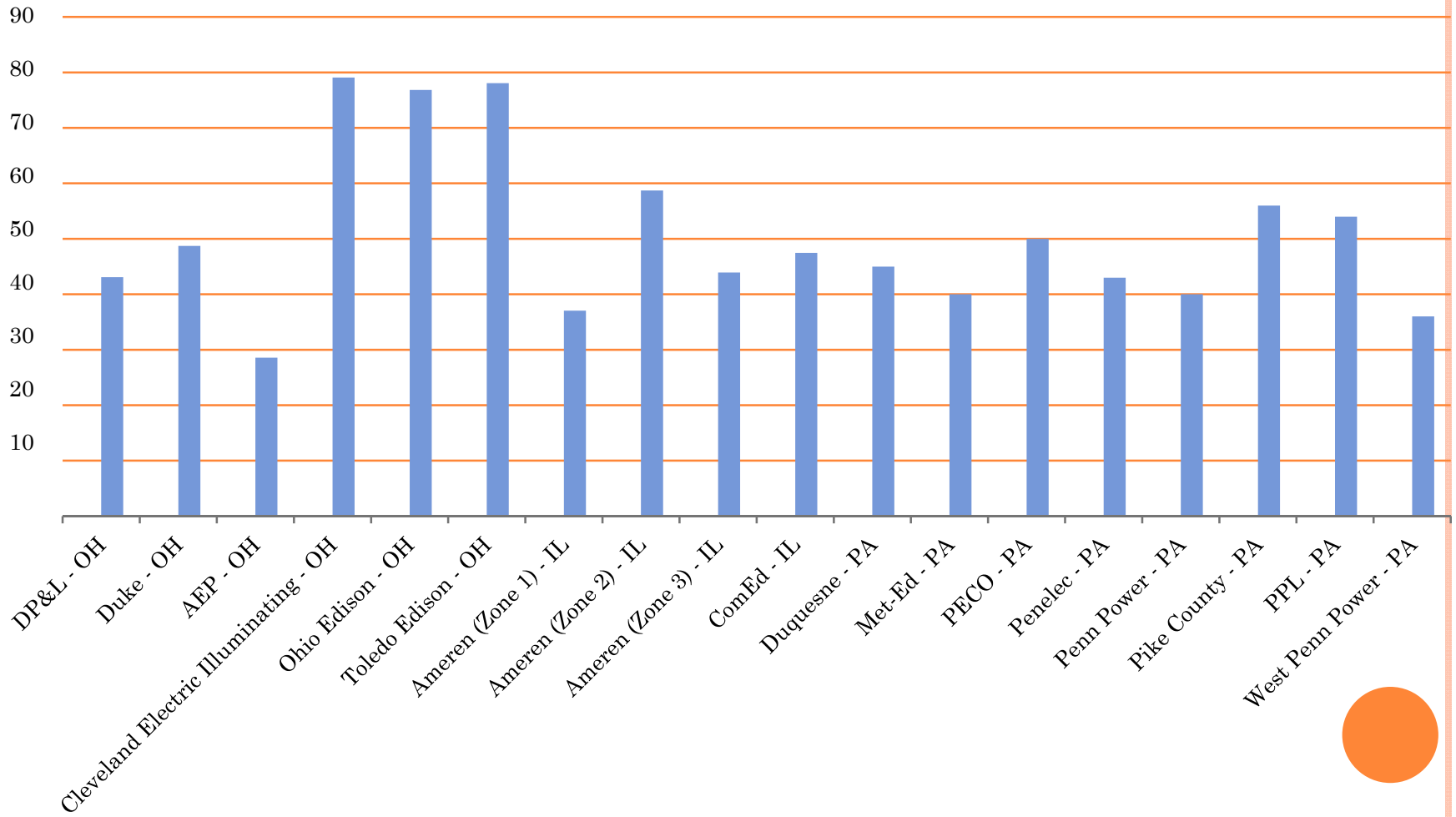
Question 16: How has Michigan, and how have other jurisdictions treated the various customer classes in terms of participation in restructured retail markets or partially restructured retail markets?

Switch Rates As percentage of actual customers
2008 vs. 2012 all rate classes



Question 3: What is the experience with retail electric choice in other states/provinces/countries in terms of customer participation, rates, savings, competitive providers, and other characteristics? How was the transition to choice to full restructuring?

Percentage of Eligible Residential Customers on Competitive Supply



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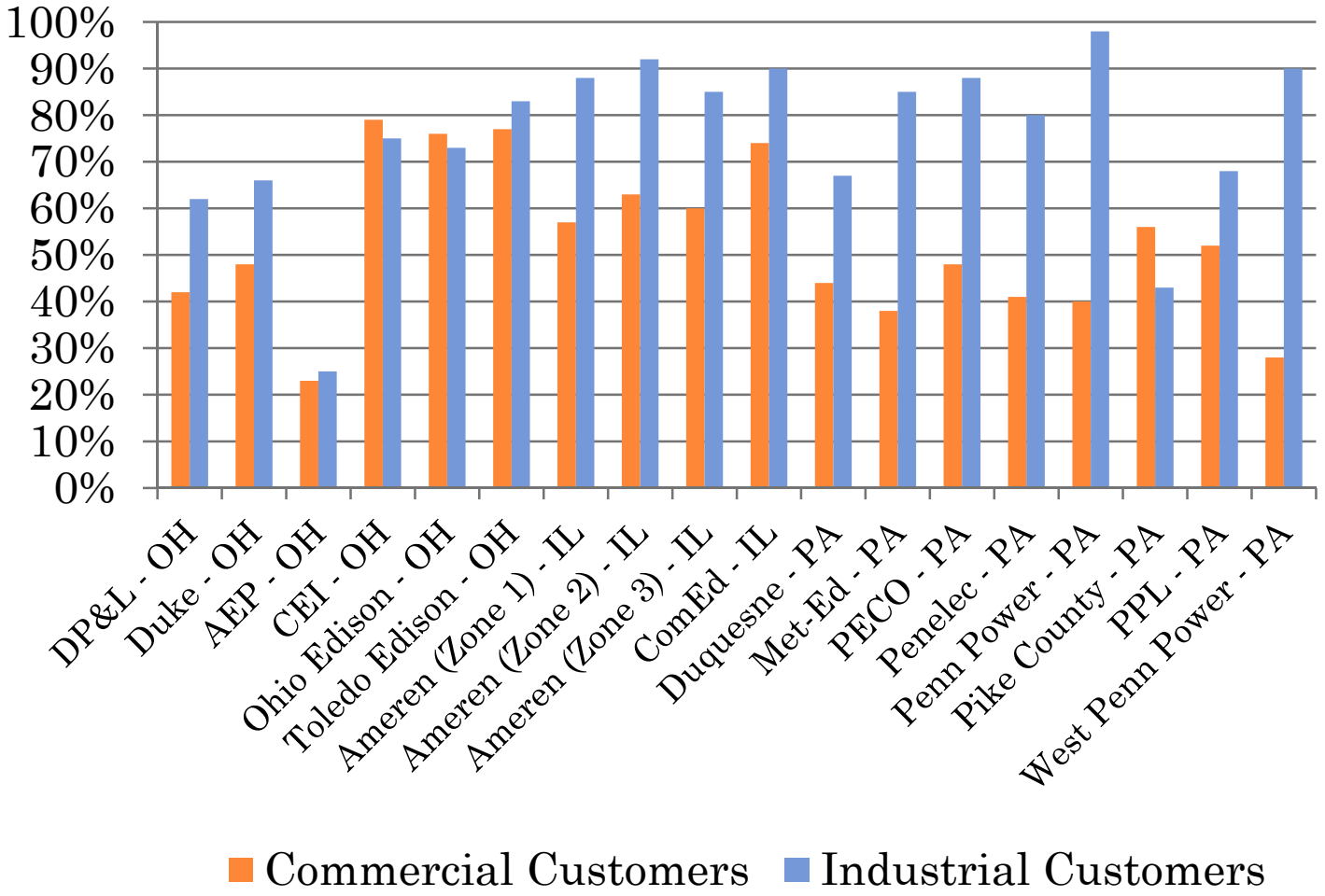
Percentage of C & I Customers on Competitive Supply



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Ameren Illinois is also a MISO utility, but unlike Michigan, Illinois allows customers to switch.
Currently available residential offers are 44% less than current Michigan utility prices

Lowest Competitive Offer Residential	Ameren Residential Price	DTE Residential Price	Consumers Residential Price
$0.0475 kWh fixed for 12 months + $25 Visa Card	$0.05467 kWh	$0.08377	$0.08654

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PRICE STATISTICS 2008 VS. TODAY

	2008 Avg Price All Sectors*	2012 YTD Avg Price All Sectors*
National Average	9.74	9.88
Ohio	8.55	9.07
Michigan	9.17	11.01
Maryland	13.90	11.33
Illinois	9.06	8.55
Pennsylvania	9.36	9.90

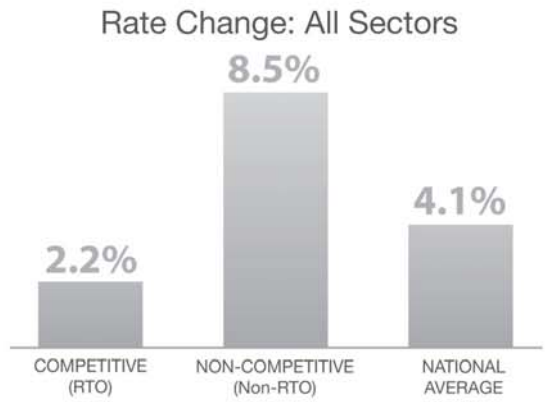
*EIA Data YTD average price all sectors

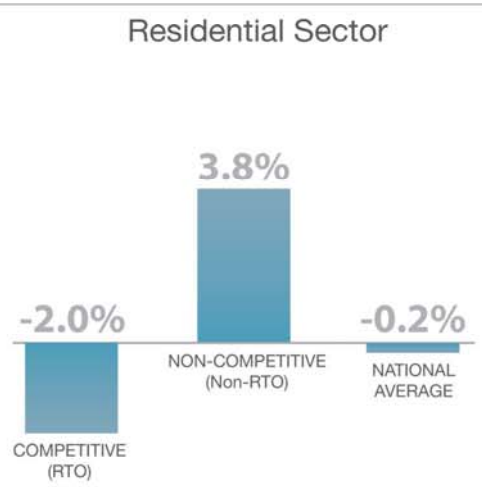
Question 5: Are electric rates lower in choice states than fully regulated states after considering historical trends as well as rate freezes, price caps and re-regulation?

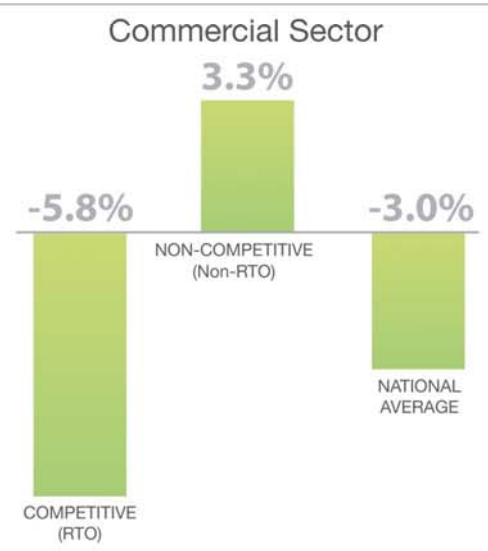
UPDATED: Competitive Electricity Markets Continue to Post Lower Rate of Change

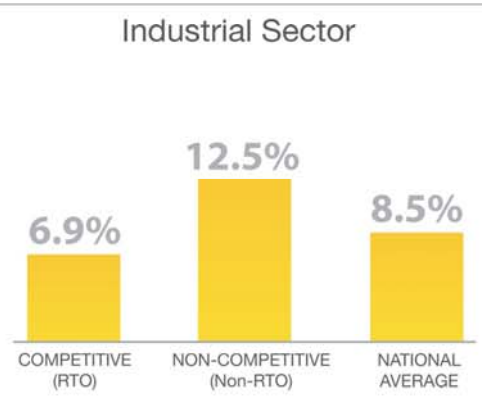
COMPETE
Electricity Competition Drives Innovation and Consumer Benefits

Comparison of Rate Changes Across Electricity Markets: 1997–2011
Competitive Markets (RTO*) vs. Non-Competitive (Non-RTO**) Markets









* An RTO is a regional electricity market operated by an independent administrator, in which prices are set through a competitive transparent process. Competitive (RTO) states include: CA, CT, DE, IL, IN, IA, KY, ME, MD, MA, MI, MN, MO, NH, NJ, NY, ND, OH, PA, RI, TX, VA, VT, WV, WI and DC

** Non-RTO markets, operated by monopoly utilities, do not use a competitive, transparent process to set prices

Results were calculated using price information from the U.S. Energy Information Administration (EIA) and a Consumer Price Index of Urban Consumers (CPI-U) of 40.1% for the period between 1997 and 2011. Sources: EIA and The Bureau of Labor Statistics.

Investment in New Generation in Restructured States

Data Specific to Midwest:

As of 12/31/09 there was 75,996 MW of non utility new build generation in the Midwest (OH, IN, IL, MI, WI).

Nationwide from 1980-2011 there has been 332,255 MW of non utility new build

- From the Edison Electric Institute Statistical Yearbook of the Electric Power Industry 2010 Data published December 2011

- **Data Specific to New England:**

  10,000 MW of merchant generation development in New England for the period between around 1996 and 2005 (which is most of what's been built there).

  - From the New England Energy Alliance A Review of Electricity Restructuring in New England 2005

- **Data Specific to New York:**

  Empire Generating Co, LLC The new 635 MW combined cycle natural gas fired power plant came online in 2010.

  Bayonne Energy Center The Bayonee Energy Center is a fast-start 512 MW power plant.

Question 6: Would a change in the choice cap have an impact on the financial stability of utilities and investors' ability to make long term, substantial investments in new generation?

Investment in New Generation by non-utilities in Restructured States

- **Data Specific to Texas:**
- Some $36.5 billion (in 2008 dollars) has been invested in generation capacity in the ERCOT service region since 1999, while another $5.8 billion has been spent on transmission infrastructure.
- The past 10 years have seen more than 41,000 MW of additional generation capacity.
  - Perryman Study (February 2009)
- The ERCOT market has experienced unprecedented investment in the generation sector since restructure, all at the risk and expense of the generation developers. To the extent the owners of generation make decisions that ultimately turn out to be poor economic choices or operate their units in an inefficient manner, the owners bear the risk of foregone profit or an inadequate return on their investment.
  - 2008 Texas State Energy Plan -- Governor's Competitiveness Council -- June 2008
- **Data Specific to California:**
- $12.6 billion in IPP investments in California -- 8600 MWs of projects in development -- almost an equal number of renewables vs. natural gas (4300 MWs respectively).

Question 6: Would a change in the choice cap have an impact on the financial stability of utilities and investors' ability to make long term, substantial investments in new generation?

LICENSING OF AES

- All states require alternative suppliers to both license with the state public service commission.
- All licensing including Michigan require proof of FERC, ISO, and creditworthiness.
- Some states also require a bond to protect customers in the case of any fines for misconduct.
- There is also typically a financial posting with the individual utilities to protect customers in the event of default. Proof is typically required for the license but the posting is with the utility who actually sees the level of load served.
- Consumer protection rules vary by state. As the market has grown protection rules have changed over the years to encompass new products and customer education.
  - Contract verification requirements
  - Early termination penalties
  - Contract and record keeping requirements
  - Requirements on sales practices

Question 15: What has Michigan, and what have other jurisdictions, proposed or put in place regarding alternative electric supplier (AES) licensing process or requirements?

LOW INCOME AND UNCOLLECTIBLES

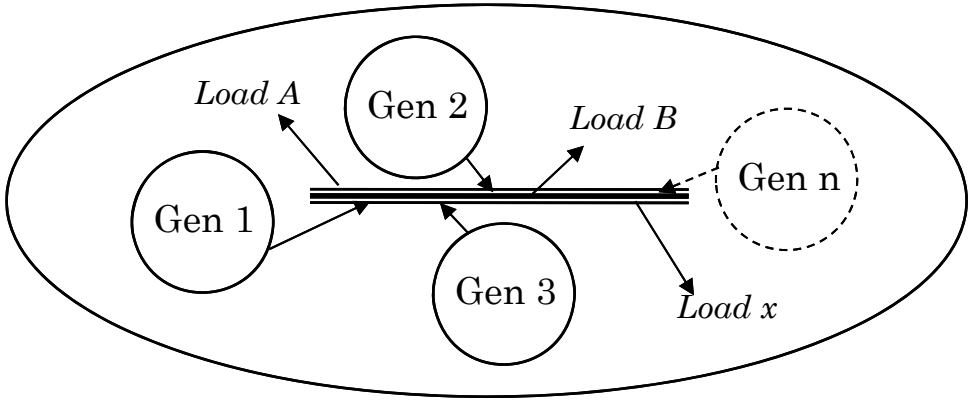
- All restructured states continue to offer low income programs including percentage of income, HEAP and other programs.
- In Texas the retail providers offer these programs and have requirements to offer payment plans. Retail providers issue the bill not the utility so all credit and collection falls on the retail provider. However, disconnect for non-payment of retail provider charges (after all offers of assistance are made) is allowed.
- Illinois, Mid-Atlantic and New England states have purchase of the retail provider receivable for small commercial and residential customers. This creates a single point of contact for all collection for the customer. Larger commercial customers are billed directly by their providers and negotiate payment terms.
- Ohio has a payment priority which favors the retail provider. One utility has purchase of receivable. Ohio rules allow for the retail provider to issue the bill.

Question 21: How have various restructured or partially restructured retail markets handled the issues of low income customers and uncollectibles?

Regional Reliability

<u>All suppliers</u> – both utility and competitive – are required to own rights to generation capacity sufficient to cover their load plus reserves.

Midwest ISO Region
injection & withdrawal of energy



a. **Each LSE Has Same Obligation** – Each LSE must provide capacity to the MISO dispatch pool in an amount equal to the LSE's forecast peak, plus a reserve margin.

b. **All Resources Serve All Load** – It is not accurate to claim that specific generators serve specific loads – for example, that "Utility A's customers are served by the Utility A's generation."

c. **Customer Switching Does Not Affect Reliability** -- If a customer switches from Supplier A to Supplier B, the total regional load does not change, nor does the generation dispatch.

d. **Generation Hedge** -- Ownership of generation provides a <u>financial hedge</u> against variable market prices, but <u>does not increase or decrease reliability</u> for the supplier's own customers.

e. **Capacity is Fungible** -- If a customer switches from Supplier A to Supplier B, then Supplier A <u>no longer needs</u> a commensurate portion of its generation capacity rights, which now it <u>can sell via the market</u> to Supplier B, if B needs more capacity.

Regional Reliability

The operational factors that affect the four aspects of reliability are the same whether the customer is served by a full-service traditional utility or by an AES under Electric Choice.

Consequently, a customer receives the same reliability no matter if a utility or AES serves it, and no matter where the utility's or AES's capacity is located.

"Collective Reliability" via MISO Pool

- *All resources serve all load.*
- *Same services provided, regardless who serves the customer.*

Operational Factors Affecting Reliability	***Full Service***	***Electric Choice***	***Difference?***
• **Generation Capacity & Reserves**	• Provided by local utility to meet MISO requirements	• Provided by AES to meet MISO requirements	• ***Identical quantity***
• **Dispatch of Regional Generation**	• Controlled by MISO. All gen serves all load.	• Controlled by MISO. All gen serves all load.	• ***Identical dispatch***
• **Transmission Service**	• Provided by MISO	• Provided by MISO	• ***Identical service***
• **Local Delivery Service**	• Provided by local utility without discrimination.	• Provided by local utility without discrimination.	• ***Identical service***