IGS Energy's Response to the Michigan Electric Choice Report

IGS Energy appreciates the opportunity to respond to the Electric Choice Report. IGS Energy is a competitive retail electric and natural gas supplier serving over 1,000,000 customers nationally and serving over 100,000 customers in Michigan's successful natural gas Choice program. IGS commends the Michigan Public Service Commission (MPSC) and the Michigan Office of Energy (MOE) for the thorough and thoughtful recitation of initial comments submitted by interested parties. IGS Energy submits the following comments in response to the Electric Choice Report.

I. Electric Competition has been Successful in Multiple Jurisdictions

The Electric Choice Report discusses the performance of electric restructuring across multiple regions and states.[1] However, the Electric Choice Report does not sufficiently discuss the multitude of states that have been successful at restructuring their electric industries. Rather, the Report largely cites the Joint Utility Response that claims that electric restructuring has failed in other states.[2] To understand the fallacy of these claims, one only need to look around the states surrounding Michigan, such as Ohio, Pennsylvania, and Illinois that are seeing the benefits of electric competition, particularly over the past five years. IGS submits the following comments in response to the claims that electric competition has failed. IGS also gives examples of states where electric competition has been extremely successful and brought great benefits to customers.

[1] Electric Choice Report at 15-19.
[2] Electric Choice Report at 17.

A. Electric Competition Has not Failed

California is often cited as an example of a state where restructuring has failed. Critics of competition claim that restructuring was responsible for the California energy crisis and utility bankruptcies in that state. However, restructuring did not cause the California energy crisis. The California energy crisis occurred because even after the electric utilities divested their electric generation assets, they were still required to offer a fixed regulated rate to customers; thus retail prices could not adjust in response to changing wholesale prices. Economics and common sense tells us that this is an untenable model for any market.

No one is suggesting that Michigan should restructure its electric industry in the way that California did. Instead, states that have subsequently restructured have learned from California. Once the utilities have divested generation in those state, any default rate provided by the electric utility are market based rates that can adapt to changing markets. To be clear, not even regulated utilities can offer a fixed rate to customers indefinitely. Electric prices will always eventually reflect the cost of providing electricity. Evidence of this is the fact that electric consumers in Michigan are constantly subjected to utility rate increases even under a regulated paradigm. However, the difference between regulated electric rates and unregulated rates is that unregulated rates can respond to market forces much faster and more transparently.

Other states such as Virginia, New Mexico, and Montana were cited in the Joint Utility Response as states where electric competition was not successful.[3] However, in those states competition was not even given an opportunity to succeed. Rather, monopoly utilities in those states used their political influence

[3] Electric Choice Report at 19.

and scare tactics to shut competition down prematurely before competitive forces were able to take hold. The bottom line is that any state that restructured correctly and gave it a chance to succeed (instead of squashing it in its infancy) has seen great benefits from competition. Fortunately, Michigan has enough examples of electric market restructuring to learn from the mistakes and successes of other restructured markets.

B. Texas Has a Successful Competitive Market

Texas is probably the most mature competitive electric generation market in the country and it is an example of how to restructure electric markets correctly. First, it should be noted that Texas currently has the second fastest growing economy in the United States.[4] Further, GDP in Texas has nearly doubled since 2000.[5] Despite electricity demand in Texas growing significantly since Texas restructured its electric markets, the most recent statistics published by the EIA identifies Texas as having electric rates 15% below the national average.[6] Further, the Public Utilities Commission of Texas in the *Scope of Competition in Electric Markets in Texas* "found that the competitive offers in Texas are below the electric rates prior to the introduction of competition and that every competitive market in Texas has offers that are up to 3 cents per KWH below the national average price for electricity.[7]

[4] CNN.com's list of five fastest growing states lists Texas as 2nd: http://money.cnn.com/gallery/news/economy/2013/06/12/fastest-growing-states/2.html

[5] Texas' GDP numbers can be found at the Federal Reserve Bank of St. Louis website; Total Gross Domestic Product by State of Texas. http://research.stlouisfed.org/fred2/series/TXNGSP?cid=27326

[6] The most recent US Energy Information Agency (EIA) lists Texas electric rates approximately 15% below the national average. See EIA Table 5.6.A of the EIA Electric Power Monthly September 2013 Report. This data can also be found on the EIA webpage for information on state retail electric prices: http://www.eia.gov/electricity/monthly/epm_table_grapher.cfm?t=epmt_5_6_a

[7] "Most competitive offers in the Texas power market are below the 2001 regulated rates in effect prior to the introduction of retail competition. Most competitive offers in the Texas power market have decreased an average of 13.1% for fixed rates and 17.5% for variable rates, not adjusted for inflation, since the state opened its market to retail competition in 2002… every competitive area in Texas has variable and one-year fixed rates that are up to three cents per kWh below the national average" *Scope of Competition in Electric Markets in Texas*, at 50. Public Utilities Commission of Texas (January 2011). A

Beyond just efficient pricing, the Texas markets offer the most diverse range of retail electric products to customers than anywhere else in the country. There are a multitude of suppliers in Texas offering customers a diverse range of products bundled with their electric service including time of use rates, solar distributed generation, smart thermostats, combined heat and power, demand response, renewable products, to name a few. While not all of these products will be the next great innovation that transforms the energy industry,– a few very well may; and, Texas will reap the benefits of economic development once it is able to export these innovation to the rest of the country.

Some opponents of competition claim that Texas is facing reliability problems that have been caused by the restructured electric markets. Those that make these claims either A) are not familiar with the Texas market or B) are willing to distort reality as a scare tactic to protect against competition. IGS Energy currently serves electric customers in Texas and is an active participant in the Texas market, and can give an actual and accurate depiction of that market.

First, as noted above, over the last 10 years Texas' electric demand has grown faster than almost any other state in the country.[8] Also, Texas has extremely hot summers which enhance Texas's peak demand requirements. Despite these unique reliability challenges that Texas faces, Texas restructured electric markets have been able to provide customers with affordable and reliable electric service for over a decade *and Texas has sufficient reserve margin to meet the demand needs of its customers*.

Second, like all states, Texas has concerns that it will be able to meet the electric reliability of its customers in the future. In fact due to its extreme heat and rapidly growing economy Texas faces more

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copy of the report can be found at: http://www.treia.org/assets/documents/reports-and-studies/puc.scopeofcompetitionreport2011.elec.pdf

[8] See footnote 3 and 4.

difficult reliability headwinds than almost every other state including Michigan. Yet despite these challenges, Texas is utilizing the competitive market to meet those concerns more efficiently than any other regulatory construct could. The Public Utilities Commission of Texas is working with interested parties to develop reliability solutions rather than spending its resources on costly and time consuming utility generation rate cases. Texas is also tapping into the innovations of the competitive market to enhance reliability for customers. These include utilizing competitive suppliers to offer off the grid reliability resources such as time-of-use rates, demand response and distributed generation. These outside-the-box reliability solutions are discouraged in a regulate monopoly regime, where the electric utilities' incentive is to build more large scale and costly generation resources, regardless of whether these resources are needed or whether they are the best way to meet reliability concerns in the face of rapid technological advancements.

Finally, the often cited reliability challenges Texas faces are based on some parties' projections of Texas' electric demand and supply for more than three years into the future. As any electric utility can tell you; it is very difficult to predict the future. However, it is very easy to use predictions of doom and gloom in the future as a scare tactic to protect entrenched interests. In the case of the opponents of competition, this is clearly what is occurring. The bottom line is that none of the policy makers in Texas (not the Public Utilities Commission of Texas, ERCOT, the legislature or the electric distribution utilities) are suggesting that the best way to ensure long term electric reliability is to return to the vertically integrated regulated electric monopoly model. This is because competition does not cause reliability concerns but rather is an effective tool that can be used to address them.

C. States Surrounding Michigan are Successfully Implementing Competition

Competition is also working in states closer to Michigan such as Ohio, Illinois, and Pennsylvania. The experience of these states with competition is instructive because they have many similarities to Michigan. All of these states are located in the Midwest and have a similar electric resource mix as Michigan. The utilities in these states are members of regional transmission organizations like in Michigan (either MISO or PJM). Each of these states has similar electric load profiles and similar economies. All of these states including Michigan enacted legislation to restructure its electric industry in the late 1990's or early 2000s. The only difference between Ohio, Illinois, Pennsylvania, and Michigan is that after competition was slow to take hold due largely to program design deficiencies, Michigan chose to abandon competition and Ohio, Illinois, and Pennsylvania chose to refine their programs and move forward with electric restructuring.

Now it has been 5 years since Michigan has chosen to re-regulate its electric industry while other states in the region moved forward with restructuring creating a natural comparison for electric competition. After five years the evidence could not be clearer that electric restructuring has significantly benefited those states that moved forward with restructuring. In 2008 Michigan had electric rates in line with the natural and regional average. Since the electric migration caps were put in place, Michigan's electric rates have risen dramatically, making it the most expensive state in the region for electricity, and one of the most expensive states in the country.[9] These generation rate increases keep occurring in Michigan even as wholesale electric generation prices are declining. In contrast, the states in the region that moved forward with restructuring (Ohio, Pennsylvania, and Illinois) have not seen the

[9] Electric Choice Report at 35.

massive rate increases experienced by Michigan. According to the most recent data released by the U.S. Energy Information Agency (EIA), Michigan electric rates are over 15% higher than Pennsylvania, over 20% higher than Ohio, and over 30% higher than Illinois.[10]

This electric price differential between Michigan and other states in the region has put Michigan at a significant disadvantage when it comes to competing with other states in the region for business and economic development. Further, the residents of Michigan have been subjected to continual rate increases during the most recent economic down turn making a difficult economic situation even worse.

No one is denying that restructuring of the electric industry will take time and regulatory resources. Ohio, Pennsylvania, and Illinois, while on the path to fully competitive markets, still have more work to do before the electric industry is fully restructured. However, the work done by the policy makers and regulators in those states have been well worth the efforts. As participants in competitive states are becoming acclimated with restructured markets the transition to competition becomes easier and easier as time goes by.

Michigan will ultimately face the same challenges of restructuring its electric market. The only question is when. Michigan can either decide to restructure now, or it can deny that changes are occurring in the market and attempt to protect the status quo. However, ultimately it will become clearer and clearer that regulated generation monopolies are no longer tenable in a rapidly evolving electric market. And when this occurs Michigan risks being left behind if it does not make the correct policy decisions today for its electric consumers.

[10] The EIA data can be found Table 5.6.A of the EIA Electric Power Monthly September 2013 Report. The data can also be found on the EIA webpage at: http://www.eia.gov/electricity/monthly/epm_table_grapher.cfm?t=epmt_5_6_a

II. Average Residential Customer Bill's is not an Appropriate Comparison

Joint Utility Response claims that the average electric bill for residential customers is the most appropriate comparison to determine if Michigan's electric prices are high. The Joint Utility Response concludes that because Michigan had below average annual residential electric bills in 2011 then Michigan electric prices are not too high.[11] The obvious flaw in this comparison is that air conditioning needs represents one of the largest uses of electricity for residential customer's.[12] However, Michigan is a northern state and has an average temperature significantly below the national average.[13] Thus it is not surprising that the average residential electric bills are lower than the national average, because residential customers simply have less air conditioning requirements than most of the rest of the country.

The other flaw in the Joint Utility Response is that average bill data from the Joint Utility Response is from 2011. However, according to the EIA, since the summer of 2011, Michigan's residential electric rates have risen by approximately 8%. This is in contrast to the nation average raise in residential electric rates of just 3.5% during that time.[14] Thus, if the same analysis was done today, Michigan's average annual electric bills would be higher compared to the nation average than they were in 2011.

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[11] Electric Choice Report at 37.

[12] See EIA statistics on electric consumption at: http://www.eia.gov/tools/faqs/faq.cfm?id=98&t=3

[13] State average temperatures can be found at USA.com; U.S. Average Temperature State Rank: http://www.usa.com/rank/us--average-temperature--state-rank.htm

[14] According to the EIA, Michigan's average residential electric rate for August of 2013 is 14.98 cents per KWH. During July of 2011 Michigan's residential electric rates were 13.76 cents per KWH representing an 8% increase in just two years. The nation average residential electric rate in July 2011 was 12.08 cents per KWH. The average national residential electric rate during August 2013 was 12.51 cents per KWH representing a 3.5% percent increase in 2 years. The EIA data can be found at Table 5.6.A of the EIA Electric Power Monthly Reports: http://www.eia.gov/electricity/monthly/epm_table_grapher.cfm?t=epmt_5_6_a

Finally, the average residential electric bill analysis completely ignores the electric bills of commercial and industrial customers. As noted above, it is undisputed that commercial and industrial customers are paying significantly more in 2013 for electricity in Michigan than the national and regional averages. These price comparisons make Michigan economically less competitive and thus should not be ignored when analyzing the reasonableness of Michigan's electric rates.

In sum the Joint Utility Response is grasping at straws when it utilizes a residential customers bill analysis from 2011 to claim that Michigan is not paying too much for electricity. The best and most obvious comparison to determine whether Michigan is paying too much for electricity is to analyze the electric prices *all* Michigan customers are paying *today*. Unfortunately based on that analysis, Michigan's electric prices are too high.

III. Electric Generation is no Longer a Natural Monopoly

Some still argue that electric generation service is a "natural monopoly" and thus a regulated electric utility is needed to provide reliable and affordable electric generation service to customers.[15] The reality is that the electric industry in Michigan, and across the country, has evolved since the initial establishment of electric generation monopolies to the extent that there are multiple suppliers willing and able to provide Michigan customers with reliable and affordable electric generation service. However, the perception that electric generation is a "natural monopoly" still persists due to entrenched interests that were created from legacy policy decisions made decades ago that have not adapted to changes in markets and technology.

[15] Electric generation service should be distinguished from electric distribution service. Electric generation service is the electrons that are generated from power plants and other generation sources and used by consumers. Electric distribution service is the delivery of those electrons through lines and wires that go into homes and businesses.

One of the many dangers of allowing a monopoly to control an entire industry is that it severely restricts innovation in that industry. Monopolistic enterprises are simply not as innovative as group of businesses competing in the marketplace for customers. It is axiomatic that if there is just one business in a marketplace that has captive customers, that business has very little incentive to improve and become more efficient. However, if a business knows that it can lose customers to a business that is more innovative, that business has great incentive to improve and become more efficient. Further, the innovation of one business leaks out to other businesses in the marketplace. To see an example of competitive innovation, one only needs to look at the smart phone industry. When Apple released the iPhone in 2007 it was one of a kind. Now, just 6 years later there are a myriad of other companies, including Samsung, Microsoft, Google and Nokia that are continually releasing new and innovative products in order to gain and maintain customers in that market.[16] This kind of innovation simply cannot exist in an industry that is controlled by a monopoly.

Another danger of a monopoly is that it has the potential to charge artificially high prices because the monopoly market power gives little incentive to bring down prices. Due to the potential to abuse market power, public utilities commissions or public service commissions have traditionally been given jurisdiction to regulate electric monopoly pricing. However, a regulated price cannot beat a market price in terms of transparency and efficiency. A regulated price will necessarily contain inefficiencies, subsidies and lack transparency. Further, no matter how effective regulators are, ultimately electric utilities have a great deal of discretion to report the cost of service and need for new investment. This

[16] It should be noted that much like the electric industry in Michigan, the telecommunications industry was at one point a state sanctioned monopoly. However, the policy makers wisely decided due to changing economic and technological innovations to restructure the telecommunications industry and break up the telephone utility monopolies. Since the telecommunications restructuring, the industry has evolved dramatically, to the benefit of all customers and society

enables utilities to manipulate pricing to the benefit of their shareholders and to the detriment of customers. In contrast, participants in a competitive market are subject to market discipline when setting prices. In a competitive market if a business is not price competitive, that business will not acquire or maintain customers and ultimately risk going out of business.

Finally, once a monopoly is granted it becomes extremely influential where it exists. Monopolies accumulate significant economic power from the profits they extract from captive customers and those monopolies will almost always use their economic power to yield political power. The political power obtained by having a monopoly can be utilized to protect the entrenched monopolistic interests by gaining influence over politicians and regulators.[17] Often this political power can be extremely difficult to overcome as the monopoly can use its influence to keep competition out of the marketplace. This tendency is manifest in in Michigan and other states that maintain monopoly generation utilities despite the significant changes that have occurred in the electric industry and the overwhelming evidence that competition brings benefits to customers.[18]

With the emergence of integrated regional transmission organizations, fluid electric trading hubs, new generation technologies, including on-site generation and load shifting technologies, we no longer live in a world where one large electric generator serves one set of customers. Rather, electrons are constantly flowing back and forth across state lines and utility service territories from a myriad of

[17] An example of this can be seen in the state granted oil monopoly in Venezuela. Petróleos de Venezuela, S.A. ("PDVSA") is Venezuela's largest private employer, and has monopoly control over Venezuela's largest industry. This gives PDVSA great political power, and despite the fact that Venezuela's oil capacity has declined dramatically over the past five years, and that PDVSA has long been known as a source of corruption, PDVSA still yields tremendous political support amongst the politicians and bureaucrats in Venezuela. http://www.thecordobagroup.com/2012/05/08/after-chavez-de-socialize-and-transform-pdvsa/

[18] This problem is exacerbated in the electric utility world because the market presence of an electric monopoly is paid for by all customers whom have no choice but to receive electric service from that monopoly.

different generation sources owned by a myriad of different businesses. These changes in the market dynamics have enabled multiple entities to have the ability to serve retail customers within multiple utility service territories on a competitive basis. Yet despite these new capabilities and despite dozens of suppliers willing and able to serve Michigan customers competitively and reliably, Michigan utilities still claim that electric generation service is a natural monopoly.

The electric generation monopolies seeking to preserve market power should no longer be given the benefit of the doubt. Rather, we should be extremely skeptical of those that argue the need to maintain a monopoly. Capitalistic societies tend not to sanction monopolies because basic economics tells us that monopolies are almost always bad for customers.[19] This is why competitive market structures are utilized for almost every product and service; even essential goods and services such as food, shelter, clothing, and transportation fuels such as gasoline. Even in industries such as railroads and telecommunications that were once regulated monopolies, when markets and technologies changed, those industries were restructured to introduce competition. In the words of Nobel Prize winning economist Milton Friedman “"there are very few natural monopolies that last indefinitely; almost always there are alternatives…in practice the claim of a natural monopoly is more often an excuse for intervention desired on other grounds than a valid justification for intervention.”[20]

[19] In fact, the Communist Soviet Union experimented with state sanctioned monopolies for procurement of goods and services. As history has shown that experiment failed.

[20] In his *Essay Liberalism, Old Style* Friedman discusses how railroads had an element of natural monopoly when the railroad industry first started to emerge. Friedman notes though that changes in the market with the emergence of the airline and trucking industries eliminated any natural monopoly element in the railroad industry. However, even after the railroad industry no longer had the justification for natural monopoly, the Interstate Commerce Commission became a means to protect the railroads from the competition of trucks and airlines, rather than protecting the public from the absence of competition. *Indispensable Milton Friedman: Essays on Politics and Economics, Edited by Dr. Lanny Ebenstien, 2012, pg. 19.*

Michigan now does have an alternative to the electric generation monopolies. However, just like railroad, and telephone industries, Michigan's entrenched monopolies are fighting to maintain the status quo in the face of overwhelming evidence that the world has changed. Just like those previously restructured industries, the antiquated regulated monopoly model should be abandoned in favor of competitive forces in the marketplace.

IV. Conclusion

Electric utilities remain a powerful force. After enjoying the benefits of monopoly for so long it is difficult to stop utilities from exerting their power to protect their monopoly. Even harder to stop though is progress. History is ripe with examples of businesses that have used their resources to protect the status quo rather than adapting to changes in marketplace. In the long run, things tend to not work out so well for these companies. Now the utilities are attempting to utilize this very same strategy to keep electric competition out of Michigan. In the short run this strategy may help to keep the electric utilities quarterly earning higher; in the long run this strategy will fail, much as it has for the multitude of other companies that fought changes that are brought on by new technologies and innovation.

Not only is it a bad business strategy to try to stop progress, it is also a bad government policy. Michigan business and customers are missing out on the many benefits of competition. As each year goes by that Michigan maintains its electric generation monopolies, Michigan is falling farther and farther behind that states that embrace competition. It is time to stop giving the monopoly electric utilities the benefit of the doubt and to start giving Michigan customers a choice for their electric supply.