Electricity Restructuring in Michigan:  
*The Effects to Date of Public Act 141 and Potential Future Challenges*

**Executive Summary**

With the passage of Public Acts (PAs) 141 and 142 of 2000, the Michigan Legislature ushered in a new era for customers purchasing retail electric supply. Previously, electricity providers in Michigan operated under a natural monopoly market structure whereby utilities—regardless of whether the utility was investor owned, a cooperative, or a municipal corporation—were provided a near-exclusive geographical area of service in return for regulated rates and an obligation to serve all customers in the area.

PA 141 restructured Michigan’s electric industry by

- allowing customers to purchase their electricity from an alternative energy supplier (AES) at a market rate,
- requiring regulated utilities to divest their transmission facilities or join a multistate regional transmission system organization approved by the Federal Energy Regulatory Commission (FERC),
- creating limits on the market share for generation capacity in Michigan’s energy market, and
- lowering residential rates by 5 percent while simultaneously freezing any future increases until January 1, 2006.

Since the cap on residential rates has now expired, it is an appropriate time to take a look back at the successes and failures of electric restructuring in Michigan, review the lessons learned, and look ahead to the emerging challenges facing Michigan’s electric choice market over the next decade.

**Electricity in Michigan before PA 141**

Prior to PA 141, the majority of electricity in Michigan was provided by two main companies: Consumers Energy (Consumers) and Detroit Edison (Edison). Together, these two companies supplied approximately 90 percent of the power in the state. Their product offerings (tariffs) were regulated by the Michigan Public Service Commission (MPSC), which established rates for customers that included an allowed rate of return on investment for the power companies.

The regulated rate structure in place before the implementation of PA 141 was both “bundled” and “skewed.” A bundled rate combines all of the various charges associated with electric service (generation, transmission, and distribution) into a single rate or charge. Skewing refers to the fact that regulated rates for rate classes (residential, commercial, and industrial) are not set at actual cost; rather, some rates are intentionally set above cost to allow others to be set below cost.
In Michigan—based on the policy choices of the legislature and the MPSC—regulated residential rates were set at 10 to 20 percent below the actual cost of providing service, while commercial rates for regulated utilities were set at 10 to 20 percent above the cost of service. These skewed rates were not changed by PA 141, or by subsequent MPSC rulings. They continue to distort the market since the regulated prices offered to customers do not reflect the actual costs of electric service.

**Has PA 141 Worked?**

- **Has PA 141 lowered residential electric rates?** The answer in terms of real prices and the short term is unequivocally “yes.” Rates for residential customers were immediately lowered in 2000 by PA 141 and then frozen or capped through the end of 2005. Thus, in real terms, residential customers have been economically better off over this period.

- **Has PA 141 lowered residential rates through competition?** The answer here is unequivocally “no.” In Michigan, regulated rates in the residential market were shielded from any competitive influences by skewing and the rate cut and cap.

- **Has PA 141 lowered business electric rates?** Yes, but recent trends of business exiting the choice market and returning to incumbent utilities makes it unclear whether the price reduction is a sustainable long-term effect of PA 141-encouraged competition or a short-term effect induced by PA 141’s artificial incentives for business customers.

**Future Challenges**

- **De-skewing.** A critical development that will affect the success or failure of PA 141 to create a competitive electric market is de-skewing regulated rates. Until the market-based rates of AESs are on a par with an incumbent utility’s true costs to serve each rate class, AESs are competing against the upwardly skewed rates of an incumbent utility for commercial and industrial rate classes—which favors AESs—and against the downwardly skewed rates of incumbent utilities for the residential rate class—which favors the incumbents.

- **Natural gas prices.** Most AESs active in Michigan utilize natural gas power plants or purchase energy from the wholesale market from producers (including Consumers and Edison). For the AES-owned generation facilities, the cost of producing electricity is often determined by the current market price for natural gas. Thus, while these power plants are cheaper to build than coal-fueled plants, they are inherently more susceptible to changes in the market for natural gas. If AES rates continue to rise in concert with price changes in the wholesale electric market (not to mention natural gas prices) while the rates of regulated utilities fall as the residential subsidy potentially ends, the development of a large number of viable electricity suppliers may be significantly hampered.

- **Obligation to serve.** Prior to PA 141, Michigan’s obligation to serve was a mutual agreement: customers were obligated to purchase electricity from the regulated utility, and the utility was required to serve all customers with rates approved by the MPSC. After PA 141, Michigan has attempted to have the benefits of competition (lower short-term prices) combined with one of the benefits of a regulated monopoly
(affordable, long-term, reliable access to power), but the obligation to serve has shifted. Customers—especially commercial and industrial customers—can choose from a number of electricity suppliers, but the regulated utilities are still required to serve all potential customers in their area with rates approved by the MPSC. This attempt at the “best of both worlds” is unsustainable, and thus policymakers must decide on their ultimate priorities regarding the future of the electricity generation and distribution market in Michigan.

Overall, it is clear that PA 141 is a flawed attempt at restructuring Michigan’s electricity market. While the flaws stem from many sources, a primary source is the incomplete nature of the reform. In an attempt to garner the benefits of a free-market system while shielding Michigan residents from any potential costs, PA 141 only serves to create an economically unsustainable system. The challenges presented by the legislation have been exacerbated by the MPSC’s early implementation decisions, in which explicit attempts to develop artificial incentives for consumers to move to the choice program were combined with a long-standing price distortion in the form of skewed regulated rates.