

**STATUS OF ELECTRIC COMPETITION
IN MICHIGAN**

February 1, 2001

MICHIGAN PUBLIC SERVICE COMMISSION

Introduction

The Customer Choice and Electric Reliability Act (2000 PA 141) requires the Public Service Commission (Commission) to file a report with the Governor and the Legislature by February 1 of each year that includes all of the following:

- (A) The status of competition for the supplying of electricity in Michigan.
- (B) Recommendations for legislation, if any.
- (C) Actions taken by the Commission to implement measures necessary to protect consumers from unfair or deceptive business practices by utilities, alternative electric suppliers, and other market participants.
- (D) Information regarding customer education programs, approved by the Commission, to inform customers of all relevant information regarding the purchase of electricity and related services from alternative electric suppliers.

Since the passage of 2000 PA 141, there have been significant events in other states that could impact the progress towards electric competition in Michigan. The unique electric restructuring program created in California is universally regarded as a failure. Wholesale prices of power in California have increased approximately ten-fold (1000%) since last spring. In the last three weeks, the state has been on an almost continuous energy emergency alert and has experienced several rolling blackouts, even though winter is the off-peak period for electric demand in California. The two largest California utilities are \$12 billion in debt and are on the verge of bankruptcy.

It is important to note that Michigan is not expected to repeat the California experience. That state made at least four major errors that were not made in Michigan.

First, utilities in California were required to divest (sell) at least 50% of their electric generating plants and there were provisions in the statute to encourage them to sell more. The three investor-owned California utilities sold all of their fossil-fueled generating plants to other suppliers. In Michigan, the market power test (in section 10f of 2000 PA 141) explicitly recognizes that a utility can maintain generating plants needed to serve its firm retail load plus a reasonable reserve margin. Thus, in Michigan there is no artificial requirement that utilities sell power plants that they need to serve their customers.

Second, utilities in California were prohibited from entering into long-term contracts to obtain needed power. Instead, the utilities were required to purchase all of their power supplies through the California Power Exchange, which operates a spot market on a day-to-day basis. Few, if any, would contend that the spot market run by the Power Exchange is efficient. Recently, California utilities have been permitted to purchase power from other sources, and the volume of purchases on the California Power

Exchange has declined by 95%! In Michigan, there are no artificial restrictions on the ability to purchase power from the best available supplier.

Third, it is very difficult to build new generating plants in California. In addition to numerous environmental and local restrictions, a license from the California Energy Commission is required. During the decade of the '90s, that agency did not authorize a single large generating plant to be built. In contrast, the Michigan statute was designed to encourage the development of major new merchant plants. Since the act was passed, two new generating plants have broken ground, a third is expected to do so shortly, and several more are under consideration (see Attachment IV). By way of comparison, Michigan generates approximately twice as much power per capita as California (10.24 megawatt-hours per person in Michigan compared to 5.78 in California).

Finally, California set up a single-state Independent System Operator (ISO), which has not been able to deal with the state's supply problems. Approximately 25% of the power used in California is imported from generating units outside the state. Because the California ISO has no regional jurisdiction outside the state, the ISO has had to resort to ad hoc emergency measures to obtain needed power. In order to be effective, an ISO must be established on a broad regional basis so that it realistically matches the actual power flows being experienced by the electric transmission system.

Even though Michigan has not made the kind of mistakes that California did and is not expected to repeat the California experience, nonetheless, the California problems are having an effect on the development of the electric market in Michigan. Wholesale electric prices have increased nationally and in the Midwest, although nowhere near as significantly as in California. This increase has made it difficult for suppliers to obtain power supplies for resale at competitive prices and has limited the amount of growth in the customer choice market. However, this market is expected to grow as new merchant plants are brought on line.

Michigan's approach to electric restructuring is similar to that being used with positive results in Pennsylvania, where over 500,000 customers have chosen to receive service from alternative suppliers. Although the Michigan program is not as far advanced, the structural elements in this state are very similar to those in Pennsylvania. It is also important to note that Pennsylvania is a member of a regional ISO along with New Jersey and Maryland (known as PJM ISO), which avoids the problems associated with a single-state ISO (like California). There is currently no broad regional ISO serving the Midwest, but the Commission is working with other stakeholders in a Federal Energy Regulatory Commission (FERC) proceeding to attempt to develop a consensus out of two competing proposals.

In summary, the electric industry has changed dramatically since 2000 PA 141 was enacted. The severely dysfunctional market created by California's peculiar law is not expected to occur in Michigan, but the development of a fully competitive market has been slowed somewhat by those problems.

I. Status of Competition for Supplying Electricity

A. Introduction

Michigan's existing electric competitive programs are a result of efforts initiated five to six years ago. In 1995, the Governor sent to the Commission a whitepaper outlining the broad parameters of a customer choice program. Thereafter, the Commission conducted public hearings and directed the state's utilities to implement such a program. When the Michigan Supreme Court ruled that the Commission lacked jurisdiction to mandate a program, the focus shifted to the Legislature, which resulted in the passage of 2000 PA 141, including a confirmation of prior Commission orders.

At present, there are four active programs in Michigan which permit electric customers to select competitive suppliers of generation services. The programs are offered in the service territories of The Detroit Edison Company (DE) and Consumers Energy Company (CE). The DE programs are the Experimental Retail Access Program (ERAP) and the Electric Choice Program (ECP). The CE programs are the Direct Access Program (DA) and the Electric Customer Choice Program (ECC). These programs are positioned as trials or transitions to full open access to electric generation sources, which commences January 1, 2002.

There are a few indicators that can be used to measure or evaluate the current status of competition in Michigan's electric supply market. These indicators include the number of authorized or licensed alternate suppliers for the ECP and ECC programs, the amount of load and number of customers these suppliers are serving and the electric supply infrastructure within and outside Michigan available to support competitive entry. Following is a description of each of these indicators and a report of their status at this point in time.

B. Alternative Electric Suppliers

An Alternative Electric Supplier (AES) is a person selling electric generation service to retail customers in the state of Michigan. An AES is not necessarily the entity who physically delivers electric energy directly to retail customers. Under 2000 PA 141, Sections 10(a)2, 10(e)2 and 10(g), AESs are required to be licensed by the Commission. As of February 1, 2001 the Commission has issued 10 AES licenses. Attachment I is the current list of licensed AESs.

While there are 10 licensed AESs, only DTE Energy Marketing, Nordic and Quest Energy are serving retail customers in the ECP and ECC programs. The structure of the DA program and the ERAP program was developed prior to the requirement for licensing of AESs. Providers acting in roles similar to that of an AES in these programs include Engage Energy US and Nordic.

C. Load Served by the Open Access Programs

1. Direct Access Program

Consumers Energy's DA program was the first in Michigan and also one of the very first in the U.S. to offer retail customers choice in electric generation supply. This program was limited to about 135 megawatts (MW) of load. At various points in time that total amount was being served, with 20 customers and seven suppliers participating. The program was scheduled to expire on December 31, 2000. The Commission extended the program ending date so that it will coincide with the approval of revised ECP and ECC tariffs for DE and CE respectively. That is expected to occur in the fourth quarter of 2001. At or around December 31, 2000, due to price and supply uncertainty, many of the DA customers elected to return to bundled service from CE. As of January 1, 2001 only two customers continue to take this service, with a total load of approximately 9.6 MW.

2. Experimental Retail Access Program

This DE program is limited to 90 MW of load. The first customer started taking service on December 6, 1999. As of January 22, 2001, a total of four retail customers with a total load of approximately 87 MW are being served. The customers participating in this program were selected by lottery. The program is scheduled to end on June 30, 2004.

3. Electric Choice Program

This is DE's retail open access program established by Commission orders and 2000 PA 141. During the phase-in period, ECP is limited to a maximum load of 1,125 MW which is approximately 12.5% of DE's peak load. On January 1, 2002, the ability for customers to choose generation service suppliers will be unrestricted. Capacity allocations for the phase-in period were awarded through a bid process. Parties' bids represented the amount they were willing to pay per kilowatt-hour, through December 31, 2001, toward the recovery of stranded costs associated with DE's participation in the competitive electric marketplace in Michigan. Five bid cycles of 225 MW each were completed.

As of January 22, 2001, DTE Energy Marketing, Nordic and Quest are serving 10, 41 and 42 MW of retail load respectively. It is expected that Nordic will scale back its participation in the DE program, but when and by how much is unknown at this time.

4. Electric Customer Choice

ECC is CE's retail open access program similar to DE's. The participation limit for this program through December 31, 2001 is 750 MW which is approximately 12.5% of CE's load. Capacity allocations were also made in a 5-phase bid process similar to that utilized by DE.

As of the week ended January 26, 2001 only Quest was providing service to retail customers in CE's program. Quest's participation was approximately 67 MW. Until early January, 2001, Nordic had been serving approximately eight MW of retail load. Due to difficulty in acquiring or maintaining an economical firm source of generation, Nordic elected to cease serving retail customers in the CE program at this time.

Attachment II presents a summary of participation in each of these programs in tabular form. The Commission's web site provides information related to these programs and links to the DE and CE web pages where more detailed information is presented. See <http://www.cis.state.mi.us/mpsc/electric/restruct>.

II. Lessons Learned From Pilot Programs

Generally, the pilot programs have been helpful in developing the operational systems that will be needed for the implementation of full-scale customer choice in Michigan. The Commission Staff has audited the processes used by utilities to enroll customers in the choice programs and has identified deficiencies that need to be corrected.

The pilot programs have also demonstrated the importance of transmission in making customer choice effective. Without adequate transmission, new suppliers are unable to secure and deliver power to their customers. The existing transmission system is physically not adequate to support a vibrant competitive market. In addition to the physical limitations, the operating procedures under FERC regulation make it difficult for new suppliers to meaningfully participate in the process of obtaining adequate transmission. The Commission is working with stakeholders in state and FERC proceedings to attempt to address both issues. In our view, FERC's preoccupation with the California situation has caused it to neglect the need for an effective regional transmission organization in the Midwest.

III. Electric Supply Infrastructure serving Michigan

Based on filings made by DE and CE in Case Number U-12702, the utilities indicate they will need to purchase approximately 2900 MW of generation capacity in order to maintain an adequate reserve margin for the summer of 2001. That amount represents approximately 15 percent of the estimated total demand and is similar to recent years. On very hot summer days when air conditioning loads are greatest, Consumers and Edison purchase power from out-of-state suppliers in order to meet peak customer demands. The utilities' estimate assumes that over 400 MW of retail load will have migrated to the retail open access programs of DE and CE by the time of summer peak usage -- an assumption that appears doubtful at the present time. These filings are available on the Commission's Web site, at: <http://www.cis.state.mi.us/mpsc/electric/capacity/>.

In addition to the need for more generation in Michigan, the import capability of the transmission system surrounding Michigan is constrained. On a peak day, the transmission system is physically capable of importing power amounting to no more than approximately 20% of the Michigan demand. Moreover, the transmission reservation system established by the Federal Energy Regulatory Commission utilizes a bidding process to allocate available transmission capacity (ATC), whose design permits entities with firm reservations of transmission capability to retain those entitlements under a “right of first refusal” concept. While this system has enabled DE and CE to maintain or expand their ability to import needed resources, the new entrants (AESs) operate at a significant disadvantage. The availability of transmission services needed to serve retail access customers in Michigan has been limited. This lack of resources accounts for, in part, the modest amount of AES supplied retail load in Michigan.

Two factors should ameliorate this resource shortage. While these factors may not play a significant role in 2001 or even 2002, they do present the potential for the development of an infrastructure able to support a robustly competitive electric generation marketplace in Michigan.

A. Transmission System Expansion

The first of these factors is the statutory requirement that the availability of transmission capability into Michigan must be increased by 2000 megawatts by mid-2002. To the extent DE and CE must rely on imports from generation resources outside of Michigan, this enhanced capability expands the resources available for use by them as well as AESs. At present, competing plans have been filed with the Commission by American Electric Power in Case Number U-12780, and DE, CE and Great Lakes Electric Cooperative in Case Number U-12781. As required by 2000 PA 141, the Commission is conducting hearings to determine the appropriate transmission upgrade plan.

B. Generating Plant Additions

While generating capacity expansion in Michigan has not been overwhelming, the Commission is aware of certain facilities which have been completed by both regulated utilities, their affiliates and others. Since there is no requirement to report this type of construction, the additions shown on Attachment III are those for which the Commission and its Staff have knowledge. This list is not intended to be comprehensive. Since 1999, over 2000 megawatts of generating capacity has been added in Michigan. While these additions are comprised of upgrades of existing plants or installation of peaking units, nonetheless they do provide additional resources to meet the electric demands of Michigan.

Construction of more generating plants in Michigan has been announced. There is no reporting requirement at the Commission for this construction except in the case where the generation is also an AES. The information shown Attachment IV is not intended to be comprehensive, but represents the information available to the Commission and its Staff. Attachment IV presents a rather aggressive expansion plan of well over 8000 megawatts of generation additions in Michigan by 2004. The Commission is encouraged by these announcements. It also believes the regulatory certainty associated with the passage of 2000 Public Acts 141 and 142 provides the needed incentive for private

participation in the electric marketplace in Michigan. According to the respected ratings agency, Regulatory Research Associates, “[e]lectric restructuring in Michigan has evolved in a constructive manner.”

IV. Summary

Competition in the electric marketplace in Michigan remains in its infancy. Participation by alternative electric suppliers and retail customers electing to choose non-utility sources of electric generation has been modest. This modest beginning can be attributed in part to uncertainty created by power market problems elsewhere and in part to incumbent utilities and competitors moving up the competitive services learning curve. Systems need to be designed, tested and implemented.

Incumbents and competitors alike have been exploring uncharted territory, and some stumbles resulted. For example, some commercial and industry customers are currently expressing frustration with the enrollment process (metering and billing) and access to available transmission. Michigan’s existing electric industry infrastructure, which had supported the traditional vertical supply relationships, is not yet capable of fully accommodating the entry of competitive suppliers. However, the recently changed Michigan regulatory scheme will permit the introduction of competition to continue. It also provides incentives for non-utility entrants in the Michigan electric marketplace.

V. Recommendations for Legislation

At the present time, the Commission has no recommendations for new legislation. However, implementation has proven to be a complicated affair across the country, so the Commission would reserve the right to seek legislative remedies if the marketplace in Michigan fails to fully develop. The Commission is in the process of implementing the requirements of 2000 PA 141. All implementation dates in the Act have been met and no significant problems requiring legislative attention have been identified.

Of course, the electric market nationally is in flux. There may be developments that would make additional legislation desirable. The Commission will continue to monitor the national electric scene and will keep the Governor and Legislature apprised of any developments that may require further action.

VI. Measures to Protect Consumers

On December 4, 2000, the Commission adopted a code of conduct applicable to all electric utilities and alternative electric suppliers in Case No. U-12134. In that order, the Commission adopted a comprehensive code designed to address all potential forms of abuse in the development of a competitive market.

Petitions for rehearing have been filed by Unicom Energy, Detroit Edison, Energy Michigan, Michigan Electric Cooperative Association, and Consumers Energy. Responses have been filed by Detroit Edison, Wisconsin Public Service Corporation, Upper Peninsula Power, Northern States Power, Wisconsin Electric Power Company, Energy Michigan, Consumers Energy, Michigan Alliance for Fair Competition, and Exelon Energy. The Commission is considering these filings and will issue an order on rehearing shortly. Thereafter, the utilities and alternative electric suppliers will have 60 days to file compliance plans.

VII. Customer Education

The Commission uses all forms of available media to inform the public of the status of electric restructuring in Michigan.

A. Electronic

The Commission maintains a comprehensive “Michigan Electric Utility Restructuring” web site at: <http://www.cis.state.mi.us/mpsc/electric/restruct/>. The web page includes access to: (1) the Customer Choice and Electric Reliability Act, (2) all Commission orders relating to the subject, (3) all relevant reports, (4) utility implementation plans, (5) a directory of alternative electric suppliers, (6) a glossary of terms, (7) a section devoted to Frequently Asked Questions, (8) links to ten other Michigan sites, (9) links to five sites addressing electric restructuring in other states, and (10) links to four other web resources: National Association of State Energy Officials, U.S. Energy Information Administration, Federal Energy Regulatory Commission, and National Association of Regulatory Commissioners. The Commission’s electric restructuring web site has been widely used and praised. Last year, it was accessed by 18,848 outside users.¹ In addition, 15,406 outside users accessed the Electric Division web site, which contains a significant amount of material relating to electric restructuring.

One prominent item on the Electric Restructuring web site is a complete directory of licensed alternative electric suppliers at: <http://www.cis.state.mi.us/mpsc/lic-enf/aesprog/aeslist.htm>. This directory includes: company name, address, phone number, fax number, and web page address. Last year, 4,407 external users accessed this directory.

B. Print

Since 2000 PA 141 was enacted, the Commission has issued eleven press releases designed to inform the public of progress being made in the implementation of the act. The Commission also issued and distributed an Information Brochure entitled “Shedding Some Light on Electric Restructuring.” In addition, the Commission distributed a Consumer Alert entitled “Changes Are Here for Michigan’s Electric Utility Customers,” which includes information on electric rate cuts, choice of electric

¹ This and other data excludes any internal use by Commissioners and Staff.

generation suppliers, education programs, slamming and cramming, low income and energy efficiency programs, and licensing of suppliers.

CHOICE Advisory Council

The Commission has established an advisory council named Customers Have Options in Choosing Electricity (CHOICE). The CHOICE Advisory Council includes representatives from the Small Business Association of Michigan, The Heat and Warmth Fund, Michigan Environmental Council, Michigan Consumer Federation, Michigan Community Action Agency Association, American Association of Retired Persons, Consumers Energy Company, Detroit Edison Company, Michigan Manufacturers Association, Michigan League for Human Services, Engage Energy, Michigan Electric and Gas Association, Nordic Marketing, Michigan Retailers Association, and Michigan Electric Cooperative Association.

The CHOICE Advisory Council has issued a report recommending a customer education program. The Commission has completed hearings on the report and will issue a decision in the near future.

C. Other

In addition to the above, Commissioners and Staff routinely participate in public meetings designed to explain electric restructuring.

LICENSED ALTERNATIVE ELECTRIC SUPPLIERS

CMS MS&T MICHIGAN LLC

CMS MARKETING, SERVICES AND TRADING CO.

DTE ENERGY MARKETING, INC.

ENGAGE ENERGY US, L.P.

NICOR ENERGY, L.L.C.

NORDIC ELECTRIC, LLC

NORDIC MARKETING, LLC

QUEST ENERGY, LLC

UNICOM ENERGY INC.

WOLVERINE POWER MARKETING COOPERATIVE, INC.

February 1, 2001

Current Status of Michigan Competitive Electric Generation Services

| | ROA Meters ^a | ROA MW | DA Meters ^a | DA MW | Total Meters ^a | Total MW | Percent of Peak Load ^b |
|------------------|----------------------------|-----------|---------------------------|----------|------------------------------|-------------|--------------------------------------|
| Consumers Energy | 30 | 66.7 | 2 | 9.6 | 32 | 76.3 | 0.9% |
| Detroit Edison | 993 | 93.5 | 8 | 86.9 | 1001 | 180.4 | 1.5% |
| Total | 1023 | 160.2 | 10 | 96.5 | 1033 | 256.7 | 1.3% |

^a Some utility customers have more than one meter, so the number of meters reported is frequently larger than the number of customers.

^b Peak Load estimates for summer 2001, as indicated in utility forecasts filed in MPSC Case No. U-12702.

New Michigan Capacity Since January 1, 1999

| Facility Name | Capacity (MW) | Status | Operating Date |
|---|---------------|----------|----------------|
| CMS Generation-Dearborn Industrial Generation (DIG) - in 3 phases | 160 | Complete | Jun 1999 |
| CMS Peakers @ Kalamazoo & Livingston | 160 | Complete | Jun 1999 |
| Conners Creek conversion from coal to natural gas | 200 | Complete | Jun 1999 |
| DECo - 8 new peakers @ Greenwood, Belle River, Delray | 570 | Complete | Jun 1999 |
| Alpena Power | 54 | Complete | Jun 2000 |
| Cobb 1-3 conversion from coal to natural gas | 180 | Complete | Jun 2000 |
| DECo & CEC Co Upgrades | 334 | Complete | Jun 2000 |
| Holland Peaker | 80 | Complete | Jun 2000 |
| MCV uprated from original design to 1500 mws | 110 | Complete | Jun 2000 |
| Modular Power | 43 | Complete | Jun 2000 |
| Other non-utility generators | 50 | Complete | Jun 2000 |
| DTE Rouge 1 conversion from coal to natural gas | 225 | Complete | Jul 2000 |
| TOTAL CAPACITY TO DATE | 2166 | | |

Announced or New Capacity Under Construction

| Facility Name | Capacity (MW) | Status | Operating Date |
|---|---------------|--------------|----------------|
| CMS Generation - Dearborn Industrial Generation (DIG) - in 3 phases | 550 | Construction | Sep 2001 |
| Covert Generating Co., LLC (PG&E) - phase in over 2 years | 1140 | Permitting | Jun 2002 |
| KM Power Co (Jackson) | 550 | Construction | Jun 2002 |
| Decker Energy International, Inc. @ Carson City - phase in over 2 years | 1500 | N/A | Jun 2003 |
| Indeck Inc @ Niles, MI | 1100 | N/A | Jun 2003 |
| Southern Energy Inc (Zeeland) 1 st phase | 300 | Construction | 2001 |
| Southern Energy Inc (Zeeland) 2 nd phase | 530 | Construction | Jun 2003 |
| Panda Tallmadge Power (Grand Rapids) | 1000 | N/A | Sep 2004 |
| Albion Industrial Park Peaking Capacity | N/A | N/A | N/A |
| Calpine @ Niles, MI | N/A | N/A | N/A |
| Cornerstone Alliance in Berrien Co. | N/A | N/A | N/A |
| Duke Energy @ two Berrien Co sites (Baroda or Benton Harbor) | N/A | N/A | N/A |
| Indeck @ West Branch | 500 | Permitting | N/A |
| New CMS Generation @ Midland - gas combined cycle | 500 | N/A | N/A |
| New Generation @ Battle Creek | N/A | N/A | N/A |
| New Generation in Otsego Co | N/A | N/A | N/A |

N/A = Not Available