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Sunday, June 5, 2005

High-priced power

Michigan has the highest overall electric rates of all the Midwest states. It also has the highest rates for commercial and industrial customers and the second highest for residential customers:

Rates are cents per kilowatt hour:

State	Commercial	Industrial	Residential	Overall
Michigan	7.66¢	5.22¢	8.40¢	7.16¢
Wisconsin	7.19	4.97	9.08	7.03
Ohio	7.65	4.69	7.80	6.64
Illinois	7.15	4.74	7.71	6.57
Minnesota	6.10	4.64	7.63	6.14
Indiana	6.31	4.20	6.99	5.61
Regional average	7.01	4.74	7.94	6.53

Source: U.S. Energy Information Administration

The Detroit News

Deregulation Shorts Out

Electric choices falter in Michigan

Failure to promote competition results in higher rates for consumers, businesses.

[By Mark Hornbeck and Charlie Cain / The Detroit News](#)

Four years after the launch of electric choice in Michigan, virtually all state residents and the overwhelming majority of businesses here still rely on the two giant utilities to supply the juice when they flip on the light switch or crank up the assembly line.

Customers in this state continue to pay substantially higher electricity rates than their midwestern neighbors, and average Michigan home owners are staring at double-digit rate hikes beginning next year, a three-month examination of the electric industry by The Detroit News shows. More lofty increases are likely to follow in the next five years as the state moves away from business subsidies for residential ratepayers.



Daniel Mears / The Detroit News

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Electric restructuring, which swept the nation about five years ago, was designed to usher in competition and lower prices. In fact, choice for residential customers in Michigan is still non-existent and rates for 3.8 million households are still the second highest in the region. Anthony Earley Jr., CEO of DTE Energy, the state's largest utility, said it's doubtful average home owners will ever have a list of companies to choose from to provide their electricity.

"There may be some high-end residential customers, with a 10,000-square foot house and heated pool... but your average residential customer, no," said Earley, explaining that there isn't enough profit margin for energy marketers to go after Joe and Jane Six Pack. They'd rather woo medium and large businesses that are easier and more lucrative to serve.

Competition for commercial and industrial customers is going better, but still less than one-fifth of commercial and industrial customers are using alternative suppliers. That percentage flattened out last year and is now trending down leaving industry experts to wonder whether the dip is due to the ebb and flow of the market, or whether competition will ever truly take hold here.

"Are we going to see a resurgence of choice or further reversal? I don't think we have the answer to that right now," said David Joos, president and CEO of Consumers Energy.

Electricity was to be the next frontier in a deregulation movement that has stepped up competition and lowered bills in the telephone, airlines and trucking industries. The idea of breaking up regulated electric power monopolies initially was embraced by nearly all states until 2001 when choice led to a collapse of the electric industry in California, resulting in skyrocketing prices and rolling blackouts. Today, only 21 states, including Michigan, are active in deregulating or restructuring their electric markets.

Many have likened the experience here to a boulder that rolled down hill, gathered steam and started climbing the next hill, but then lost inertia and is now rolling backward. Interviews with dozens of industry experts and stakeholders show the state is left with an unstable, unpredictable electricity market that is scaring off investors for new \$1 billion power plants at a time when

DTE Energy official James Padgett checks a turbine. DTE and Consumers Energy control 90 percent of Michigan's market.



Daniel Mears / The Detroit News

People fish at a pier overlooking the DTE power station in Monroe. A major plant hasn't been built in Michigan in 16 years.



David Coates / The Detroit News

Critics cite industry pressure in the decline of business clients that choose alternate suppliers. Consumers Energy CEO David Joos said it's unclear whether the trend will continue.

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many say the state should already be adding to generation capacity to meet mushrooming demand. There has not been a major power plant built in Michigan in 16 years, and many plants in its current fleet are over 40 years old. Part of the reason for the loss of momentum is DTE Energy and to a lesser extent Consumers Energy using their considerable clout in Lansing to stall the effort to spur competition in the electric power industry and bring cheaper, reliable electricity to the homes and businesses of Michiganians.

The two utilities, which control 90 percent of the marketplace, have spent over \$1.7 million in political campaign contributions over the past three election cycles, a review of campaign finance records shows. That includes hundreds of thousands of dollars that went to lawmakers who serve on committees that directly oversee the electric industry.

Additionally, Edison shelled out at least \$5.5 million on a mass media ad campaign last year that critics say was designed to frighten ratepayers, scare off competition and influence the Legislature and Public Service Commission, a three-member panel charged with regulatory control over the utilities. Both utilities maintain offices for lobbyists in the state building where the Public Service Commission is located. "DTE has put pressure on the Legislature and the Public Service Commission to kind of go back to the wonderful old days of regulation, and that troubles me," said Nora Mead Brownell, one of four members of the Federal Energy Regulatory Commission.

"The political clout of utilities was the most disastrous thing to happen to telecommunications and now to electric deregulation. These companies not only write checks, they pay for the bus to drive everybody to the game, they build playgrounds. Economic problems deserve economic solutions, not political solutions."

The utilities' campaign to fight off competition appears to be working. Pressure on the Legislature and in turn the Public Service Commission led to \$338 million in rate relief to Detroit Edison last year. The utility also got \$44 million in special charges paid by all ratepayers - including those who left the utility -- which made switching to alternative providers less attractive. Savings that three years ago averaged better than 25 percent were cut in half or in some cases eliminated under the PSC orders. The value of DTE stock shot up.

"Detroit Edison did have some obvious revenue issues and that's what we addressed," said PSC Commissioner Laura Chappelle. "I don't think we did so at the expense of killing choice."

The result: One in five of the business customers who had gone to lower cost suppliers has returned to the Edison fold in the last few months and even more returns are expected by summer. Consumers Energy reports about 10 percent of their choice customers have come back.

Another key reason for the decline of business choice customers: The price of natural gas, which is both directly and indirectly linked to electricity costs, has tripled in recent years cutting into discounts alternative suppliers can offer to lure customers away from the utilities.

Ted Bolema, Central Michigan University professor of law and finance and former trial lawyer on energy



Robin Buckson / The Detroit News

DTE CEO Anthony Earley Jr. says it's unlikely residential customers will ever be able to buy from cheaper suppliers.

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issues for the U.S. Department of Justice said the utilities have successfully stalled competition, but only for the short term.

"Eventually competition will find its way in. The genie is out of the bottle," Bolema said. "In the long run, the structure is in place that would support competition. We should let that play out."

Meanwhile, electric rates for commercial and industrial customers range from 9.3 percent to 10.1 percent higher than the regional average, according to the U.S. Department of Energy, hampering this state's economic development efforts at a time when Michigan has the nation's second highest unemployment rate. Michigan customers spend well over \$7 billion a year for electricity.

"This is an area where Michigan can reduce its business costs," said Barry Cargill, executive director of the 6,000-member Small Business Association of Michigan. "Rather than electric costs going down, they're going up putting Michigan in an uncompetitive position with other states."

Residential customers, who are already paying rates about 6 percent higher than home owners in other Midwest states, should brace for at least an 11 percent spike in electric bills early next year when an artificial price cap put on by the Legislature to attract supporters to choice is lifted.

Look for residential bills to shoot up by double digits again between 2007 and 2011 when state regulators are expected to allow utilities to gradually charge residential customers the true cost of power.

Historically, businesses subsidize residential rates anywhere from 10 to 20 percent primarily for political reasons. Residential ratepayers are voters.

"With the freeze lift and the end of subsidization, I can see residential rates going up 28 percent," said Eric Schneidewind, a former PSC chairman who now represents alternative energy providers.

Concerns about energy prices drove the Michigan Jobs Commission in 1996 to conclude that this state was losing out on business attraction and retention partly because of high energy costs. That triggered the move to deregulation.

After years of study and haggling, a restructuring law was finally passed in 2001 that was designed to encourage competition in the electric market without killing the two big utilities. Edison, Consumers Energy, the business community, Gov. John Engler and others signed off on that package.

As business customers left Edison in pursuit of lower electric costs offered by alternative suppliers, the utility's profits dwindled.

"We went from a company that was earning \$330 to \$350 million in net income a year to one that was earning about half that last year and we would have continued to go down hill if we hadn't said anything," said DTE chief Earley. "This was a company heading for a train wreck."

A year ago, Edison decided to take its case to the public. It launched a TV and radio ad campaign the company estimates cost \$5.5 million but critics like the Small Business Association of Michigan say was closer to \$10 million. It quickly became known as the "wolf's at the door" campaign and left the audience with the impression that California-like blackouts, Enron scandals and broke utilities were in Michigan's immediate future unless the choice law was fixed. A stalking wolf was depicted in TV ads.

"I can't tell you how many legislators came to me who saw those ads and said we have to do something about Public Act 141 (the electric choice law)," said Ken Bradstreet, former chair of the House Energy & Technology Committee who now consults for Wolverine Power, a Cadillac-based electric cooperative. "I'd say, 'oh yeah? What?'"

At the same time, a panel headed by Sen. Bruce Patterson was hearing testimony sounding those same warnings. One such report was delivered by Leslie Rich, a financial analyst for Bank of America. She said the current law "creates an unsustainable business model" for Edison. She failed to mention that her company last year had \$361 million worth of DTE stock, the utility's fourth largest institutional

shareholder.

Sen. Patterson conceded that Rich should have revealed that her company was a major DTE stockholder, but says he has yet to hear anything that would refute her statement about the utility's viability under the electric choice law.

"There's no doubt in my mind she was an expert witness," Patterson said, but added that if he were a trial judge, he would have insisted Bank of America's DTE investments were part of the record.

Patterson acknowledged that DTE "played a major role" in drafting the legislative package, but added it could have been worse.

"Edison at first asked me to repeal Public Act 141. I said no way, no how," Patterson recalled.

Rich's phrase became a slogan for those wanting to protect Edison and change the electric choice law. The package of bills was introduced last summer in Patterson's committee, triggering an outcry from the business community that the utility was using its political heft to kill electric choice. The legislation never came out of committee, but much of what it intended to accomplish was embodied in Public Service Commission final order that came out in November.

"The legislation was introduced to put pressure on the PSC," said Cargill of the Small Business Association. "Their decisions are supposed to be based on science rather than politics, but they're human. It's unfortunate the companies utilize the regulatory process in order to be profitable.

"That campaign probably got DTE an additional \$100 million in rate relief out of the PSC. That's a pretty good business decision for a \$10 million expenditure (for the ad campaign)."

Added former Rep. Bradstreet: "The outcome of the rate case was quite favorable to DTE, so you could conclude that it was a very effective marketing campaign."

PSC commissioners denied being influenced by the ad campaign and DTE lobbying efforts.

"The Edison campaign had no effect whatever on my decision," said Peter Lark, chairman of the PSC, and potential candidate for attorney general next year.

Lark has assumed the role of Gov. Jennifer Granholm's point person on electric choice issues. Some give the governor credit for leaving the job to someone with expertise. Others say Granholm should be more involved in this critical economic development issue.

"According to Gov. Granholm, the No. 1 priority for Michigan is jobs. Michigan is a high-cost energy market and is not going to attract jobs under the current paradigm," said Mark Stiers, chief operating officer for Quest Energy, an alternative electric supplier. "I am at a loss as to why electricity issues aren't higher on the governor's agenda. It's an economic development issue that's more easily addressed than others she's working on."

Liz Boyd, spokeswoman for Granholm, said the governor is "very engaged" on the issue and receives regular updates from the PSC.

"The governor would agree that rates are generally high and we need get them lower to spur economic development," Boyd added. "But the rates are handled by the commission, which is an independent agency the governor doesn't control."

Likewise, Attorney General Mike Cox draws barbs for not taking up the cause for ratepayers in utility cases the way his predecessors -- most notably long-time office-holder Frank Kelley -- did.

"I'm amazed that the attorney general was not more active. He was not at all active in legislative discussions," said Dave Svanda, former PSC commissioner and now a private consultant. "You would expect the premier consumer advocate of the state to place closer attention to these issues. He showed no interest."

For his part, Cox recently has taken the utilities to task on a couple of issues and said in a news conference

that he intends to be an advocate for consumers in the same vein as former attorneys general Kelley and Granholm.

The three public service commissioners said the electric choice law is working well and no one expected it to provide options for every consumer overnight. They concede the residential market has been passed over but hold out hope that choice will be available to home owners in the future.

They say their orders have accomplished the mission of keeping the utilities healthy.

Earley said Edison's financial health "is improving." But it won't get back to pre-choice profits until next year at the earliest.

Joos also said the financial outlook is getting better, although he's still troubled by the company's debt as a percentage of total investment. Consumers Energy made several ill-advised foreign investments in the 1990s that fractured the company's bottom line.

"We're working hard to reduce the debt, but we've made good progress," he said.

Charles Fishman, a utility analyst with A.G. Edward & Son in St. Louis, said Michigan's electric utilities are generally in good financial shape.

"DTE probably has the better balance sheet. CMS Energy doesn't have as good a balance sheet although it has improved in the last two years," Fishman said. "CMS would not be a utility I'd necessarily recommend for widows and orphans but it's been a wonderful investment for those who can take a more aggressive approach."

He said a good part of DTE's success has been its investment in non-regulated business.

Edison is often criticized for having electric rates that are among the highest in the Midwest. Critics say that's because the company is not efficiently run. The company has 11,000 employees compared to 8,000 for the more streamlined Consumers, even though Consumers' territory is geographically larger and tougher to service, the critics point out. Edison's electric rates are considerably higher than Consumers'. "If DTE continues to be inefficient, how can they survive in a world of competition," the Small Business Association's Cargill said. "They need to focus on becoming more efficient instead of influencing the regulatory process."

Added PSC Commissioner Bob Nelson: "Consumers had a big problem with foreign investments and that was a real drag on the financial outlook for the company. They've divested a lot of those, gone back to basics and made a lot of cuts that they had to make and are a very lean and well-managed company right now. Edison hasn't gone through the same thing."

Earley said Edison's rates are lower than the U.S. average and also lower than rates charged by several companies in the region. But he quickly added that there are many cost pressures on the company's rates. "We have to ship[coal long distances, so that tends to have an impact," Earley said. "Wages and benefit rates are another issue. In Michigan, particularly with benefits, they're driven by the UAW. In order to compete for labor we have to have very competitive benefits packages. "Also, Michigan has been more aggressive on the environmental front than many states... and finally, large urban areas traditionally have higher rates because of the economics. It costs more every time we have to do a repair in Detroit, either you're in a manhole or you dig up a street. And you have collections problems with low-income populations."

Critics say all ratepayers are still paying dearly for mismanaged development of nuclear power plants.

Edison's Fermi 2 plant in Monroe had cost overruns of about \$4 billion while costs for Consumers Energy's Midland nuclear plant exceeded initial estimates by more than \$5 billion. The Midland nuclear project was eventually abandoned and the utility instead opened a natural gas co-generation facility at the site which now sits idle because of the exorbitant cost of that fuel. Utility officials say the cost overruns

were due to a tangle of federal regulations on nuclear energy in the wake of the 1979 near-disaster at Three Mile Island.

Footing the enormous bill for the nuclear plants is a major factor in the special charges that customers of all electric providers are paying - charges that reduce the margin available to alternative suppliers to offer discounts to attract choice customers.

"All customers pay for the securitization of Fermi, but only those that stayed with Edison are getting the benefits off low-cost energy generated by Fermi," said Stiers at Quest Energy. "It's like paying for a rental car and not getting to use it at all."

He said Quest remains committed to this state for now, but added: "Michigan is in such a state that developers will look to other markets where opportunity is stabilized. This market is in turmoil. Other markets are more predictable, more sustainable. That's where our attention and the attention of other alternative supplies will be."

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Daniel Mears / The Detroit News

Huge mounds of coal fire DTE Energy's power plant in Monroe. Investors willing to put up \$1 billion for new power plants are being frightened away, at a time when many say the state should be adding to generation capacity to meet growing demand. Many plants in Michigan are more than 40 years old.

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