

Electric Choice Question 12: What data and studies would help identify the relative importance of pricing stability and market-based pricing to Michigan residents and businesses?

Executive summary

1. Surveys of residential and small-business customers in Michigan and other states indicate that these customers place the most value on price stability and predictability, electric system reliability, and other attributes of a regulated electric model. Even if they could get lower rates through a deregulated model, customers say they are not willing to trade off these attributes for lower rates
2. These survey findings are supported by the evidence which shows very limited residential customer switching when the option is available. In fact, studies suggest that the transaction costs and risks of switching may outweigh the benefits to residential and other small customers, even when they might be able to get a lower rate from a retail supplier
3. Residential and small business customers are strongly opposed to deregulation if it results in lower rates for a few at the expense of others – this is the current situation in Michigan’s partial retail access model
4. Large businesses’ preferences for stable versus market-based pricing are clearly revealed through their *actual behavior* when they are presented with the option to choose. These customers prefer the “free option” of switching between the lower of regulated or market-based rates (which is available in Michigan), but when that option is more restrictive than Michigan’s (for example in Virginia), or when they bear its full cost, most customers prefer to stay with the more stable, regulated rates

1. Surveys of residential and small-business customers in Michigan and other states indicate that these customers place the most value on price stability and predictability, electric system reliability, and other attributes of a regulated electric model. Even if they could get lower rates through a deregulated model, customers say they are not willing to trade off these attributes for lower rates.

There has been limited research into the preferences of customers for the different attributes of regulated and deregulated electric models. As former Michigan Public Service Commission staffer and industry expert Martin Kushler writes, “Despite all the rhetoric about customer choice, amazingly little effort has been made by policymakers to actually determine the opinions and preferences of average customers.”

However, surveys conducted in a few states – including Michigan – provide some insight into customers’ preferences. The central finding of these surveys is that reliability, stability and predictability of rates, and other attributes of regulated utility models are far more important to most customers than having a choice in their electric provider. Factors like reliability are even more important than having lower rates, and

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consumers are not willing to trade off performance on these other factors for a lower price.

Customers are also not interested in “choice” for the sake of choice. In a study of Michigan customers, the majority of those who said they supported “choice” supported it because they thought it meant lower rates (compared to only 10% who said they supported it because they wanted to choose their supplier). Yet the reality is that “choice” has *not* led to the lower rates consumers expected or hoped for (see response to Electric Choice Question 5 for evidence).

[Surveys include: Maine Public Utilities Commission Customer Surveys on Electric Industry Restructuring; Vermont Department of Public Service, A Consumer Information and Education Plan; New York State Consumer Protection Board, Residential and Small Business Electricity Consumer Survey Results; Energy Center of Wisconsin, Qualitative Assessment of Public Opinion on Restructuring of the Electric Utility Industry in Wisconsin; Michigan Public Service Commission, Michigan Residential Energy Efficiency Survey; Michigan Electric Cooperative Association, Statewide Survey of Electric Customers]

*[Source: Martin Kushler, “Restructuring and ‘Customer Choice’: Vox Populi or Dictum Dictatorium?”, *The Electricity Journal* 11(1), p 30-36]*

2. These survey findings are supported by the evidence that shows very limited residential customer switching when the option is available. In fact, studies suggest that the transaction costs and risks of switching may outweigh the benefits to residential and other small customers, even when they might be able to get a lower rate from a retail supplier.

In jurisdictions that allow all customers to choose between regulated and market rates, there is relatively little switching among residential and other small customers.

An economics study, “Consumer preference not to choose: Methodological and policy implications”, found that “residential consumers in the United States have shown little interest in choosing electricity from a supplier other than the incumbent” even in the states with what deregulation proponents consider the “most successful implementation of retail competition.”

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This lack of switching was found to be particularly true for prepayment customers (generally lower income), who in theory should be more likely to switch for even a small savings in rates.

The time and effort associated with researching options and switching, as well as the “aversion to risk in supply of an essential product,” make the costs of switching not worth it for most residential and small business customers. In fact, the author of this study concludes that “for many, if not most residential customers, increasing choice in and of itself entails a welfare loss.”

[Source: T.J. Brennan, “Consumer preference not to choose: Methodological and policy implications,” *Energy Policy* 35 (2007), p 1616-1627]

Many residential customers have difficulty assessing whether the prices offered by deregulated energy suppliers are fair and accurate. In Texas, the number of customer complaints received by the Public Utility Commission increased eightfold following deregulation. In Michigan, some deregulated natural gas suppliers have been found to use deceptive, fraudulent, or misleading strategies. Customers can be confused by the different rates and service providers under complicated deregulated pricing structures.

[Source: Texas Coalition for Affordable Power, “Deregulated Electricity in Texas: A History of Retail Competition”, December 2012 and MPSC Order in Case U-15509, 15577, 15929, April 1999]

In Connecticut, the Department of Energy and Environmental protection’s commissioner recently stated that,

“We are ten years plus on into what was meant to be a competitive marketplace for electricity generation in Connecticut, and fewer than half of our residential electric customers have gone into the marketplace... This says something is not right in the system”

[Source: Brian Dowling, “State details plan to auction ‘standard service’ electric ratepayers”, *The Hartford Courant*, February 28 2013]

This phenomenon of limited residential switching when the option is available is not unique to the United States. According to a 2011 International Energy Agency report,

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“Relatively few customers have switched from regulated prices to free-market retail prices in those European countries where they can choose... More than 80% of the market chooses the regulated product”

[Source: “Empowering Customer Choice in Electricity Markets”, International Energy Agency Information Paper, October 2011, p 27]

3. Residential and small business customers are strongly opposed to deregulation if it results in lower rates for a few at the expense of others – this is the current situation in Michigan’s partial retail access model.

Some surveys have asked residential and small business customers about their reaction to potential electric restructuring that results in slightly higher rates for residential and small business customers, but lower rates for large business or industry – with the explicit qualification that lower industry rates might help improve the state’s economy. Even with this qualification, residential and especially small business customers strongly opposed this outcome and ranked it as the least desirable outcome of restructuring.

[Source: Martin Kushler, “Restructuring and ‘Customer Choice’: *Vox Populi* or *Dictum Dictatorium?*”, *The Electricity Journal* 11(1), p 30-36]

These findings were reaffirmed in April 2013, when a poll of Michigan voters found that 82% of respondents disagreed with the statement, “As long as deregulation results in lower costs for big businesses, I am okay if prices go up for residential and small business customers.”

[Source: TargetPoint Consulting poll conducted April 3-7, 2013. See Overall Question 2 for additional details about this poll and its findings]

However, this is exactly the situation in Michigan today, with more than 99% of Michigan customers (mostly residential and small business) paying an extra \$300 million every year to subsidize a few (mainly large business) customers on “Choice” (see Electric Choice Question 26 for details). If the cap were to be increased, this dynamic would be amplified, with residential and small business customers absorbing an even larger share of system costs for the benefit of a handful of customers.

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Interestingly, customer panels and surveys of industry executives reveal that most people expect deregulation to provide little or no reduction in rates to residential customers, while possibly benefitting only large business / industrial customers.

[Source: Martin Kushler, "Restructuring and 'Customer Choice': *Vox Populi* or *Dictum Dictatorium?*", *The Electricity Journal* 11(1), p 30-36]

4. Large businesses' preferences for stable versus market-based pricing are clearly revealed through their actual behavior when they are presented with the option to choose. These customers prefer the "free option" of switching between the lower of regulated or market-based rates (which is available in Michigan), but when that option is more restrictive than Michigan's (for example in Virginia), or when they bear its full cost, most customers prefer to stay with the more stable, regulated rates.

Businesses with the option of switching between regulated rates and market-based rates show a clear pattern of selecting regulated rates when market prices are high and selecting market prices when they are low. When this switching is a "free option," with the costs borne by other customers, businesses obviously like it.

From 2002 to 2005, when Midwest wholesale power prices were low, 4,000 MW of demand left the regulated Michigan utilities' systems for the lower market rates. Then, from 2005 to 2009, when wholesale power prices increased, most of that demand returned to the regulated system, with customers leaving the volatile and higher wholesale market rates for the more stable and lower regulated rates. When wholesale power prices fell again in 2009, another 1,500 MW of demand once again left the regulated utility system – and more would have left without the 10% retail access cap in place. This uncertainty and variability of demand presents substantial challenges to utilities trying to plan reliability investments, and is likely to lead to underinvestment in the system, since utilities do not want to invest to serve load that may disappear next time market prices fall, thus saddling the remaining customers with the entire burden of guaranteeing system reliability. (See responses to Electric Choice Question 6 and 7 for further discussion of this issue.)

Because Michigan allows customers to switch between regulated utility rates and market rates, in effect business customers do not currently have to choose between rate stability and market-based rates – they can select the one that has the lowest price

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at any given time. They like this option to switch because they do not bear the full costs of it – this “free option” is subsidized by all other customers who remain with the utility.

Other jurisdictions have stricter rules limiting customers’ ability to freely switch between regulated and market rates to avoid the problem of subsidization by other customers and the challenges to utility planning when demand can come on and off the system. The experience in these jurisdictions shows that very few customers select market-based rates if they do not have the safety of an easy switch back to regulated rates.

In these jurisdictions with stricter rules, large nonresidential customers are allowed retail access but may not switch back without approval, or must remain on retail access for a long period (e.g., 5 years in Virginia), or pay a switching fee. In those states, virtually no customers actually select this retail access option. This reveals that, when forced to choose between the two, large business customers tend to prefer the stability of regulated rates over the uncertainty and risk of market-based pricing.

[Source: “Annual baseline assessment of Choice in Canada and the United States”, Distributed Energy Financial Group, 2012; Energy Information Administration, State Commissions]