S T A T E   O F   M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **INDIANA MICHIGAN POWER COMPANY** for approval to implement a power supply cost recovery plan for the 12 months ending December 31, 2021.	))))))	Case No. U-20804

At the November 18, 2021 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Daniel C. Scripps, Chair
Hon. Tremaine L. Phillips, Commissioner
Hon. Katherine L. Peretick, Commissioner

ORDER

History of Proceedings

On September 30, 2020, Indiana Michigan Power Company (I&M) filed an application, with supporting testimony and exhibits, pursuant to Section 6j of Public Act 304 of 1982 (Act 304) as amended, MCL 460.6j, requesting approval of its proposed 2021 power supply cost recovery (PSCR) plan and proposed PSCR factor.

A prehearing conference was held on November 19, 2020, before Administrative Law Judge Sharon L. Feldman (ALJ)[1], at which Sierra Club and the Michigan Department of Attorney

[1] Administrative Law Judge Sharon L. Feldman presided over the pre-hearing conference in this proceeding in place of Administrative Law Judge Kandra K. Robbins who presided over the remainder of the proceeding. The abbreviation of Administrative Law Judge (ALJ) in this order refers to Kandra K. Robbins from this point forward.

General (Attorney General) were granted intervention. I&M and the Commission Staff (Staff) also participated in the proceeding. On December 22, 2020, the ALJ entered a protective order.

On March 12, 2021, the Staff and Sierra Club filed testimony and exhibits, and on April 9, 2021, I&M filed rebuttal testimony and exhibits. An evidentiary hearing was held on April 28, 2021. I&M, Sierra Club, and the Staff filed initial briefs on May 27, 2021. The same parties filed reply briefs on June 24, 2021.

On August 2, 2021, the ALJ issued a Proposal for Decision (PFD). On August 23, 2021, I&M filed exceptions to the PFD. On September 7, 2021, the Staff and Sierra Club filed replies to exceptions. The record in this case is comprised of 387 pages of transcript and 57 exhibits admitted into evidence.

<u>Applicable Law</u>

A PSCR proceeding concerns the recovery of a utility's power supply costs on an annual basis. A power supply cost recovery clause is:

> a clause in the electric rates or rate schedule of an electric utility that permits the monthly adjustment of rates for power supply to allow the utility to recover the booked costs . . . of fuel burned by the utility for electric generation and the booked costs of purchased and net interchanged power transactions by the utility incurred under reasonable and prudent policies and practices.

MCL 460.6j(1)(b). A power supply cost recovery factor is "that element of the rates to be charged for electric service to reflect power supply costs incurred by an electric utility and made pursuant to a power supply cost recovery clause incorporated into the rates or rate schedule of an electric utility." MCL 460.6j(1)(c). Subsection 6j(3) of Act 304 requires a utility with a PSCR clause to annually file a PSCR plan describing the expected sources of electric power supply and changes in the cost of power supply anticipated over the 12-month period following the filing of the plan. The PSCR plan must also describe all major contract and power supply agreements for the 12-

month period. A utility must contemporaneously file "a 5-year forecast of the power supply requirements of its customers, its anticipated sources of supply, and projections of power supply costs, in light of its existing sources of electrical generation and sources of electrical generation under construction." MCL 460.6j(4).

Subsection 6j(5) of Act 304 provides that, after a utility files its PSCR plan and five-year forecast, the Commission shall conduct a proceeding to evaluate the reasonableness and prudence of the PSCR plan and to establish PSCR factors for the period covered by the plan. In its final order in a PSCR plan case, the Commission must "evaluate the reasonableness and prudence of the decisions underlying the [PSCR] plan" and must "approve, disapprove, or amend the plan accordingly." MCL 460.6j(6).

In evaluating the decisions underlying the PSCR plan, Subsection 6j(6) of Act 304 states that "the commission shall consider the cost and availability of the electrical generation available to the utility; the cost of short-term firm purchases available to the utility; the availability of interruptible service; . . . whether the utility has taken all appropriate actions to minimize the cost of fuel; and other relevant factors." This subsection also requires the Commission to approve, reject, or amend the 12 monthly power supply cost recovery factors requested by the utility in its PSCR plan. The finalized PSCR factors shall not reflect items the Commission could reasonably anticipate would be disallowed in a PSCR reconciliation proceeding. MCL 460.6j(6).

In its final order the Commission shall also evaluate the decisions underlying the five-year forecast filed by a utility and may indicate any cost items in the five-year forecast that the Commission would be unlikely to permit the utility to recover from its customers in rates, rate schedules, or PSCR factors established in the future. MCL 460.6j(7). This is known as a Section 7 warning.

Positions of the Parties

I&M requested that the Commission enter an order approving implementation of the company's proposed PSCR plan and PSCR factor in rates for 2021 jurisdictional sales of electricity that are subject to the PSCR clause. I&M requested that the Commission approve the company's request for a 2021 PSCR factor of 18.92 mills per kilowatt-hour (kWh), resulting in a proposed Michigan jurisdictional PSCR factor of 2.85 mills per kWh applicable to the billing months of January 2021 through December 2021. I&M requested that the Commission accept the company's five-year forecast and reject the request to issue a Section 7 warning pursuant to MCL 460.6j(7). I&M's initial brief, pp. 21-22.

I&M argued that, in accordance with Act 304, its proposed 2021 PSCR plan contains all the elements which are required to be included and described in a PSCR plan. I&M contended that the proposed 2021 PSCR plan is reasonable and prudent. I&M argued that it has taken all appropriate actions to minimize the cost of fuel. The company argued that the proposed 2021 PSCR factors do not reflect items that the Commission could reasonably anticipate would be disallowed under Section 6j(13) of Act 304. *Id*.

The Staff recommended that the company's 2021 PSCR factor be approved as reasonable given that it will be reconciled and reviewed in the company's future 2021 PSCR reconciliation case. Staff's initial brief, pp. 4-5. The Staff contended that the Inter-Company Power Agreement (ICPA) costs included in the company's 2021 PSCR plan case fall within a range of reasonableness and should be approved subject to reconciliation and further review for reasonableness and prudence in a reconciliation case. *Id*., pp. 5-6.

The Staff agreed with Sierra Club that the dispatch of the Rockport units is uneconomic as "must run." However, the Staff maintained its position that the company's application in this case is acceptable for the purposes of setting a reasonable and prudent PSCR factor in 2021. Although, considering the uneconomic must run, the Staff recommended that the Commission order the company to provide an analysis of the Rockport units' actual dispatch in the reconciliation proceeding of this case. Staff's reply brief, p. 2. The Staff recommended that if I&M fails to provide this information or provides information that does not adequately support its position to commit the Rockport units as must run, the Commission should warn the company that it may disallow fuel costs associated with uneconomic must run decisions in future reconciliation cases. *Id*.

Sierra Club recommended that the Commission determine that the ICPA is substantially higher cost than the value of the products and services provided by the Ohio Valley Electric Corporation (OVEC) to I&M and therefore, the OVEC contract is not reasonable or prudent under current market conditions for the 2021 plan year. Sierra Club's initial brief, p. 3. In addition, Sierra Club asked that the Commission find that the ICPA is projected to cost significantly more than equivalent market products and services during the forecast period of 2022 to 2025 such that it is outside the range of reasonable and prudent costs. *Id*. Sierra Club recommended that the Commission amend the PSCR plan by removing the costs of the ICPA from the maximum PSCR factor and reduce I&M's forecast costs by the difference between OVEC's expected costs and the expected cost of market purchases for energy and capacity during that time period. *Id*., p. 4. Sierra Club requested the Commission issue a Section 7 warning to I&M that based on present evidence it will likely disallow I&M's recovery of the Michigan jurisdictional share of compensation for the ICPA in 2022-2025. *Id*. Sierra Club argued that the Commission should reaffirm that OVEC is an affiliate of I&M under the Michigan Code of Conduct (Mich Admin Code, R 460.10101 *et seq*.), and the Commission should apply the Code of Conduct's affiliate price cap. Applying the affiliate price cap would direct a disallowance equal to the difference between the payments I&M makes under the ICPA and the costs that I&M ratepayers would pay for the same amount of energy and capacity at market prices. *Id*.

Finally, the Sierra Club contended that the Commission should warn I&M that it will disallow recovery in PSCR reconciliation dockets of the fuel portion of all net revenue losses incurred because of imprudent unit commitment decisions at the Rockport units. *Id*.

Proposal for Decision

The ALJ provided an overview of the record and positions of the parties on pages 2-34 of the PFD which are summarized here for reference. The ALJ also provided an overview of the applicable regulations under Act 304. As the ALJ states, "[t]he Company bears the burden of proof in an Act 304 proceeding to demonstrate that its proposed PSCR factors are reasonable and prudent. The applicable standard of proof for purposes of determining whether they are reasonable and prudent is the preponderance of the evidence standard." PFD, p. 34. The PFD recommended that the Commission:

> 1. Apply the affiliate price cap and direct [a] disallowance equal to the difference between I&M's payments under the ICPA and the costs I&M ratepayers would pay for the same amount of energy and capacity at market prices.
>
> 2. Direct that the PSCR plan should be amended to remove the costs of the OVEC ICPA from the maximum PSCR factor and reduce I&M's forecast costs by the difference between OVEC's expected costs and the expected cost of market purchases for energy and capacity.
>
> 3. Amend the plan to include the impact of the Rockport Unit 2 purchase in the forecasting of costs.
>
> 4. Warn I&M that it will disallow recovery in PSCR reconciliation dockets of the fuel portion of all net revenue losses incurred as a result of imprudent unit commitment decisions at Rockport.

PFD, p. 40.

Exceptions and Replies to Exceptions

I&M takes exception to the PFD on seven points: (1) the ALJ failed to acknowledge the Commission's findings in Case Nos. U-20529 and U-20224, (2) the ALJ did not analyze the reasonableness and prudence of I&M's projected ICPA costs as required under MCL 460.6j, (3) the ALJ erred in recommending removal of ICPA costs from the PSCR factor by misapplying MCL 460.6j(6), (4) the ALJ erred in recommending applying the Code of Conduct's pricing provision in I&M's 2021 PSCR plan case, (5) the ALJ substantively misapplied the Code of Conduct by ignoring requirements set forth in Section 4 of Mich Admin Code, R 460.10108 (Rule 8), (6) the ALJ erred in recommending the PSCR plan be amended to include the impact of I&M's planned purchase of Rockport Unit 2 in the forecasting of costs, and (7) the ALJ erred in recommending that I&M be warned the Commission will disallow recovery in PSCR reconciliations of the fuel portion of all net revenue losses incurred as a result of imprudent unit commitment decisions at the Rockport units. *See*, I&M's exceptions, pp. 9-42.

In replies to exceptions, Sierra Club asks that the ALJ's decision be affirmed and adopted by the Commission. Sierra Club contends that the issues regarding I&M's 2021 PSCR plan have not been presented to the Commission for consideration or decided by the Commission because the issues were not ripe for decision until this proceeding. Sierra Club argues that the Commission could not previously determine the following issues presented in this case: (1) whether I&M's 2021 PSCR costs were reasonable and prudent, (2) whether OVEC costs in the 2021-2025 forecast warrant a Section 7 warning, and (3) whether OVEC 2021 PSCR costs comply with the Code of Conduct. Sierra Club states that it has:

> heeded the Commission's instruction in Case No. U-20529, which stated that "the comparison to the PJM [Interconnection, LLC] (PJM) capacity market is insufficient, on its own, to warrant a disallowance," and presented substantial evidence about why the OVEC costs were unreasonable that was not part of the record in Case Nos. U-20529 and U-20224−including [American Electric Power]'s (AEP's) own PJM capacity market forecast, the price the Company recently paid to purchase Rockport unit 2, and [Cost of New Entry](CONE) as calculated by PJM.

Sierra Club's replies to exceptions, p. 9.

Sierra Club argues that the ALJ's recommendations in this case are consistent with the Commission's orders in Case Nos. U-20529 and U-20224 and are the logical continuation of the orders in those cases. Sierra Club quotes the May 13 order in Case No. U-20529 (May 13 order), stating:

> However, on a going forward basis, the Commission will closely scrutinize costs incurred under this contract between affiliates, reminds I&M of its obligations under the Code of Conduct, including I&M's "continuing duty to support its long-term contracts and affiliate transactions," and "will expect to see evidence that the company has taken steps to minimize the cost of [power], including efforts to renegotiate contracts, and will look to comparisons with other long-term supply options as informative as to whether this particular contract adheres to the Code of Conduct."

May 13 order, pp. 18-19 (alteration in original) (citing the April 8, 2021 order in Case No. U-20543 (April 8 order), pp. 6-7).

Sierra Club goes on to argue that the issue of whether I&M is an affiliate of OVEC has been conclusively decided in Case No. U-20529 and that this decision was reiterated in Case No. U-20224. Sierra Club also notes that the Commission has already addressed the issues of federal preemption, the reasonable utility standard, and issue preclusion under *Pennwalt Corp v Pub Serv Comm*, 166 Mich App 1, 9; 420 NW2d 156 (1988).

Sierra Club posits that the ALJ's recommendations are based on the Commission's Code of Conduct, not the reasonableness and prudence language of MCL 460.6j alone. Sierra Club argues that while Subsection 6j of Act 304 applies to all decisions and projected costs in a PSCR plan, a determination of compliance with the Code of Conduct price cap applies only to affiliate transactions. Sierra Club's replies to exceptions, pp. 23-24.

Sierra Club contests I&M's assertion that contracts are not subject to review of their costs from year-to-year. Sierra Club cites to the language of the May 13 order, which stated "[m]erely approving recovery of costs under the ICPA does not amount to a finding that the ICPA, and all future costs, are reasonable," and that "the Commission also has a duty under the statute to continuously evaluate the reasonableness of the PSCR and factors, including the cost arising under the ICPA and its amendments." Sierra Club's replies to exceptions, p. 25 (citing May 13 order, pp. 13-14).

Sierra Club argues that the Code of Conduct is within the purview of "other relevant factors" that the Commission must consider when it approves, disapproves, or amends a PSCR plan. Sierra Club asserts that the Code of Conduct governs the permissible prices regulated utilities may pay their affiliates and is a relevant factor when the PSCR plan includes buying substantial amounts of power from an affiliate. Sierra Club's replies to exceptions, p. 27. Sierra Club points out that:

> [i]n practice, the Commission has repeatedly removed costs from PSCR factors based on items other than those listed in subsection (13). These items have included projected costs of natural gas that were too high; projected coal costs that were too high; and projected power supply costs resulting from a projected random outage rate that was too high.

Sierra Club's replies to exceptions, p. 28 (citing the July 22, 1992 order in Case No. U-9960, pp. 23-25).

Sierra Club replies to I&M's exception that the ALJ's decision is inconsistent with the PSCR plan and reconciliation processes established in MCL 460.6j. I&M argues that the Commission should reject the PFD's approach and review the difference between the company's projections and actual data in the reconciliation process. I&M's exceptions, p. 4. Sierra Club replies that the

Commission should reject this contention as it would be "inconsistent with the statute and with prior Commission decisions, which have reduced PSCR factors when a cost is too high rather than waiting for the reconciliation." Sierra Club's replies to exceptions, p. 29.

Sierra Club contests I&M's assertion that "the Commission's stated intention that it will only scrutinize ICPA costs under the Code of Conduct for newly filed cases must also apply to the present PSCR Plan case." I&M's exceptions, p. 25. Sierra Club argues that nowhere in the May 13 order does the Commission state that the Code of Conduct will only apply to newly filed proceedings as I&M implies. Sierra Club's replies to exceptions, p. 31. Sierra Club states that "[t]he fact that the Commission declined to issue a Section 7 warning in a plan case—in part because the reconciliation for that same year had already been filed does not equate to a holding by the Commission that the Code of Conduct will not apply to OVEC costs in any other I&M case filed before the Order in U-20529 was issued." Sierra Club's replies to exceptions, p. 32. Sierra Club argues that I&M's due process arguments are invalid because "the Company was free to put forward any OVEC-related evidence it wanted to." *Id*., p. 34.

Sierra Club replies to I&M's exception to the ALJ's determination that I&M and OVEC are affiliates and therefore purchases under the ICPA are subject to the Code of Conduct. Sierra Club argues that this exception is an attempt to relitigate an issue that the Commission has already decided in the May 13 order and reaffirmed in the June 23, 2021 order in Case No. U-20224 (June 23 order). *Id*., p. 34. Sierra Club reiterates its original positions on the affiliate relationship between I&M and OVEC. Sierra Club posits that the Commission has rejected I&M's assertions that the August 28, 2018 order in Case No. U-18361 (August 28 order) and federal preemption arguments are determinative in this case. *Id*., pp. 37-41.

Sierra Club rejects I&M's assertion that:

> the PFD substantively misapplied the requirements set forth in Rule 8(4) by concluding, without sufficient legal analysis or evidentiary support, that, if OVEC is an affiliate, then the Code of Conduct's price cap mandates a direct disallowance equal to the difference between I&M's payments under the ICPA and the costs I&M customers would pay for the same amount of energy and capacity at market prices.

I&M's exceptions, p. 36. Sierra Club replies that the proper application of Rule 8(4) would not be to apply the pricing provision that governs utilities providing services to affiliates, which bases compensation on the higher of fully allocated embedded costs or fair market price, but to apply the provision that governs purchases of services or products from an affiliate, which states:

> If an affiliate or other entity within the corporate structure provides services or products to a utility, and the cost of the service or product is not governed by section 10ee(8) of 2016 PA 341, MCL 460.10ee(8), compensation is at the lower of market price or 10% over fully allocated embedded cost.

Sierra Club's replies to exceptions, p. 42 (citing Rule 8(4)).

Sierra Club replies to I&M's exception that the ALJ erred in recommending that the PSCR plan be amended to include the impact of the company's planned purchase of Rockport Unit 2 in the forecasting of costs. Sierra Club argues that because I&M has agreed to purchase Rockport Unit 2, the output will be paid for by Michigan customers, and because the purchase cost has been included in the record for this case, the inclusion of the Rockport Unit 2 purchase cost in the analysis of this case is reasonable. Sierra Club's replies to exceptions, p. 43. Additionally, Sierra Club replies that the ALJ is correct to warn I&M about imprudent self-scheduling of the Rockport units. *Id.*, pp. 43-44.

The Staff filed replies to exceptions on three points. The Staff concurs with I&M that the ALJ improperly failed to address whether the projected 2021 ICPA costs fall within an acceptable range of reasonableness. Staff's replies to exceptions, p. 2. The Staff concurs with I&M that Commission precedent dictates that cost recovery related to ICPA/OVEC should occur after the upcoming integrated resource plan (IRP) and subsequent PSCR proceedings. *Id*., p. 3. Lastly, the Staff agrees with I&M that a Section 7 warning in this case would be improper. *Id*., p. 4. The Staff concludes by reiterating its position that I&M's 2021 PSCR factor presented in this case is reasonable and should be approved by the Commission.

Discussion

The exceptions filed in this case raise two contested issues. The first is the classification of I&M as an affiliate of OVEC and the application of the Commission's Code of Conduct. The second is the operation of the Rockport units and the purchase of Rockport Unit 2. The Commission will address each issue in turn.

A. Ohio Valley Electric Corporation Inter-Company Power Agreement

I&M's PSCR plan includes costs associated with the purchase of power from OVEC under the ICPA. It is uncontested that OVEC is an entity jointly owned by 12 utilities in Ohio, Indiana, Michigan, Kentucky, West Virginia, and Virginia. OVEC operates two 1950s-era coal fired power plants—Kyger Creek, a five-unit, 1,086 megawatt (MW) plant in Gallia County, Ohio, and Clifty Creek, a six-unit, 1,303 MW plant in Jefferson County, Indiana. OVEC supplies the power from these plants to utilities through a long-term contract, the ICPA. Together the utilities are responsible for the fixed and variable costs of OVEC. OVEC bills utilities a variable, demand, and transmission charge. 2 Tr 301-302. It is also uncontested that I&M is responsible for 7.85% of OVEC's fixed and variable costs and is entitled to a 7.85% share of OVEC's power output. The cost of the ICPA is passed through to I&M ratepayers as a direct cost. 2 Tr 302.

The ICPA was set to expire on December 31, 2005. Before the contract was set to expire, the sponsors to the contract (Sponsors or Sponsoring Companies) agreed to extend the terms of the

ICPA to 2026. In September 2010, the Sponsors again agreed to revise the ICPA to extend its terms until 2040. I&M and other Sponsors are obligated to cover the costs of the OVEC plants through 2040. 2 Tr 302. As the Staff testified in this case, I&M has not presented the ICPA for review by the Commission. 2 Tr 284. I&M did not seek approval from the Commission for the decision to extend the contract in 2004 or 2010. The actual costs resulting from I&M's participation in the OVEC ICPA are therefore reviewed each year in the PSCR process for reasonableness and prudence. 2 Tr 285.

1. Affiliate Status of Indiana Michigan Power Company and Ohio Valley Electric Corporation

The Commission again reaffirms its determination that an affiliate relationship exists between I&M and OVEC. I&M argues that it does not have an ownership interest in OVEC. I&M states that it is a participating member in OVEC, but its parent company, AEP, and not I&M, has an ownership interest in OVEC. This argument fails to recognize that ownership is not required under the Code of Conduct to constitute an affiliate relationship. Rule 2(1)(a) of the Commission's Code of Conduct defines an affiliate as follows:

> "Affiliate" means a person or entity that directly or indirectly through 1 or more intermediates, controls, is controlled by, or is under common control with another specified entity. As used in these rules, "control" means, whether through an ownership, beneficial, contractual, or equitable interest, the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a person or entity or the ownership of at least 7% of an entity either directly or indirectly.

Mich Admin Code, R 460.10102 (Rule 2).

Sierra Club filed testimony to support the position that I&M is an affiliate of OVEC. As shown in the 2019 OVEC annual report, I&M is a Sponsor of the ICPA. I&M has a 7.85% OVEC power participation benefit. Three AEP Companies−Appalachian Power Company (15.69%), I&M (7.85%), and Ohio Power Company (19.93%)−represent the largest participation block in the ICPA totaling 43.47%. AEP, the parent company of I&M, holds the largest shareholder percentage of equity in OVEC also totaling 43.47%. The participation and requirements benefits of these three companies equate to the exact equity share that AEP has in OVEC. The Commission finds that I&M holding a participation and requirements benefit that amounts to an equal level of shareholder control signifies a level of interest between the company and OVEC that meets the definition of "affiliate" found in Rule 2(1)(a) of the Commission's Code of Conduct.

Additionally, the record shows that the three subsidiaries of AEP are entitled to one vote on the OVEC Operating Committee. In replies to exceptions, I&M states:

> To the extent a Sponsoring Company may vote on any matters before the Operating Committee, which is separate from OVEC's Board of Directors, I&M currently has only one vote on the Operating Committee. Paragraph 9.05 of the Amended and Restated ICPA establishes that I&M, AEP Ohio, and Appalachian Power Company have one joint vote on the Operating Committee, "if any two or more Sponsoring Companies are Affiliates, then such Affiliates shall together be entitled to appoint only one member to the Operating Committee."

I&M's replies to exceptions, p. 29 (citing Exhibit SC-17, p. 53). In discovery, I&M stated "AEP Service Corporation participates on the Operating Committee on behalf of AEP Sponsoring Companies, including I&M." Exhibit SC-28, p. 1.

Rule 2(1)(a) of the Code of Conduct does not require that an entity directly control another specified entity to constitute being an affiliate. To the contrary, the definition of control enumerates that the interest in the specified entity may be an ownership, beneficial, contractual, or equitable interest. The definition also states that control need not be direct, but that the power to cause the direction of the management or policies of an entity amounts to an affiliate interest. As noted above, it is uncontested that I&M is entitled to a 7.85% share of OVEC's power output and is responsible for 7.85% of OVEC's fixed and variable costs. This alone would meet the definition in the rules of a beneficial interest. The fact that I&M's participation share equates exactly to the shareholder percentage held by its parent company, AEP, and that AEP is a voting member of the OVEC Operating Committee only reinforces the affiliate relationship. As such, the Commission concludes that I&M possesses the power to cause the direction of the management or policies of OVEC. I&M is thus an affiliate of OVEC and subject to the Commission's Code of Conduct.

As an investor-owned utility that purchases power through the ICPA to serve retail customers, I&M's power purchase agreements are subject to the regulation of the Commission. I&M argues that the August 28 order regarding the applicability of the Code of Conduct to federally regulated wholesale services is determinative in the present case. Though the Commission has previously rejected this argument, it will reiterate its reasoning for the decision based on the record in this case. I&M contends that the Commission is not permitted to set the price of federally regulated wholesale contracts and that the Commission failed to follow the substance of its own promulgated rule. The Commission again finds that the transaction at issue in the present case is distinguishable from the facts and record at issue in the August 28 order.

The August 28 order addressed concerns raised by Wolverine Power Supply Cooperative, Inc. (Wolverine), a member-regulated generation and transmission cooperative, which buys power from the market to sell to wholesale customers. In the rulemaking at issue in Case No. U-18361, Wolverine suggested that the definition of utility as an electric utility "regulated by the commission" could lead to the Commission asserting jurisdiction over federally regulated electric cooperatives, such as Wolverine. As a federally regulated generation and transmission cooperative utility, Wolverine is not subject to the same regulations as an investor-owned electric utility under

Rule 2(1)(e). Thus, the Commission clarified in its rulemaking that the Code of Conduct does not apply to federally regulated wholesale services.

In the present case, however, I&M is an investor-owned utility under Rule 2(1)(e), and the power purchased through the ICPA is used to serve its retail customers. As the Commission noted in the May 13 order, "[e]xpanding the conclusions of the August 28 order to include any and all transactions−even between affiliates−that flow through regional wholesale markets or involve a contract approved by [the Federal Energy Regulatory Commission](FERC) would render meaningless the provisions of the Code of Conduct. That the Commission cannot do." May 13 order, p. 16.

As such, Commission again finds that the August 28 order is distinguishable from the case at hand, and that as an investor-owned electric utility serving retail customers in the state of Michigan, I&M is subject to the regulation of the Commission and, thus, the Commission's Code of Conduct.

I&M further argues that, even if it is deemed to be subject to the Code of Conduct,

> because the record was closed in Case No. U-20804 and the parties [briefed] this PSCR case with a record that does not contemplate the May 13 order, the Commission's stated intention that it will only scrutinize ICPA costs under the Code of Conduct for newly filed cases must also apply to the present PSCR Plan case. To hold otherwise would offend fundamental notions of due process because the Commission's May 13 Order arose during the course of this case.

I&M's replies to exceptions, p. 25. The Commission disagrees with this assertion on two points. In its May 13 order, the Commission stated that it "agree[d] with the ALJ that the comparison to the PJM capacity market is insufficient, on its own, to warrant a disallowance and finds that a Section 7 warning is not appropriate at this time, particularly given the reconciliation for the 2020 plan year has already been filed." May 13 order, p. 18. The present case differs from Case No. U-20529 in that additional evidence of appropriate market comparisons was presented on the record. In addition, while the docket in Case No. U-20805 has been opened, the reconciliation for the 2021 plan year has not yet been filed, providing an additional important distinction between the present case and Case Nos. U-20529 and U-20224. The Commission notes that the decisions made in a PSCR plan case are applied prospectively to inform reconciliations and not retroactively to PSCR factors set in earlier plan years, and as such it is appropriate to apply the Code of Conduct to the case at hand.

Lastly, the Commission would like to address I&M's assertion that the approach put forward in the PFD will "have a chilling effect on the developing renewable market because nobody will sign long-term purchase agreements for renewables if there is a threat the Commission could disallow those costs later because the market price for energy decreases or the costs of renewables vary in the future." I&M's replies to exceptions, p. 3.

Unlike other long-term contracts involving renewables or any other generation, however, the ICPA extension has never been presented to the Commission for approval. Indeed, despite the fact that the ICPA had been extended through 2026 just six years before, and that in that time Michigan had enacted specific statutory provisions allowing an electric utility that proposes to enter into a power purchase agreement for the purchase of electric capacity for a period of six years or longer to submit an application to the Commission seeking a certificate of necessity for that investment and a portion of the costs associated with that investment are then allocable to retail customers in this state, when I&M joined other Sponsoring Companies in September 2010—sixteen years ahead of the expiration date of the extension agreed to in 2004—to further extend the ICPA through 2040, it chose not to seek Commission approval for the extension.

Public Act 3 of 1939, as amended by Public Act 286 of 2008 included the following language:

> An electric utility that proposes to. . .enter into a power purchase agreement for the purchase of electric capacity for a period of 6 years or longer may submit an

> application to the commission seeking a certificate of necessity for that construction, investment, or purchase if that construction, investment, or purchase costs $500,000,000.00 or more and a portion of the cost would be allocable to retail customers in this state.

MCL 460.6s(1). The statute then provides that "the commission shall include in an electric utility's retail rates all reasonable and prudent costs for an electric generation facility or power purchase agreement for which a certificate of necessity has been granted." MCL 460.6s(9). The statute further states "[t]he commission shall not disallow recovery of costs an electric utility incurs in . . . purchasing power pursuant to a power purchase agreement for which a certificate of necessity has been granted." *Id*. As shown in the OVEC benchmark study conducted after the contract was submitted to FERC, "the ICPA was expected to have a cost of $7.51 billion on a present value basis between the years 2011 and 2040. This means I&M's share of the contract was expected to cost $589.4 million on a present value basis in 2011." 2 Tr 310; Exhibit SC-7. I&M had the opportunity to apply for a certificate of necessity in 2010 before the contract was amended to extend its term until 2040, which would assure recovery of the contracts associated costs, and the company failed to do so.

The ICPA also remains unapproved by FERC. On March 23, 2011, OVEC filed revisions to the ICPA among OVEC and the Sponsoring Companies, and the power agreement between OVEC and Indiana Kentucky Electric Corporation. The filing was canceled and refiled on April 27, 2011, to correct the file type. The agreements reflected the extension of the terms and agreements of the ICPA from March 13, 2026, to June 30, 2040. The filing was accepted by FERC and notice was published in the Federal Register with interventions and protests due on or before May 18, 2011. No protests or adverse comments were received. According to FERC, the acceptance of this filing "does not constitute approval of any service, rate, charge, classification, or any rule, regulation, contract, or practice affecting such rate or service provided for in the filed documents." *In re Amended and Restated Inter-Company Power Agreement and Amended and Restated OVEC-IKEK Power Agreement*, order of the Federal Energy Regulatory Commission, entered May 23, 2021 (Docket No. ER11-3181-000, *et al*). The ICPA has thus not been approved at the state level by the Commission nor at the federal level by FERC.

As the Commission stated in its December 9, 2020 order in Case No. U-20203; April 8 order; May 13 order; and June 23 order, while long-term contracts are encouraged, this does not absolve a utility from monitoring and responding to market conditions and system needs and making good faith efforts to manage existing contracts. As these orders state, such efforts may include meaningful attempts to renegotiate contract provisions to ensure continued value for ratepayers as market conditions change. As the Commission has repeatedly stated, the Commission will expect to see evidence that utilities have taken steps to minimize costs, including efforts to renegotiate contracts, and will look to comparisons with other long-term supply options as informative as to whether this particular contract adheres to the requirements of the Code of Conduct.

The Commission does not control the business judgment or decisions of utilities, but the Commission has a duty to customers to assure utilities are not subsidizing uneconomic, unreasonable, and imprudent decisions through customer rates. The Commission's decision does not prevent the company from fulfilling their contractual duties under the ICPA, but establishes what costs are appropriate to recover from ratepayers.

2. Section 7 Warning

Subsection 6j(7) of Act 304 states that in its final order in a power supply and cost review, "[t]he commission may also indicate any cost items in the 5-year forecast that, on the basis of present evidence, the commission would be unlikely to permit the utility to recover from its customers in rates, rate schedules, or power supply cost recovery factors established in the future."

The record shows that independent analyses and those conducted by OVEC Sponsors demonstrate that on a forward-looking basis the operation of the OVEC units is uneconomical. The record shows a March 2017 analysis of the ICPA by Duke Energy Ohio projected substantial net losses associated with holding a position in the ICPA. This analysis, scaled to I&M's share, suggests losses of $67 million relative to market alternatives between 2020 and 2025. 2 Tr 319-320. Moody's Analytics' December 2018 assessment of the ICPA, scaled to I&M's share, found annual losses of $16-$20 million. 2 Tr 320. Economic assessments done by Sponsoring Companies to the ICPA also demonstrate the long-term negative economics of the OVEC units. In April 2019, FirstEnergy Solutions, another ICPA Sponsor, conducted a forward-looking analysis through 2040 and found projected losses, scaled to I&M's share, of $267 million relative to market alternatives. *Id*. I&M's AEP affiliate AEP Service Corporation performed a forward-looking analysis of the ICPA in 2015 and 2016, the results of which were confidential, but were presented to OVEC's board. *Id*.

Based on the above analyses, the Commission finds that a Section 7 warning is appropriate in this case. The company is put on notice that the Commission is unlikely to permit the utility to recover these uneconomic costs from its customers in rates, rate schedules, or PSCR factors established in the future without good faith efforts to manage existing contracts such as meaningful attempts to renegotiate contract provisions to ensure continued value for ratepayers. The Commission issues a Section 7 warning that I&M may not be able to recover its full costs under the ICPA as part of the reconciliation of its 2021 PSCR plan.

3. Affiliate Price Cap

Sierra Club filed testimony and exhibits to support the position that I&M customers are paying unreasonable prices to OVEC under the ICPA. Sierra Club's Testimony, p. 3. Sierra Club testified that "[i]f I&M can purchase the energy, capacity, or ancillary services it needs from the PJM market at a lower cost than it would pay to purchase power from OVEC under the ICPA, then it is paying above market price for the OVEC power." 2 Tr 303. Sierra Club testified that it "compared the total energy charges billed to Sponsoring Companies under the ICPA and the revenue that I&M earned selling that energy into the PJM energy market" and found that

> I&M's own data shows that in 2020 OVEC billed I&M $18,487,826 in energy charges for 721,476 MWh [megawatt hours] of electricity. That works out to an energy cost of $25.63/MWh. But I&M only earned $15,960,650 in energy and ancillary market revenue selling that energy, which works out to a value of $22.12/MWh. That means that on a marginal cost basis alone, in 2020 I&M lost $2.5 million for its ratepayers (excluding demand charge and capacity value).

2 Tr 304; PFD, pp. 20-21. Sierra Club testified that the ICPA is not delivering value to the I&M ratepayers and that "[t]he cost for power under the ICPA has been significantly above market value since at least 2017." 2 Tr 307.

Sierra Club argues that the Code of Conduct establishes requirements for transactions with affiliates, including a price cap. Sierra Club argues that the Commission should disallow excess OVEC costs in this case because I&M's payments to OVEC run afoul of the Code of Conduct's affiliate price cap. Sierra Club's reply brief, p. 6. Sierra Club contends that OVEC costs are excessive from 2017 through 2025 based on data from AEP's own PJM capacity market forecast, the price the company recently paid for Rockport Unit 2, and the CONE as calculated by PJM. *Id.*, p. 11.

In concluding that I&M and OVEC are affiliates, and that a Section 7 warning is appropriate in this case, the Commission must also address the issue of compensation. Under Section 1 of Rule 8, "[a] utility shall not discriminate in favor of or against any person, including its affiliates." Section 4 of Rule 8 further provides:

> If an affiliate or other entity within the corporate structure provides services or products to a utility, and the cost of the service or product is not governed by section 10ee(8) of 2016 PA 341, MCL 460.1033(8), compensation is at the lower of market price or 10% over fully allocated embedded cost.

Mich Admin Code, R 460.10108(4).

As a result, I&M's recovery is capped at the lessor of the market price or 10% over the fully allocated embedded cost. As previously noted, based on the record in this case the embedded cost of the ICPA is higher than the PJM market price. However, in the May 13 order, the Commission found that reviewing costs associated with a long-term contract as they relate to short-term market purchases is not an appropriate basis for comparison and a comparison to the PJM capacity market, on its own, was insufficient to warrant a disallowance of funds. May 13 order, p. 18. The Commission stated that it would look to comparisons with other long-term supply options as informative as to whether this particular contract adheres to the requirements of the Code of Conduct. Sierra Club provided three alternatives with which to compare the ICPA costs on the record in this case. While there may be other available comparisons, the Commission finds that the Rockport sale capacity value and net CONE may be appropriate proxies for calculating market price and I&M's resulting PSCR factor. There may also be legitimacy in valuing the attributes of price stability, supply certainty, and resilience afforded by a utility's Fixed Resource Requirement (FRR) alternatives to the PJM capacity market.

The Commission will look to the upcoming IRP and reconciliation filings for greater evidence on whether the market price of net CONE is the appropriate proxy, or how best to price these incremental attributes associated with FRR resources for application of the affiliate price cap. In addition, should I&M seek to use a proxy other than the capacity value of the recent sale of Rockport Unit 2, it should prefile testimony in the reconciliation addressing why the OVEC market value differs from the Rockport unit's capacity value.

The Commission recognizes that, while never approved at either the state or federal level, the OVEC ICPA is a long-term supply option, and as such, the Commission expects that it will be considered in long-term planning. The Commission agrees with the Staff's recommendation that any renegotiation efforts the company undertakes with ICPA members should be described in future IRP cases. The Commission reiterates the directive from the May 13 order that I&M shall file a comprehensive analysis regarding the ICPA with its 2021 IRP. As directed, the company shall file a net present value of the revenue requirement and model a sensitivity to its preferred course of action. The sensitivity model shall include the company's preferred course of action with and without energy and capacity purchased under the ICPA, along with a model of optimized resources to replace the ICPA resources.

B. Rockport Units 1 and 2

I&M's PSCR plan also includes the capacity of the Rockport Plant generating units. Exhibits IM-5, IM-6. The Rockport Generating Station is a two-unit coal-fired power station located in Spencer County, Indiana. Rockport Unit 1 has an expected capacity of 1,072 MW and Rockport Unit 2 has an expected capacity of 1,051 MW for the present plan year. *Id*. Rockport Unit 1 is owned in 50% shares by I&M and AEP Generating Company (AEG), and Unit 2 is leased on the same percentage basis as I&M and AEG. AEG sells 70% of its share of the power from each Rockport unit back to I&M and 30% to Kentucky Power under a Unit Power sales agreement. 2 Tr 328. I&M pays AEG under a FERC-approved power agreement that includes both energy charges and demand charges. I&M pays AEG demand charges associated with 35% of the capacity of the Rockport plant and recovers its share of demand charges from its Michigan customers in the PSCR. 2 Tr 260.

I&M's and AEG's leases of Rockport Unit 2 were set to expire in December 2022. On April 22, 2021, I&M announced its purchase of Rockport Unit 2. During cross-examination, I&M indicated that the impact of the purchase of Rockport Unit 2 by I&M and AEG was not included in any of the forecasting completed for this filing in September 2020. 2 Tr 254.

Sierra Club testifies that I&M has operated, and continues to operate, the two Rockport units uneconomically. Sierra Club argues that I&M incurred net losses relative to market energy prices of $25.1 million in 2020 on a variable cost basis. Sierra Club presents testimony that these losses could have been mitigated with more prudent unit commitment practices. Additionally, Sierra Club argues that I&M's latest PSCR plan indicates that I&M intends to continue its uneconomic operation and commitment practices at the Rockport units. 2 Tr 332. Sierra Club posits that I&M plans to pass on the costs incurred from (1) generation fuel costs (for the portion I&M owns and leases), and (2) power purchased from AEG (for the portion it purchases under PPA), which combined, exceed market revenues over the next five years. 2 Tr 300.

As such, Sierra Club recommends that the Commission caution I&M that if the company extends its lease or enters into a new purchase agreement with current or future Rockport Unit 2 owners to continue to lease or purchase power from Rockport Unit 2 without contemporaneous Commission approval of the lease or purchase agreement decision, the Commission may disallow recovery of all or part of those costs in future proceedings. 2 Tr 336. Sierra Club also recommends the Commission indicate that it will disallow recovery in future fuel cost reconciliation dockets of the fuel portion of all net revenue losses incurred as a result of imprudent unit commitment decisions. 2 Tr 301.

In rebuttal, I&M's witness, Jason Stegall, testifies that I&M's use of energy generated from its Rockport units to satisfy Michigan customers' energy requirements is reasonable and thus, the

Commission should continue to allow the company to include these resources in its PSCR plan. 2 Tr 103. Witness Stegall also testified on cross-examination that I&M and AEG are going to acquire a 100% interest in Rockport Unit 2. 2 Tr 111. In rebuttal, I&M witness Heimberger testified that Sierra Club's calculations were flawed. Witness Heimberger testified that I&M's generating units are operated, along with the units of other PJM members, to meet the total PJM load requirements on the most economical basis, based on price offers, subject to transmission limitations. Witness Heimberger argues that this operation was simulated in the development of the generation forecast by means of the PLEXOS simulation model, a production-costing computer program that AEP uses to simulate a market-price dispatch of its generation units. *Id*. Witness Heimberger states that PLEXOS commits units in PJM based on variable energy costs (fuel and variable O&M), which is the same basis with which the PJM market-price is determined. Witness Heimberger testifies that the PLEXOS forecasting model will not dispatch or run the Rockport units uneconomically. 2 Tr 243-244. I&M argues that the company's updated analysis demonstrates the errors in Sierra Club's conclusions and recommendations. 2 Tr 246.

The Commission agrees with the Staff's assertion that I&M's decision to commit the Rockport units as must run is uneconomic and warrants additional review in the reconciliation of this plan case. The Commission finds that I&M shall document, and make available to the Staff upon request, the basis for the company's decision to designate a generating unit as must run when the company's forecast demonstrates that the decision to do so will result in marginal costs to operate the generating unit that would exceed the revenue attributed to supplying that power to the PJM market. The Commission may disallow fuel portions of all net revenue losses incurred as a result of imprudent unit commitment decisions at the Rockport units.

I&M's purchase of Rockport Unit 2 was announced just prior to the evidentiary hearing in this case, and no forecasts included the purchase in the evaluation of the PSCR plan and costs. The Commission does not believe it is necessary for the company to refile its PSCR plan as the forecast was accurate at the time the case was filed and the PSCR factor for this year is accurate. The Commission finds that I&M shall include the impact of the purchase of Rockport Unit 2 in its 2021 PSCR reconciliation proceeding.

THEREFORE, IT IS ORDERED that:

A. Indiana Michigan Power Company's application to implement a power supply cost recovery plan for the 2021 plan year is approved as amended by this order.

B. Indiana Michigan Power Company's proposed power supply cost recovery factor is approved.

C. The Commission issues a warning under MCL 460.6j(7) and the Commission's Code of Conduct, Mich Admin Code, R 460.10101 *et seq*., that Indiana Michigan Power Company may not be able to recover its full costs under the Ohio Valley Electric Corporation's Inter-Company Power Agreement nor the fuel portions of all net revenue losses incurred because of imprudent unit commitment decisions at the Rockport units unless justified as part of the annual reconciliation of its 2021 power supply cost recovery plan.

D. Indiana Michigan Power Company shall, as part of its 2021 integrated resource plan filing, provide a comprehensive review and analysis of the Inter-Company Power Agreement as described in the May 13, 2021 order in Case No. U-20529.

E. Indiana Michigan Power Company shall document, and make available to the Commission Staff upon request, the basis for the company's decision to designate a generating unit as must run when the company's forecast demonstrates that the decision to do so will result in excess costs as described in this order.

F. Indiana Michigan Power Company shall include the impact of the purchase of Rockport Unit 2 in its 2021 power supply cost recovery reconciliation proceeding.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26. To comply with the Michigan Rules of Court's requirement to notify the Commission of an appeal, appellants shall send required notices to both the Commission's Executive Secretary and to the Commission's Legal Counsel. Electronic notifications should be sent to the Executive Secretary at mpscedockets@michigan.gov and to the Michigan Department of the Attorney General - Public Service Division at pungp1@michigan.gov. In lieu of electronic submissions, paper copies of such notifications may be sent to the Executive Secretary and the Attorney General - Public Service Division at 7109 W. Saginaw Hwy., Lansing, MI 48917.

MICHIGAN PUBLIC SERVICE COMMISSION

Daniel C. Scripps, Chair

Tremaine L. Phillips, Commissioner

Katherine L. Peretick, Commissioner

By its action of November 18, 2021.

Lisa Felice, Executive Secretary

P R O O F   O F   S E R V I C E

STATE OF MICHIGAN)

Case No. U-20804

County of Ingham)

Brianna Brown being duly sworn, deposes and says that on November 18, 2021 A.D. she electronically notified the attached list of this **Commission Order via e-mail transmission**, to the persons as shown on the attached service list (Listserv Distribution List).

Brianna Brown

Subscribed and sworn to before me
this 18th day of November 2021.

Angela P. Sanderson
Notary Public, Shiawassee County, Michigan
As acting in Eaton County
My Commission Expires: May 21, 2024

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