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January 11, 2019

Ms. Kavita Kale
Executive Secretary
Michigan Public Service Commission
7109 W. Saginaw Highway
P.O. Box 30221
Lansing, Michigan 48909

Re: MPSC Case No. U-20165

Dear Ms. Kale:

Attached for electronic filing in the above-referenced matter, please find the Reply Brief of Energy Michigan, Inc., as well as the Proof of Service. Thank you for your assistance in this matter.

Sincerely yours,

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Enclosures
c. ALJ
All parties of record.

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of CONSUMERS ENERGY COMPANY for Approval of an Integrated Resource Plan under MCL 460.6t and for other relief.	)))))	Case No. U-20165

REPLY BRIEF OF ENERGY MICHIGAN, INC.

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REPLY BRIEF OF

ENERGY MICHIGAN, INC.

I. INTRODUCTION

This Reply Brief is filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by its attorneys, Varnum LLP. Failure to address any issues or positions raised by other parties should not be taken as agreement with those issues or positions.

II. ARGUMENT

A. Consumers' PURPA Proposals Should be Rejected as Violating the Letter and Spirit of the Law

1. Consumers' Proposal to Eliminate the 20-year Fixed-Price PURPA PPA Should be Rejected.

Consumers has proposed to eliminate the 20-year, fixed-price PPA for PURPA QFs that the Commission approved in U-18090, and replace it with either a fixed-price 5-year contract with energy prices based on an LMP forecast, or a variable rate 15-year contract with energy prices that fluctuate with the actual LMP rate.[1] As SEIA pointed out in its Initial Brief, Consumers has made these same arguments before and they have previously been heard and

[1] See Consumers Initial Brief, p. 118.

rejected by the Commission.[2] As before, Consumers here relies on arguments that its customers will be exposed to increased risk of market fluctuation if the utility is required to enter into long-term contracts at fixed rates. However, this is an old argument that has been considered and rejected both by this Commission and by FERC.

During FERC's PURPA rule promulgation process, commenters objected that paying a QF projected avoided costs for the life of the contract, estimated at the time the contract is agreed to, would have the potential to lead to overpayment for avoided costs. The FERC's response is instructive:

> The Commission recognizes this possibility, but is cognizant that in other cases, the required rate will turn out to be lower than the avoided cost at the time of purchase. The Commission does not believe that the reference in the statute to the incremental cost of alternative energy was intended to require a minute-by-minute evaluation of costs which would be checked against rates established in long term contracts between qualifying facilities and electric utilities.[3]

Or as the FERC summed it up, even if there are inaccuracies inherent in long-term projections, "in the long run, 'overestimations' and 'underestimations' of avoided costs will balance out." Id. Therefore, FERC rules not only do not prohibit forecasts and projections of avoided costs, but make allowances for the inevitable variability that must come with them: "[I]n the case in which rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery."[4] See also *New York State Elec. & Gas Corp.*, 71 FERC ¶61,027 (1995) (declining to find contract in violation of PURPA where rates based on avoided costs at time contract obligation was incurred

[2] See SEIA Initial Brief, pp. 38-39.

[3] 45 Fed Reg 12214, 12224, Order No. 69.

[4] 18 CFR 292.304(b)(5).

exceed avoided cost). Therefore, Consumers' concerns about the risks of overpayment in long-term, fixed-rate contracts should not dissuade the Commission from maintaining the course it has set with its orders in U-18090.

Consumers also ignores that the basis for long-term contracts under PURPA is to ensure the ability of QFs to obtain financing. These issues were extensively litigated, as SEIA noted, in U-18090. In this proceeding, IPPC witness Darwin Baas testified to the importance of long-term contracts for Kent County's waste-to-energy facility, and noted that "[t]he value in the PPA is the contract length that ensures debt service needs can be met and facility/equipment refurbishment is completed when necessary."[5] Mr. Marc Pauley, similarly testified that Energy Developments' landfill gas QF operations in the state require long-term contracts in order to remain viable, adding "[l]ike investor-owned utilities, Qualifying Facilities require term lengths that are financeable, which is typically 20 to 30 years."[6] Another IPPC witness, Mr. Lee Mueller, testified that long-term contracts are necessary to meet the unique challenges facing hydropower QF projects in terms of investment and financing.[7] He also noted that, in general,

> Long-term contracts are needed to evidence sufficient revenue support for conventional financing. The debt service for a short-term loan would be greater than the net income necessary to service that loan. Thus, PPAs with a short term would make us unable to obtain financing for the types of projects and maintenance discussed here.[8]

There is thus ample support on the record from existing QFs of the importance of long-term contracts for the financeability and on-going health of QF projects in the state, none of which is addressed by Consumers' proposal.

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[5] 9 Tr 2853.

[6] 9 Tr 2862.

[7] 9 Tr 2865-2869.

[8] 9 Tr 2869.

It is also noteworthy that the Michigan Legislature has made a determination that 17.5 years is a reasonable *minimum* contractual length to support a QF's financing period. In setting forth the standards by which the Commission should review for recovery the costs of a utility's PPAs, the Legislature ensured that QFs would have long-term pricing stability necessary for financing by including the following limitation on the Commission's ability to retract the approval of a PPA:

> The financing period for a qualifying facility during which previously approved capacity charges are not subject to commission reconsideration is 17.5 years, beginning with the date of commercial operation, for all qualifying facilities, except that the minimum financing period before reconsideration of the previously approved capacity charges is for the duration of the financing for a qualifying facility that produces electric energy by the use of biomass, waste, wood, hydroelectric, wind, and other renewable resources, or any combination of renewable resources, as the primary energy source.

MCL 460.6j(13)(b)(ii). This provision was not changed in the recent statutory amendments under Public Act 341 of 2016. There thus appears to be a legislative intent to provide contracts to PURPA QFs of at least 17.5 years, making the Commission's 20-year contracts in U-18090 very reasonable.

2. Consumers' Capacity Need Should Continue to be Determined Over a 10-Year Period.

Energy Michigan agrees with ELPC, SEIA, IPPC, and other parties who maintain that Consumers' capacity need for PURPA purposes should continue to be determined over a ten-year period. Consumers originally proposed a three-year forecast for PURPA capacity planning, but adjusted that to a five-year forecast at the rebuttal stage.[9] A three-year forecast is plainly too short, as the utility must make a four-year forward resource adequacy demonstration every year to the Commission under Section 6w, showing that it either owns or has contracted for adequate

[9] See, Consumers Initial Brief, pp. 121-122.

resources to meet its load. Given that statutory requirement, it is reasonable to expect that Consumers will never be short of capacity three years ahead, as it will have demonstrated sufficiency for four. In that context, even a five-year forward capacity window, as now suggested by Consumers, is effectively only a one-year window because of this four-year forward rolling capacity resource demonstration.[10]

Furthermore, a three- or five-year capacity forecast of PURPA need is inconsistent with FERC requirements, which require state commissions to consider "[t]he electric utility's plan for the addition of capacity by amount and type, for purchases of firm energy and capacity, and for capacity retirements for each year during the succeeding 10 years."[11]

If there is a concern that a ten-year capacity forecast for PURPA can lead to the utility being required to take on QF contracts years in advance of its actual capacity need, this can be addressed in other ways.[12] As ELPC notes, witness Douglas Jester has proposed one solution, involving payment of a reduced capacity rate up until the time when the capacity need actually arises.[13] Or put another way, the Commission can require that while a capacity need can be identified within the 10-year horizon, the contracts need not be entered into until the year the capacity need arises. Furthermore, as SEIA notes, if Consumers plans for annual competitive solicitations, as ELPC, Staff, and others have recommended, then all of the utility's capacity needs will be met through that process.[14] Under these circumstances, there is no need for a shortened forward forecast.

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[10] See MCL 460.6w(8).

[11] 18 CFR 292.302(b)(2) (emphasis added).

[12] 8 Tr 1265.

[13] ELPC Initial Brief, p. 7, citing 8 TR 2258-59.

[14] SEIA Initial Brief, p. 41-42.

3. The Commission Should Maintain its Determinations From U-18090 on Ownership of RECs.

In its avoided cost proposal in this proceeding, Consumers proposes that the energy costs it pays be reduced by the market value of the RECs produced by the QF.[15] Consumers essentially argues that because small QFs are renewable generators, that the utility should therefore obtain the benefits of the environmental attributes of that generation for free, in addition to the energy and capacity or which it is paying. This issue has already been addressed by the Commission repeatedly in the U-18090 proceeding, and the Commission determined in that proceeding that it was consistent with FERC's precedent on the issue to allow the QF to retain ownership of the environmental attributes.[16] As the Commission determined in May 2017, FERC has held in *Windham Solar* that PURPA contracts are compensation for energy and capacity only, and that state commissions cannot therefore assign RECs as part of those contracts.[17] The Commission should adhere to its own sound precedent, which is consistent with FERC's rulings on this matter.

B. Consumers' Competitive Bidding Proposal Should be Accepted, With Modifications to Make it More Open and Transparent.

Energy Michigan agrees with other parties such as ELPC, Michigan EIBC, MEC, and MCC that Consumers' competitive bidding proposal is a significant step in the right direction and Energy Michigan believes that a form of competitive bidding should be approved for use by the utility. Energy Michigan also shares the concerns voiced by the above parties and others who worry about fair and open access to the process by third-party developers. In particular, Energy

[15] Consumers Initial Brief, p. 117.

[16] See Order dated May 31, 2017 in Case No. U-18090, p. 26, citing, *Windham Solar LLC and Allco Finance Ltd*, 156 FERC P61,042, ¶ 4 (2016) ("*Windham Solar*").

[17] *Ibid.*

Michigan has concerns about the solicitation formation process, as this is often where "gatekeeping" is done, such that the solicitation is constructed in a way that prevents most or all third parties from being capable of meeting the requirements.

Energy Michigan supports the proposals by MEC and Michigan EIBC to allow for some public review and input into the solicitation formation process.[18] Such public review of the solicitation terms should help prevent any gaming of the solicitation to favor or disfavor particular projects or developers, utility-affiliated or otherwise. Having an independent administrator run the competitive solicitation process will only be helpful if the solicitation itself is fair. Without steps to make that preliminary guarantee, the entire process can be compromised from the start. Energy Michigan notes that there was considerable controversy surrounding the solicitation and bid review processes associated with the recent UMERC and DTE CON proceedings. It is clear that reforms of the competitive bidding process as currently practiced by utilities in Michigan are needed, and we hope that the sensible changes proposed by witnesses for intervening parties will be carefully weighed and considered by the Commission and judiciously adopted so as to ensure the fairness and transparency of the process.

Finally, while Energy Michigan has historically been supportive of the 50/50 ownership concept embodied first in PA 295, and here resurrected by Staff in their proposal, Energy Michigan has some concerns about its implementation in this context. The PCA as proposed by Consumers has the potential to open up the utility's future energy resource acquisition process entirely to competitive third-party bids, which Energy Michigan views as good for the utility, customers, and independent developers. The benefits for all that are inherent in that new model are diminished if the utility is effectively guaranteed 50% ownership, and so may simply choose

[18] 8 Tr 1790 and 9 Tr 2839.

to build and own half of its needed generation. Staff's proposal would seem to push the utility toward this model and away from considering third-party options for 100% of its resource needs.

Energy Michigan would support a 50% ownership cap for the utility if it was paired with a requirement that all utility resources go through the competitive bidding process (one that has the reforms discussed by intervenors in this proceeding). Thus, 100% of the utility's needs would be competitively bid, but once that 50% ownership cap is reached, the utility would not participate in the competitive bidding process, since its own facilities would no longer be eligible to win.

C. A Modified Financial Compensation Mechanism Should be Approved if Consumers Implements an Open Competitive Bidding Process for Future Resources.

A change in State law late in 2016 enabled the Commission to provide utilities with a "financial incentive" to enter into power purchase agreements ("PPAs") with third parties:

> For power purchase agreements that a utility enters into after the effective date of the amendatory act that added this section with an entity that is not affiliated with that utility, the commission shall consider and may authorize a financial incentive for that utility that does not exceed the utility's weighted average cost of capital.

MCL 460.6t(15). However, the size of the incentive that the Commission is authorized to provide under this statute is specifically bounded by the utility's weighted average cost of capital. It is not obvious from the record in this case what the utility's "weighted average cost of capital" ("WACC") is, as meant in this statutory provision. Staff notes that the Commission approved a WACC for Consumers of 5.89% in its last rate case.[19] Staff, however, go on to admit that there is room for debate about whether or not WACC as used in the statute means pre-tax or after-tax WACC, and that the former would be a higher number than 5.89%.[20] Staff do not provide an

[19] Staff Initial Brief, p. 69.

[20] See Staff Initial Brief, p. 80, note 25.

estimate of this higher number. Consumers itself suggests that the pre-tax WACC should be 9.27%.[21] In either case, the FCM as proposed appears to exceed the utility's WACC, and so it would be in violation of the statute if adopted.

Various alternative formulations for the FCM have been proposed by parties in this proceeding, and even by Consumers itself. Energy Michigan is skeptical of justifications of the FCM that rely on imputed debt or other constructs that fail to recognize that the principle basis in both law (MCL 460.6t(15)) and policy for the FCM is to act as an *incentive* to the utility to forego the earnings on capital investment in generation units it would own, and instead to purchase power from third parties. When viewed simply through that lens, the Commission's determination boils down to deciding how much of an incentive is necessary to spur the utility to engage in competitive solicitations for power needs as opposed to building its own generation, while not providing so much additional that third-party PPAs are competitively disadvantaged as compared to utility self-build, and ratepayer's cost savings aren't lost. In short, it's a balancing act and a judgment call. The only firm point of reference for the Commission is that the Legislature has set a ceiling of the utility's WACC. That ceiling must be respected. Within these boundaries, Energy Michigan supports a reasonable FCM for Consumers in order to provide the necessary incentive for the utility to move to a competitive solicitation business model for its future power resource needs.

III. CONCLUSIONS AND PRAYER FOR RELIEF

WHEREFORE, Energy Michigan, Inc. hereby respectfully requests that the Commission do the following:

[21] See Consumers Initial Brief, p. 244, citing 7 Tr 749.

a) Reject Consumers' proposals to eliminate the 20-year fixed-price PURPA PPA for QFs;

b) Reject Consumers' proposal to shorten the period over which its capacity need for PURPA purposes is determined;

c) Maintain the determinations from U-18090 on QF ownership of RECs;

d) Accept Consumers' competitive bidding proposal with appropriate modifications, as suggested herein;

e) Approve a Financial Compensation Mechanism for Consumers that is at or below the utility's weighted average cost of capital.

Respectfully submitted,

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January 11, 2019

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PROOF OF SERVICE

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) ss.
COUNTY OF INGHAM)

Kimberly J. Champagne, the undersigned, being first duly sworn, deposes and says that she is a Legal Secretary at Varnum LLP and that on the 11th day of January, 2019, she served a copy of the Reply Brief of Energy Michigan, Inc. and this Proof of Service upon those individuals listed on the attached Service List via email at their last known addresses.

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