Michigan Capacity Need Forum:

Policy Recommendations
and Replies to Staff Proposal
from Interested Parties

September 2005
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Appendix H

Policy Recommendations and Replies to Staff Proposal from Interested Parties

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October 10, 2005

During the August Capacity Need Forum meeting, George Stojic presented Staff’s recommendations for changing the Commission’s current resource addition policy (for reference, see Presentation 3 on CNF website (http://www.cis.state.mi.us/mpsc/electric/capacity/cnf/index.htm). Attached are the comments submitted by CNF participants, regarding Staff’s recommendations.

Pat Poli
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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission’s own motion, to)  
Commence an Investigation into Future Capacity )  
Requirements. )  
__________________________________________ )  

Comments of the  
Michigan Independent Power Producers Association  
On the Commission Staff August 25, 2005 Proposal  

September 16, 2005
I. Introduction

The Michigan Independent Power Producers Association files these comments in response to the Commission Staff’s proposal circulated on August 25, 2005 to participating parties in the Commission’s Capacity Needs Forum (“CNF”) established pursuant to the Commission’s October 10, 2004 order in Case No. U-14231. MIPPA has been an active participant in the CNF because of the critically important nature of the issues the Commission is attempting to address through the Forum on MIPPA’s members collective businesses, the Michigan electric generation industry, and the State as a whole.

II. About MIPPA

The Michigan Independent Power Producers Association (“MIPPA”) is a voluntary association with its principal place of business at 1845 S. Cedar Street, Suite 100, Mason MI 48842. MIPPA is comprised of independent energy companies whose business is producing electric power for sale. Currently all member facilities are powered by renewable resources. Power is produced primarily for sale to Consumers Energy Company (“Consumers”) and Detroit Edison (“DECO”) from hydroelectric, wood, landfill gas, and wind resources. Members include Qualifying Facilities (“QFs”) operating under the provisions of the Public Utilities Regulatory Policies Act of 1978 (“PURPA”). MIPPA members that are QFs operate their facilities and supply electricity pursuant to contracts approved by this Commission under procedures established by the Commission to implement PURPA as required by Federal Energy Regulatory Commission (“FERC”) rules.
MIPPA was formed to promote and support the common interests of its members, to protect the continuing viability of the facilities they own and operate, to promote the role of independent power producers in a deregulated Michigan generation market, and to enhance the viability of renewable energy in Michigan.

III.
General Comments

How the Commission and its Staff frame the issues to be resolved by the CNF will have a monumental impact on how the Michigan electric generation market evolves from this point forward. MIPPA is extremely supportive of the Commission’s efforts to build consensus and find practical, workable options to what everyone agrees are complex, controversial issues. MIPPA’s comments are from the perspective of existing, Michigan based, suppliers of generation powered primarily by renewable resources that seek the opportunity to expand their Michigan operations affording the State the economic benefits associated with the construction and operation of new generating facilities. In the last several years development opportunities for renewable based generation have been relatively scarce despite the existence of promising sites. Some members have shifted development activities to other states due to lack of opportunity in Michigan. MIPPA members consider their target markets to be Michigan utilities through Power Purchase Agreement (“PPAs”), wholesale generation markets for both capacity and energy, Alternate Electric Suppliers (“AES”), and end users of energy, capacity, and ancillary services. Having a sound market structure is a prerequisite for continuing development of new generation in this State whether by MIPPA or anyone else including the State’s electric utilities. At present, all indications are -- based on MIPPA’s assessment of the CNF’s review to date—1) that there is an overwhelming need for new base load capacity and 2) that Michigan’s current capacity expansion planning scheme, based on traditional utility regulation, no longer
works. Nor does relying upon merchant plants to simply build new capacity on the chance that someone might buy it. Under existing conditions neither the State’s utilities nor the non-utility/merchant power industry are considered creditworthy by Wall Street. The clear message is that ownership form is not the root cause to be addressed. Rather it is establishment of a workable market structure that provides a reasonable level of risk relative to the potential reward (earnings) inherent in the generation investment refined to meet reliability and energy requirements. Such a structure has not been close to existing in Michigan since the last round of utility construction (1980’s) was followed by the demise of PURPA (1990’s). Both options were closed with the rise of deregulation. Since the passage of 2000 PA 141 certain trends have become evident. Utilities will not or cannot commit to new power purchases because they lack assurances that they will recover purchase costs. Nor can they build new generation for the same reasons. AES companies run the same risks without any guarantee of recovery other than the contractual commitments to purchase power of creditworthy customers for a period generally 3 years or less in length... Consequently AES power requirements are typically fully hedged with futures contracts matching the contractual commitments on a customer to customer basis. The need to match generation costs to revenue leads to a heavy reliance upon hedged short term wholesale purchases among AES firms. During this same period, high gas prices and lack of markets have led to widespread merchant plant bankruptcies and an abrupt halt to new construction in the once booming merchant power business. In the meantime, Michigan’s retail electric users continue to consume existing capital stock (generating plants) as load growth continues. The end result is that the time when the State will be perilously short of generation capacity is drawing closer. Based upon current CNF projections and the long lead times associated with constructing most new base load generation options this time may already be upon us.
Despite the above mentioned struggles of the existing Michigan market place, MIPPA supports a competitive market for Michigan’s generation future and pleads with the Commission and participants in the CNF not to abandon the concept at the first sign that new generation needs to be added. There is more than enough demand for all competitors including the incumbent utilities to have a fair opportunity at supplying very significant amounts of generating capacity to the Michigan market over the next twenty years. Recommending how it can be best supplied is the task assigned to the CNF. It is not the responsibility of the CNF to attempt to change the existing regulatory model but to make it work. If the CNF is to fulfill the purpose expressed in the Commission’s October 14, 2004 order it needs to put forth recommendations regarding how reasonable returns on new investments can be earned and how all parties will have a fair opportunity to compete for those returns.

IV.

Competition Best Meets the Needs of Ratepayers.

Ratepayers do come first, but it is almost universally accepted that a truly competitive market is the very best vehicle to meet ratepayer needs in the long run. The generation sector of the electric utility industry has been clearly shown since the passage of PURPA in 1978, to be fully capable of sustaining and thriving in a competitive environment. Michigan’s capacity expansion policy simply must be allowed to foster competition among generation suppliers, if rate payers truly come first. If every retail customer had the opportunity and the obligation to pick a supplier and make a contractual commitment to that supplier or run the risk that service would either not be available or be forced to pay whatever current conditions will bear then the Michigan retail electric market would take care of itself. The Commission is likely not empowered to go this far in establishing a true market even if it is willing. Given that the Michigan generation market is a hybrid of competition and regulation, MIPPA recommends that the Commission consider taking
steps to foster an independent entity capable of making such decisions for customers without any bias or vested interest. An entity similar to the New York Power Authority capable of issuing state backed financial instruments may be needed to provide the necessary risk mitigation and equal access to capital for all entities in need of generation to meet customer load. Establishing such an organization will undoubtedly require legislative action but may be a necessary step toward a workable generation market and a level playing field.

V.

Allocating Capacity Costs to AES Customers is Unfair

Competition Unless AES’ Have Equal Access to the Generation

Retail Open Access is not a program; it is a fundamental change in market structure mandated by State Law and has not been introduced at the benevolence of the local distribution utility. It is the obligation of the Commission to take necessary steps to insure that the transition to a competitive environment continues to take place. It is still necessary for this Commission to carefully balance market power concerns while creating a level playing field. Staff noted in its proposal that Detroit Edison has raised market power restrictions as a potential problem under the utility build option. Those concerns voice a very real problem with increased utility ownership with rate base treatment under the current regulatory scheme. The State is still in the process of a massive effort to help the State’s utilities recoup the investment that in theory, at least would be unrecoverable or stranded in the State’s competitive market when implemented. The prospect of charging future customers participating in “Customer Choice” for capacity built by the State’s utilities to serve bundled customers could well be a death sentence for retail competition in Michigan.

Accordingly Staff’s Proposal does not seem complete. As described in the paragraph titled “Background,” the MPSC Policy for resource addition applies to jurisdictional utilities only. What it does not mention is that under the current regulatory scene, essentially NO
capacity addition is financiable whether through a PPA or traditional construction and rate base treatment. Staff’s reliability option appears to fix the regulated utilities’ inability to obtain financing by forcing an obligation onto competitor’s customers. Quite likely it violates the requirements of 2000 PA 141. Clearly more attention needs to be given to the competitive impact of various options to add new generation.

VI
The Commission Should Expand Renewable Purchase and Energy Efficiency As Soon As Possible

MIPPA strongly supports recent efforts of this Commission and its Staff to revitalize and expand the use of Michigan's renewable resources to produce electricity for the benefit of the State's ratepayers. MIPPA believes that renewable energy resources are under-utilized in the State of Michigan. MIPPA has previously taken a position in Case No. U-13843 that unutilized renewable energy resources could support 300 to 600 megawatts of additional renewable electric generation facilities in the near term if effective policies and programs aimed at achieving this end are put in place. Results of the Alternate Generation Work Group of the CNF confirm potentially available capacity from such sources in this range and similar levels from cogeneration/CHP opportunities can be obtained.

Still, if all this capacity could be combined and brought on line as quick as it could be constructed it would probably not be possible to meet all the State’s projected demand growth requirements between now and when the first coal fired baseload unit could be brought on line. The other options available are to make power purchases relying upon out-of-state generation or build new gas fired units. Neither of these options is particularly attractive from the standpoint of ratepayer cost. Bringing all economically feasible renewable and cogeneration/CHP feasible capacity online as quickly as practical is clearly a sound move from a planning perspective given
the growth currently forecast and options available to meet it. However, even these options require some lead time and the window of opportunity to take advantage of them will quickly slip away if not acted upon. Now is the time to get started. There will be many details to be worked out as a program is assembled and begins to function, but MIPPA is convinced the Commission has adequate authority to proceed if it chooses to do so.

The Michigan Public Service Commission was directed to establish the Michigan Renewables Energy Program by Public Act 141 of 2000. Subsection 10r(6) of Act 141 states:

The commission shall establish the Michigan renewables energy program. The program shall be designed to inform customers in this state of the availability and value of using renewable energy generation and the potential of reduced pollution. The program shall also be designed to promote the use of existing renewable energy sources and encourage the development of new facilities. MCL 460.10r(6).

In short, this directive requires the Commission to promote the use of electricity generated using renewable resources and then cause that demand to be met by new and existing Michigan generating plants. Based on CNF findings to date there is ample justification to invoke this directive and move forward as rapidly as practiced.

MIPPA suggests that the CNF support opening solicitations for renewable facilities and onsite cogeneration/CHP opportunities as soon as practical until all legitimate candidates for development have been presented with contractual opportunities that can be used as the basis for obtaining construction financing. The focus of the contractual portion of the commission's policy should be establishing a fair and reasonable contract structure that can be used to obtain financing by the generation units that respond to solicitations when issued. In particular, for this program to be successful there must be an ultimate assurance that costs incurred by utilities for reasonable and prudent purchases of renewable energy are recoverable. Fortunately, there is
already in place a legislative vehicle that would allow such a recovery to take place—1987 P.A. 81. The relatively small amounts of capacity available under this option will provide a year or two window of opportunity to address the broader recovery issues in time to get new generation on line by the time we need it early in the next decade. Given the lead times associated with virtually all other development options this is about the only realistic option MIPPA sees to add cost effective base load generation in the near term. Only energy efficiency offers a credible alternative. Given the projected need for capacity identified by the New Energy analysis it should be apparent the Commission will need all it can get from both renewable/CHP/cogeneration and energy efficiency sources.

The Staff proposal discusses competitive bidding and the establishment of a cost cap for the reliability option. MIPPA has raised concerns with the practical workability of competitive bidding as a means to procure capacity. In general the concerns revolve around the need to spend substantial sums in order to develop reliable costs for bidding purposes. Gamesmanship is a constant risk with competitive bidding where there is no truly serious downside to failing to honor the bid. A low bid that results in a cancelled project because it cannot be financed at the bid price leaves the bidder in no worse shape than if it had lost the bid in the first place. Nevertheless, for purposes of acquiring new renewable and CHP/cogeneration capacity some sort of bidding /solicitation with a preset cost cap based on the findings of the CNF would probably function reasonably well. Bidders would be able to approach financial institutions with reasonable expectations for revenue streams of successful projects based on the cap. The Commission could set a level of recovery that could be considered pre-approved again based on the cost cap.
VII.

There will be a Need for Some Sort of Renewable Portfolio Standard or Other Commitment to Fully Utilize Available Renewable and CHP Resources

It is obvious from work done to date by the various CNF work groups that Michigan faces a very difficult task to obtain sufficient generation resources to meet customer requirements over the next twenty years and to maintain the accustomed and mandated level of system reliability the state has enjoyed and depended upon for decades. As stated earlier, MIPPA members support continuing efforts to utilize the State’s renewable energy resources. The definition of renewable energy from sources to be disclosed to customers by eligible power suppliers should encompass the full range of full technologies which 1) are capable of improving Michigan’s environment; 2) are currently produced from locally available renewable resources; and 3) help conserve scarce fossil fuels. These technologies include electric power generated from organic waste, biomass, municipal solid waste, waste wood, tires, landfill gas, solar, wind, hydro at existing dam sites photovoltaic and any other qualifying renewable energy resource as well as cogeneration/CHP applications that meet minimum efficiency standards. Only a few technologies are likely to provide significant capacity but all should be given an opportunity including emerging technologies whose potential may not be fully known or understood at this time.

In order to implement the plan outlined above a Renewable Portfolio Standard or other similar purchase obligation with associated recovery guarantees would likely be needed. Such a renewable energy portfolio standard target should be developed for each utility based on the need to actively support the renewable energy projects in the long term to meet and bring potential projects online as quickly as possible. MIPPA recommends the following determination for the purpose of establishing such a standard:
Set the base standard equal to the total amount of electricity generated from renewable energy resources for the year 2004 (estimated at 3 to 4%) for each utility divided by the amount of electricity sold in Michigan for the year 2004—84,564,628 MWh. The required amount of electricity generated from renewable energy resources shall be escalated annually by 1% of the amount of total energy sold in the state each year and allocated on a pro-rata percent of sales basis. New purchases should continue to be made through 2011 and then reassessed based on experience regarding future purchase levels.

This calculation will provide a realistic and achievable renewable portfolio minimum and will work to support the continued efforts of the CNF and the Commission to achieve the target reserve margin of 15% deemed prudent by the CNF to maintain an adequate level of reliability until more Traditional resources can be added. When implemented, such a requirement should result in purchases of approximately 100 MW per year of new renewable and cogeneration/CHP generation. Based on 2004 data.

VIII.
Generation is not a Public Good but it can be Made One

Reliability is a “Public Good” only if the traditional utility model of generation service is followed with respect to generation capacity. MIPPA does not agree that has to be treated as a “Public Good” or necessarily should be treated as a “Public Good”. Adopting a narrow viewpoint on this critical issue runs the risk of forcing Michigan back into a utility monopoly structure and all the inherent inefficiencies that led to the passage of 200 PA 141 in the first place. It would waste the years of regulatory and legislative effort spent to create a competitive Michigan Market in addition to the billions of dollars Michigan utilities have already been allowed to recover through stranded costs and securitization.

IX.
The Commission Must Reconcile Its Reliability Role Relative to MISO

Perhaps the most vexing question facing the Commission and its Staff through the CNF is what is the proper role of the Commission and jurisdictional regulated utilities within the Federal
scheme for reliability administered by the FERC and delegated to the Midwest Independent System Operator?

The Reliability Option proposed by staff is a continuation of traditional state monopoly utility regulation and simply does not fit within the Federal model entrusted to MISO for implementation within this region. It would be far better for the CNF, and ultimately the Commission, to focus its efforts to plan for the state’s generating capacity needs within the Parameters established by MISO even if it must take on the task of helping create those parameters.

X.

Summary

In closing, MIPPA would like to thank the MPSC, specifically those taking the initiative to advance the tough questions facing Michigan’s electric energy future. We look forward to working cooperatively with all the stakeholders to create effective solutions for success which are supportive of the State’s economic and social success. In so doing, MIPPA hopes to provide its portion of the generating capacity which will fulfill the overall needs of the State.

Respectfully submitted,

THE MICHIGAN INDEPENDENT POWER PRODUCERS ASSOCIATION

Donald W. Johns
Director
September 16, 2005
New Covert’s response, pages 17 - 24
COMMENTS OF NEW COVERT GENERATING COMPANY, LLC
MICHIGAN PUBLIC SERVICE COMMISSION
RESOURCE ADDITION POLICY
CAPACITY NEEDS FORUM
SEPTEMBER 16, 2005

New Covert Generating Company, LLC ("New Covert") appreciates this opportunity to comment on the August 25, 2005 proposal by the staff of the Michigan Public Service Commission ("MPSC") regarding Michigan's future resource addition policy ("Staff Proposal") and issues raised in the Capacity Needs Forum. This forum raises very important issues concerning how to provide for Michigan's future capacity needs. New Covert urges the staff to balance many competing factors so as to avoid anticompetitive and economically wasteful results and unintended consequences that could impair reliability.

The Staff Proposal encourages the establishment of a process whereby plant construction could be pre-approved by the MPSC and revenue stability would be ensured through a surcharge to ratepayers for the reliability component of a generating facility. The Staff Proposal is based on three broad principles or values:

(1) The ratepayers come first;
(2) Electric reliability is a public good;
(3) We need to adhere to a fairness doctrine (you get what you pay for).¹

New Covert owns a 1,170 MW natural gas-fired, combined-cycle generating facility in Covert Township, Van Buren County, within the Michigan Electric Coordinated System ("MECS"). The facility commenced operations in early 2004. The facility's energy and

¹ Email from George R. Stojic dated September 2, 2005, entitled “Capacity Needs Forum Comments on Reliability Options.”
capacity are sold primarily to Michigan's jurisdictional utilities. New Covert is an environmentally clean and efficient source of electricity, with low levels of emissions and the lowest (most efficient) heat rate in the State of Michigan. As a result, New Covert makes significant economic, environmental and reliability contributions to Michigan's jurisdictional utilities and ratepayers.

Although New Covert understands that the MPSC regulates only jurisdictional utilities, New Covert is concerned that the Staff Proposal is not balanced in that it does not take into consideration the role of competitive power suppliers in Michigan's electric markets. Although competitive suppliers are not directly regulated by the MPSC, the proposal has significant implications for future competitive investments and existing competitive suppliers. Rules incorporating a command-and-control, regulated rate of return model, where regulated utilities may function as monopolists in the generation sector, would represent a giant step backwards, would create a significant disincentive to competitive suppliers, and may strand existing investments, resulting in a loss of needed capacity.

Comments on the Staff Proposal

New Covert wishes to draw the MPSC's attention to four specific concerns regarding the Staff Proposal.

A. Existing Needed Energy Resources Must Not Be Stranded

The Staff Proposal presents a model of plant pre-approval and revenue stability which extends a strong preference to utility-owned generation,\(^2\) to the detriment of competitive

\(^2\) New Covert focuses here on policy issues and reserves its rights with respect to legal issues, including whether new legislation would be required to effect the model in the Staff Proposal.
generators. Rules adopted by the MPSC should not strand existing energy resources in an economically inefficient, anti-competitive or environmentally unsound manner.

For example, New Covert has been under-utilized and has run at under a 10% capacity factor since it achieved commercial operations in early 2004. If the Michigan electric energy market were efficient, then, theoretically, lower marginal cost resources were available at times when New Covert sat ready and idle. If new authorizations provide economic incentives to construct new base load capacity with lower marginal running costs, then New Covert may be idle more. Yet, this result may be economically inefficient. The all-in costs customers must pay to support the new vertically-integrated, rate-based investment would exceed the cost of capacity and energy from New Covert to the detriment of rate payers and New Covert. Staff may justify this result on the basis that new capacity is needed and achieved through the regulated utility investments. The consequences of such a policy, however, may have the opposite result. If new, no-risk, regulated generation investments displace energy sales from competitive generators, then their already-inadequate revenue streams will be further reduced. Such reductions in revenues may force this capacity out of the Michigan market through retirements, mothballing or relocation of turbines. These capacity and energy losses have: (a) economic ramifications as Michigan is pressed to make up this loss of capacity; (b) environmental ramifications as environmentally dirtier resources may be required more; and (c) supply adequacy ramifications if the capacity losses would result in shortages.

Moreover, if utilities are allowed to recover the costs of new generation investments, including a rate of return, through a reliability surcharge while merchant generators must recover the fixed and variable costs of their facilities through competitive rates, the reliability surcharge could pose a potentially anti-competitive subsidy to jurisdictional utilities and would
discriminate against parties that invested in Michigan’s market. Energy market revenues to independent power producers are limited: for example, gas turbines with marginal costs frequently above locational marginal prices (“LMP”) may not be dispatched. Further, during those times when energy prices would be high, reflecting scarcity, prices available in the market reflect mitigation, thereby reducing the revenue stream available to generators that depend on these high-load periods to recover a substantial majority of their costs. Additionally, regular, substantial reliance by the Midwest Independent System Operator (“MISO”) on out-of-merit generation causes artificial movement down the bid stack and results in lower market clearing prices. Unlike the utilities under the Staff Proposal, competitive generators would not receive payments covering their fixed costs and return on equity. They depend on these administratively limited market revenues. As noted, if merchant generators do not receive sufficient market revenues, plants may be mothballed, permanently retired or relocated to a more favorable market. The result – less available capacity – would be unfavorable to Michigan’s ratepayers and reliability.

B. Legitimate Investment Expectations Must Be Honored

When investing in competitive generating facilities, such as New Covert, investors expect a reasonable opportunity to cover their fixed costs and earn a return on their investment. The MPSC should not upset the legitimate investment expectations of new entrants by essentially stranding such facilities, as discussed above. The three principles set forth by Staff do not take into account fairness or balance to investors in Michigan’s electric markets, including existing competitive suppliers like New Covert. This element is critical to encouraging and retaining investment by entities unaffiliated with jurisdictional utilities in Michigan’s electric markets.
As sure as utilities with regulated rates want a fair opportunity to earn a reasonable rate of return, unregulated generators want an opportunity to earn a competitive rate of return. In either case, investors are entitled to this opportunity. In Michigan, the decision was made to proceed with competitive markets to provide this opportunity, but administrative intrusion in those markets has limited it. Well-settled law, however, dictates that utility regulators may not act solely in the interests of customers. Instead, they have a constitutional duty to balance the interests of ratepayers and their service providers. The Staff Proposal and principles must not overlook those who made competitive investments based on the promise of competitive markets.

C. Capacity Solicitations Must Include Merchant Generators

The Staff Proposal advocates the establishment of a bidding process for solicitations undertaken by jurisdictional utilities to obtain needed energy or capacity. Any rules adopted by the MPSC must allow existing independent power producers with uncommitted capacity to participate in the capacity solicitation process.

Some parties in the Capacity Needs Forum have suggested a return to a regulated rate base option which would effectively preclude or impair merchant generating facilities from participating in the competitive bidding process. The playing field is not level between two entities where one has a guarantee of cost recovery and the other is subject to market forces. Merchant generators that are not committed to load must be given the opportunity to compete. If Michigan were to change its legal-regulatory regime to allow regulated, integrated utilities to

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3 See FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) ("The rate-making process under the [Federal Power] Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests.")


5 If the energy market does not permit independent power producers to recover adequate revenue, then in addition to the potential to mothball, permanently retire or relocate gas turbines, they may seek to sell capacity and energy out-of-state, raising economic and supply adequacy issues in Michigan.
develop new resources in the state, then it is crucial to have a clear and transparent process. Such a process must hold utilities responsible for cost overruns and provide for one set of rules applicable to all competitors. Before Michigan considers embarking on such a radical change in legislation and regulation, it is essential to ensure that all sources of supply are treated in a fair and non-discriminatory or preferential manner. Michigan also should review closely the extensive efforts of other markets to solve for resource adequacy.

D. Developed Capacity Market Designs Provide A Valuable Model

Before embarking on a substantially different course that could impair competition, rather than facilitate it, New Covert urges Staff to review how neighboring independent system operators and regional transmission organizations ("ISO/RTO") are solving for resource adequacy. The three adjacent ISO/RTOs, the PJM Interconnection, Inc. ("PJM"), New York Independent System Operator, Inc. ("NYISO") and ISO New England, Inc. ("ISO-NE"), have designed capacity markets with forward demand curves and auctions to establish capacity prices. These three ISO/RTOs, comprising very substantial markets to the east of Michigan, have already devoted substantial work efforts to the best means to both ensure that necessary energy and capacity resources remain available, and to stimulate new investment when and where it is needed.

The solutions reached by the three ISO/RTOs are surprisingly similar. For example, the Federal Energy Regulatory Commission ("FERC") approved NYISO's proposal to establish an Installed Capacity Demand Curve in the Installed Capacity ("ICAP") markets in the Spring of 2003 in Docket No. ER03-647. FERC noted that the use of such demand curves will send "better price signals to investors for the construction of new generation, encourage the formation
of long-term bilateral transactions and reduce incentives to withhold capacity.\textsuperscript{6} ISO-NE is currently litigating its proposed locational installed capacity ("LICAP") mechanism before FERC in Docket No. ER03-563. It also includes a demand curve and capacity auction, so that entities providing capacity in particularly congested areas would be adequately compensated for reliability.\textsuperscript{7}

These ISO/RTOs have recognized that administrative limitations on energy market revenues in the form of price caps and mitigation must be balanced with opportunities to augment revenues – such as through capacity markets – so that generators can sustain themselves as viable resources. These structures send transparent, competitive price signals to all investors and avoid bias in favor of regulated utility investment over unregulated competitive investment. They are symmetrical in that at times of relative scarcity, they do not allow capacity prices to spike from market power and at times of modest surplus, they prevent prices from plummeting. In the long-term, they are designed to smooth volatile boom-bust cycles. Locational capacity markets with demand curves work in tandem with competitive forces so ratepayers are not left holding the bag on non-competitive generation investments. Michigan should at least consider the PJM, NYISO and ISO-NE models to solve for future capacity requirements through competitive processes. Further, although the MISO markets are new and do not yet include functioning capacity markets, expanding common or similar capacity products to markets including AEP and Exelon may increase liquidity and competition for the benefit of Michigan’s consumers.


\textsuperscript{7} See Devon Power, LLC, 111 FERC ¶ 63,063 (2005) (Initial Decision of Presiding Administrative Law Judge regarding parameters of the proposed demand curve, capacity transfer limits, capacity transfer rights and market power mitigation), 112 FERC ¶ 61,179 (2005) (order granting oral argument on issues related to the initial decision and delaying LICAP implementation to October 1, 2006).
Conclusion

Michigan embarked on a path of deregulation which allowed market forces to shape its energy markets. If Michigan now adopts a capacity policy that will harm existing investors and discourage further investment by entities unaffiliated with jurisdictional utilities, it is taking a step backward where only monopolists may prosper and customers may bear costs undisciplined by competitive pressures.

Whatever long-term capacity adequacy process Michigan considers, parties independent of regulated utilities that invested capital based on Michigan’s competitive paradigm must be allowed to compete fairly in meeting Michigan’s capacity needs. It would be manifestly unfair and unlawful to allow utilities to recover all of the fixed and variable costs of new generation while existing merchant generation becomes stranded. In a properly structured competitive solicitation process, merchant generators would be permitted to obtain a competitive price for their capacity and energy. Finally, in considering new resource adequacy models, Michigan should review the capacity market designs implemented or being developed by the three eastern ISOs/RTOs. New Covert looks forward to participating constructively in satisfying Michigan’s capacity needs.

Respectfully submitted,

James D. Neidhart, Chief Executive Officer
New Covert Generating Company, LLC
ACEEE’s response, pages 26 - 38
COMMENTS TO THE MICHIGAN CAPACITY NEEDS FORUM
(second set)

By

Martin Kushler, Ph.D.
Director, Utilities Program
American Council for an Energy Efficient Economy
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September 30, 2005

PLEASE NOTE: I am submitting comments in two parts. First, I am re-submitting my comments from August 1, 2005 because they explain key background factors underlying my new comments, and because I would like them to be a part of the record of comments to staff’s current proposal. [Those earlier comments are attached as “Appendix A” at the end of this document.]

Second, I am submitting new comments in the form of “track changes” wording changes and comment insertions applied to the staff’s proposal document. Those comments follow, beginning on the next page. [Comments are in CAPS, suggested wording changes are in lower case.]

Thank-you very much for the opportunity to file comments in this Capacity Needs Forum process.

Sincerely,

Martin Kushler, Ph.D.
ACEEE
(517) 655-7037
COMMENTS FROM MARTIN KUSHLER ON THE STAFF PROPOSAL (09/30/05)

Background

In order U-14238, the Commission asked for policy recommendations regarding its resource addition policy. This policy relates to jurisdictional utilities alone. The Commission does not approve, disapprove, or control plant construction by non-jurisdictional entities but does have jurisdiction over rate recovery of generating plant from customers of regulated utilities. The Commission has requested policy recommendations on this rate recovery method. Some participants have indicated that fundamental changes are needed to the Michigan market, including legislative changes.

We have encouraged participants to make recommendations within the Commission’s existing jurisdiction and rate recovery methods, and we intend to do that throughout the Forum’s proceedings.

IN MY ORIGINAL COMMENTS ON AUGUST 1, 2005, I INCLUDED THE FOLLOWING:

<<< I would like to strongly emphasize the need for staff to pose two additional questions:

- Assuming that energy efficiency and other related demand side programs have the potential to cost-effectively reduce the amount of additional generation needed, will the Commission’s current policy induce the necessary implementation?
- If not, what changes need to be made to the Commission’s current policy?

I would submit that the answer to the first of these additional questions is “no”, and that the prima facia evidence for that answer is that ever since the Commission allowed the utilities to terminate their energy efficiency programs in 1995, there has not been a single incidence of a Michigan electric utility requesting Commission approval, or even self-initiating, an energy efficiency resource program.

>>>  

I WOULD LIKE TO CLARIFY THAT WHILE I BELIEVE THAT THE COMMISSION’S CURRENT POLICY WILL NOT RESULT IN UTILITY IMPLEMENTATION OF ENERGY EFFICIENCY PROGRAMS, I DO BELIEVE THAT THE COMMISSION COULD IMPLEMENT POLICIES THAT WOULD RESULT IN UTILITY IMPLEMENTATION OF ENERGY EFFICIENCY PROGRAMS, UNDER THE “COMMISSION’S EXISTING JURISDICTION”. NEW LEGISLATION IS NOT REQUIRED. THE COMMISSION POSSESSES THE TOOLS AND AUTHORITY WHICH, IF PROPERLY EXERCISED, COULD RESULT IN SIGNIFICANT UTILITY ENERGY EFFICIENCY PROGRAMS. I URGE THE COMMISSION TO CREATIVELY EXERCISE THE TOOLS AND AUTHORITY IT DOES POSSESS, TO ADDRESS THE CRUCIAL ENERGY CHALLENGES WE FACE.
Participants in the Capacity Need Forum have identified several aspects of the Commission’s policies that they either affirm or argue need to be changed. These issues are:

Pre-approval of plant construction  
Revenue certainty for recovering investment costs  
Competitive bidding  
CWIP in rate base without an AFUDC offset  
Energy Efficiency  
Market Power  

In the July Capacity Need Forum meeting, Staff requested comments on the issues listed above. The comments generally reinforced earlier positions taken by various parties.

During the July meeting, Staff also discussed its belief that electric reliability is a public good. With characteristics of a classical economic public good, Staff noted that electric reliability is not likely to be provided by a competitive market alone. In fact, regional transmission organizations and states take an active role in promoting electric reliability, including those jurisdictions that rely on markets to provide electric generation services. Governmental intervention into the electric energy markets, where these markets exist, is widely practiced and accepted. Most recently, Congress has intervened to assure the reliability of the bulk power system by mandating the adoption of electric reliability standards in the Energy Policy Act of 2005. This critical public interest in electric reliability has served as a guiding principle in Staff’s assessment of the comments received to date. In order to bridge the gulf between parties regarding the Commission’s current policy, Staff offers the following suggestions for consideration by participants.

**Reliability Option**

*SOME SUGGESTED WORDING CHANGES INSERTED BELOW.*

If it chooses to do so, a utility can choose to acquire a new electricity resource in the traditional manner, that is it could finance the resource without public involvement and then request rate base recovery after the resource is completed. However, the utility could instead seek to acquire electricity resources under the reliability option discussed herein.

Under the reliability option, the utility would file an application with the Commission containing the following: (1) details of its proposed electricity resource, including expected cost and anticipated in-service date; (2) an analysis of why the proposed resource or package of resources is the appropriate resource to meet the expected need and an analysis of the public benefits associated with the proposed approach; (3) if desired, a request for placement of the electric resource’s construction work in progress (CWIP) in rate base without an offset for allowance for funds used during construction (AFUDC); and (4) if desired, a request for a reliability charge on all customers receiving
retail distribution service from the utility. The level and timing of the reliability charge
would be designed to be commensurate with the public benefits associated with the
electric resources proposed.

A contested case public hearing would be held on the utility’s application. If the
Commission determined that the electric resource’s expected reliability value warranted it,
the Commission would permit CWIP in rate base without an AFUDC offset and would
authorize a reliability charge on all distribution customers. In exchange for placing
CWIP in rate base without AFUDC, the utility would commit to capping the recoverable
value of the electric resource and an in-service date.

In exchange for paying a reliability charge, all customers would be credited with their
pro-rata share of the electric resource’s reliability value in satisfying any regional
reliability standard. Further, if customers of an alternative electric supplier (AES) pay a
reliability charge, the AES shall have a one-time opportunity to make a pro-rata
investment in the electric resource.

Competitive Bidding

Major plant construction involves large capital costs and financial risks. It is crucial for
Michigan to secure the right type of power (base load, cycling, peaking, renewable, fossil,
etc.) at the lowest possible costs. Utility construction, ownership, and operation of new
generating plant is an option for securing that power so long as a better alternative is not
available. That alternative might be a proposal by another entity to build the same plant
at a lower cost. Therefore, any cost cap proposed by a utility in a reliability option
hearing should be given considerable deference if the utility has undertaken a fair and
open competitive bid.

Energy Efficiency

None of the parties submitting comments have opposed energy efficiency, and we
consider energy efficiency to be an eligible resource option. We expect that any utility’s
proposal for acquiring electric resources would include a demonstration that a proposed
electric resource, or package of electric resources, is the appropriate resource to meet an
identified need, and would include an analysis of cost effective energy efficiency as a
resource option.

THE PROPOSED LANGUAGE ABOVE IS A GOOD START. HOWEVER, THE
LANGUAGE IS TOO GENERAL TO HAVE ANY EFFECT ON THE HISTORICAL
REFUSAL OF MICHIGAN’S UTILITIES TO VOLUNTARILY IMPLEMENT
ENERGY EFFICIENCY ELECTRICITY RESOURCES. IN ORDER TO OVERCOME
THAT DEMONSTRATED HISTORICAL FAILURE, SPECIFIC REGULATORY
ADJUSTMENTS ARE GOING TO BE NECESSARY. FOR EXAMPLE, STAFF
SHOULD PROPOSE THAT THE COMMISSION GIVE SERIOUS CONSIDERATION
TO ADOPTING A REVENUE DECOUPLING MECHANISM, WHEREBY ENERGY
EFFICIENCY PROGRAMS THAT REDUCE ELECTRICITY SALES WOULD NOT
ADVERSELY AFFECT THE UTILITY’S ABILITY TO RECOVER ITS AUTHORIZED FIXED COSTS. REMOVAL OF THAT EXISTING DISINCENTIVE TO PURSUE ENERGY EFFICIENCY SHOULD HELP UTILITIES BE ABLE TO MORE FAIRLY ASSESS THE POTENTIAL FOR ENERGY EFFICIENCY AS AN ELECTRIC SYSTEM RESOURCE. THIS TYPE OF REVENUE DECOUPLING HAS BEEN SUCCESSFULLY ADOPTED IN TWO STATES, IS UNDER ACTIVE CONSIDERATION IN SEVERAL MORE, AND PROVIDES A VALID AND PRACTICAL MECHANISM FOR OVERCOMING UTILITY RELUCTANCE TO IMPLEMENT ENERGY EFFICIENCY PROGRAMS. IN ADDITION, THERE IS PRECEDENT AND DEMONSTRATED SUCCESS IN MICHIGAN, AND IN MANY OTHER STATES, FOR THE USE OF SPECIFIC UTILITY SHAREHOLDER INCENTIVE MECHANISMS FOR DOCUMENTED GOOD PERFORMANCE BY A UTILITY IN IMPLEMENTING ENERGY EFFICIENCY PROGRAMS. SUCH MECHANISMS SHOULD ONCE AGAIN BE EMPLOYED IN MICHIGAN.

I WOULD LIKE TO CLOSE WITH THREE BOTTOM LINE CONCLUSIONS:

1) THE ABILITY OF ENERGY EFFICIENCY PROGRAMS TO SAVE ELECTRICITY AT A COST WELL BELOW THAT OF ACQUIRING NEW SUPPLY-SIDE ELECTRICITY (E.G., 3 CENTS PER KWH OR LESS VS. PERHAPS 6 CENTS PER KWH) IS WELL DOCUMENTED. MANY STATES ARE SUCCESSFULLY CAPTURING ENERGY EFFICIENCY RESOURCES FOR THEIR ELECTRIC SYSTEM, THEREBY SECURING HUNDREDS OF MILLIONS, AND IN SOME CASES BILLIONS, OF DOLLARS OF ECONOMIC BENEFITS FOR THEIR STATES.

2) MICHIGAN HAS HAD NO SUCH UTILITY ELECTRIC ENERGY EFFICIENCY PROGRAMS FOR 10 YEARS, AND ABSENT CONSTRUCTIVE ACTION BY THE MPSC, THERE IS NO REASON TO BELIEVE THAT MICHIGAN’S UTILITIES WILL INCLUDE ENERGY EFFICIENCY PROGRAMS AS A PART OF THEIR STRATEGY TO ENSURE ELECTRIC RELIABILITY IN MICHIGAN.

3) THERE ARE A NUMBER OF STEPS THAT THE MPSC COULD TAKE, WITHIN EXISTING STATUTES AND CASE HISTORY AUTHORITY, TO HELP ENCOURAGE UTILITIES TO SERIOUSLY IMPLEMENT ENERGY EFFICIENCY PROGRAMS.

I URGE THE COMMISSION TO EXAMINE THIS ISSUE AND MOVE AGGRESSIVELY TO IMPLEMENT ACTIONS WHICH WILL HELP PRODUCE SUCCESSFUL UTILITY ENERGY EFFICIENCY PROGRAMS, THEREBY ENHANCING ELECTRIC SYSTEM RELIABILITY IN MICHIGAN WHILE SIMULTANEOUSLY PROVIDING CUSTOMERS WITH CRUCIAL RESOURCES TO HELP THEM REDUCE THEIR ENERGY BILLS.

Construction Partnerships
As method to mitigate the risk of construction, Staff expects that utility proposal made under the reliability option would include an offer to other Michigan load serving entities to become partners in the plant.

**Market Power**

Detroit Edison has articulated a concern that any new proposal to construct plant may cause it to violate market power provisions of 2000 PA 141. Other parties have indicated that allowing utilities to build additional generation will cause generation to become more concentrated in a few entities and cause an increase in market power.

Encouraging multiple party participation in any new plant construction should help alleviate market power concerns. This is not likely to eliminate those concerns, but allowing a more broad based participation in a construction project should decrease the concentration of ownership and allow parties to secure long-term power at stable prices.

It is also worth noting that providing energy efficiency programs is another important way to help customers have more market “power” in their relationship to electricity providers, by assisting customers to be able to efficiently reduce their electricity purchases regardless of who supplies their electricity.
Let me say at the outset that I appreciate the opportunity to offer comments in this very important forum, and that I am very pleased that staff is conducting this process to address the crucial issue of future electric capacity needs in Michigan. Let me also say that I applaud the key principles espoused by Staff that “the ratepayer comes first” and that “electric reliability is a public good”. My comments and recommendations will be very consistent with those principles.

The remainder of this document will be organized around two fundamental points:

1. Any assessment of future electric capacity needs in Michigan needs to consider both supply side and demand side resources.
2. In order for demand side resources such as energy efficiency to play a role in Michigan, additional regulatory policies and mechanisms are going to be required.

1) Any assessment of future electric capacity needs in Michigan needs to consider both supply side and demand side resources.

It is a truism that assuring electric system reliability is a matter of balancing electricity supply and customer demand. Achieving and maintaining that balance can be done through adding additional electric supply generation, reducing customer demand, or a combination of the two. There is now over two decades of experience with various states and utilities using energy efficiency programs on the demand side as a cost-effective “resource” to help assure electric system reliability and reduce overall system costs, including several years of very effective utility energy efficiency programs in Michigan in the early 1990’s. (See Attachment A) In the most aggressive example, California has now mandated that energy efficiency will be the first priority resource in their future electricity supply “loading order”, and they expect that energy efficiency will meet over half of all future projected electric resource needs. A just-released report from the California Energy Commission found that California’s utility energy efficiency programs over the 2000-2004 period saved electricity at a levelized cost of 2.9 cents per kWh. (See Attachment B.)
In contrast, it appears that the current debate in this forum regarding capacity needs in Michigan is almost entirely dominated by discussion of additional generation (e.g., there was only a brief mention by Staff of energy efficiency under “Other Issues” in the July 18th public meeting; and the MISO representative didn’t mention energy efficiency at all - other than admitting, in response to a question, that MISO was not really considering any role in fostering energy efficiency). If only supply side generation options are considered in Michigan, our electric system will be more costly, less reliable, and more polluting than it will be if demand side resources such as energy efficiency programs are fully included.

Therefore, my first recommendation is that any assessment of future electric system capacity needs in Michigan fully incorporate the potential for energy efficiency and other demand side programs to reduce the amount of new generating plants needed to serve Michigan.

2) In order for demand side resources such as energy efficiency to play a role in Michigan, additional regulatory policies and mechanisms are going to be required.

MPSC Staff has identified a number of issues relating to the questions:

- If additional generation is needed, will the Commission’s current policy induce needed construction?
- If not, what changes need to be made to the Commission’s current policy?

and has requested comment.

I would like to strongly emphasize the need for staff to pose two additional questions:

- Assuming that energy efficiency and other related demand side programs have the potential to cost-effectively reduce the amount of additional generation needed, will the Commission’s current policy induce the necessary implementation?
- If not, what changes need to be made to the Commission’s current policy?

I would submit that the answer to the first of these additional questions is “no”, and that the prima facia evidence for that answer is that ever since the Commission allowed the utilities to terminate their energy efficiency programs in 1995, there has not been a single incidence of a Michigan electric utility requesting Commission approval, or even self-initiating, an energy efficiency resource program. Meanwhile, many other states have continued aggressive energy efficiency programs, helping to save their ratepayers hundreds of millions of dollars.¹ Michigan’s current regulatory policy and structure is

¹ For example, in the last 5 years, California’s utility energy efficiency programs have produced incremental savings of over 6,700 GWh and 1,550 MW of peak demand (see Attachment B).
clearly not sufficient to influence utility energy efficiency program implementation, as Michigan’s complete lack of such programs amply demonstrates.

As for the second additional question, there are a number of regulatory mechanism and strategies that other states employ to help bring about utility sector energy efficiency programs, including providing convenient and reliable cost-recovery mechanisms; offering financial incentives for good utility performance in delivering savings (Michigan successfully employed that in the early 1990’s); implementing regulatory adjustments to “de-couple” utility profits from their sales volume; and providing various other regulatory and public relations items important to utilities.

In this regard, my second recommendation is that this current Capacity Needs Forum process (1) explicitly acknowledge the fact that Michigan is currently failing to incorporate energy efficiency as a resource; (2) explicitly conclude that current regulatory policy is inadequate to induce utility energy efficiency resource programs; and (3) recommend that a specific initiative be launched by the MPSC on an expedited timeline to develop practical solutions to these problems, so that Michigan can capture the significant benefits of aggressive implementation of energy efficiency resource programs.

Conclusion

Michigan is wisely taking time to examine its future electric generation capacity needs. In doing so, it is crucial to bear in mind that energy efficiency programs and other demand side measures need to be a significant part of that assessment. There is substantial evidence, compiled in Michigan as well as in a number of other states, that energy efficiency can be the cheapest and fastest electricity resource available. In addition, Michigan’s almost total dependence on imported energy fuels,2 and the enormous dollar drain that causes on our economy,3 provide further compelling reasons to seriously examine the potential for energy efficiency to help reduce the amount of new electricity generation needed. Lastly, there are significant environmental benefits from using energy efficiency to reduce electricity generation, and many states and utilities are also realizing that energy efficiency can help reduce risks associated with future environmental costs associated with mercury and carbon emissions.

For all of these reasons, I strongly encourage that energy efficiency be fully considered as a resource in any examination of future electric capacity needs in Michigan, and that all necessary regulatory policies and mechanisms be developed to assure that energy efficiency programs can and will be fully incorporated as an electricity resource in Michigan.

---

2 Michigan imports 100% of the coal; 100% of the uranium; 96% of the petroleum products; and nearly three-fourths of the natural gas we use.

3 Michigan’s cost for imported energy fuels is now estimated to be approximately $18 billion per year.
## Table 3: Energy Efficiency Program Spending and Savings

<table>
<thead>
<tr>
<th></th>
<th>Budgets $ millions</th>
<th>% of revenues</th>
<th>Electricity Savings MWh</th>
<th>% of sales</th>
<th>MW</th>
<th>Year</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>AZ</td>
<td>2.0</td>
<td>0.1%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2002</td>
<td>NA = Not Available</td>
</tr>
<tr>
<td>CA</td>
<td>240.0</td>
<td>1.5%</td>
<td>933,365</td>
<td>0.8%</td>
<td>103</td>
<td>2003</td>
<td>Based on IOU PGC funding only</td>
</tr>
<tr>
<td>CT</td>
<td>87.1</td>
<td>3.1%</td>
<td>246,000</td>
<td>0.8%</td>
<td>98.7</td>
<td>2002</td>
<td>Reflects CT performance prior to 2003 funding raids</td>
</tr>
<tr>
<td>DC</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>D.C. has low-income programs only</td>
</tr>
<tr>
<td>DE</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>No utility or PGC energy efficiency programs; LI and RE only</td>
</tr>
<tr>
<td>IL</td>
<td>2.0</td>
<td>0.02%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2003</td>
<td>Reflects $1 million decrease due to state budget shortfall</td>
</tr>
<tr>
<td>MA</td>
<td>138.0</td>
<td>3.0%</td>
<td>241,000</td>
<td>0.7%</td>
<td>48</td>
<td>2002</td>
<td>EE includes low-income efficiency improvements.</td>
</tr>
<tr>
<td>MD</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>Low-income only, no EE/RE to date; may begin EE programs in 2004; some load management programs still offered—data on them not included here.</td>
</tr>
<tr>
<td>ME</td>
<td>2.9</td>
<td>0.3%</td>
<td>25,500</td>
<td>0.3%</td>
<td>NA</td>
<td>2003</td>
<td>Projected values; Efficiency Maine was created in 2002; 2003 was first full program year and included interim programs; EE includes LI-EE; full EE program budgets to be about $9 million/year</td>
</tr>
<tr>
<td>MI</td>
<td>7.8</td>
<td>0.1%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2002</td>
<td>EE only; 88% of LI and EE fund grants have gone for LI programs, including payment assistance.</td>
</tr>
<tr>
<td>MT</td>
<td>14.3</td>
<td>2.0%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2002</td>
<td></td>
</tr>
<tr>
<td>NH</td>
<td>5.2</td>
<td>0.5%</td>
<td>12,039</td>
<td>0.1%</td>
<td></td>
<td>2002–2003</td>
<td>Partial—start-up was June 2002—data for 10 months: June 1, 2002-March 31, 2003. Annual savings based on estimates of lifetime savings/15 years.</td>
</tr>
<tr>
<td>NJ</td>
<td>99.6</td>
<td>1.5%</td>
<td>171,692</td>
<td>0.2%</td>
<td>242</td>
<td>2002</td>
<td>Includes LI energy efficiency. Does not include payments on &quot;standard offer&quot; contracts established in earlier program years.</td>
</tr>
<tr>
<td>NY</td>
<td>129.0</td>
<td>1.3%</td>
<td>290,000</td>
<td>0.3%</td>
<td>382</td>
<td>2002</td>
<td>Annual data for 2002 estimated used reported cumulative data, 1999–2003</td>
</tr>
<tr>
<td>NV</td>
<td>11.2</td>
<td>0.5%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2003</td>
<td></td>
</tr>
<tr>
<td>OH</td>
<td>14.3</td>
<td>0.1%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2002</td>
<td></td>
</tr>
<tr>
<td>OR</td>
<td>19.1</td>
<td>0.9%</td>
<td>112,100</td>
<td>0.4%</td>
<td>NA</td>
<td>2002</td>
<td>Partial year data; programs began March 1, 2002.</td>
</tr>
<tr>
<td>PA</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>——</td>
<td>Sustainable Energy Fund primarily RE and R&amp;D</td>
</tr>
<tr>
<td>RI</td>
<td>16.4</td>
<td>2.7%</td>
<td>50,568</td>
<td>0.8%</td>
<td>14.6</td>
<td>2002</td>
<td>Narragansett Electric data only (~entire state ee program)</td>
</tr>
<tr>
<td>TX</td>
<td>69.0</td>
<td>0.4%</td>
<td>455,700</td>
<td>0.2%</td>
<td>135.2</td>
<td>2002</td>
<td></td>
</tr>
<tr>
<td>VT</td>
<td>16.8</td>
<td>3.3%</td>
<td>38,400</td>
<td>0.8%</td>
<td>NA</td>
<td>2002</td>
<td></td>
</tr>
<tr>
<td>WI</td>
<td>49.7</td>
<td>1.4%</td>
<td>214,800</td>
<td>0.4%</td>
<td>35.9</td>
<td>FY2003</td>
<td>Does NOT include effects from public benefits cuts, which affect FY04 and FY05 funding cycles</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>924.4</strong></td>
<td></td>
<td><strong>2,780,254</strong></td>
<td><strong>1,059.3</strong></td>
<td></td>
<td></td>
<td><strong>Percentages given are based on revenues and sales of utilities affected by public benefits funding requirements.</strong></td>
</tr>
</tbody>
</table>


### Table 5: Energy Efficiency Program Cost-Effectiveness

<table>
<thead>
<tr>
<th>State</th>
<th>Benefit/Cost All Programs</th>
<th>Benefit/Cost Comm./Ind. Programs</th>
<th>Benefit/Cost Residential programs</th>
<th>Cost of Saved Energy ($/kWh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td></td>
<td></td>
<td></td>
<td>0.03</td>
</tr>
<tr>
<td>Connecticut</td>
<td>NA</td>
<td>2.4–2.6</td>
<td>1.5–1.7</td>
<td>0.023</td>
</tr>
<tr>
<td>Maine</td>
<td>1.3–7.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Massachusetts</td>
<td>2.1</td>
<td>2.4–2.7</td>
<td>1.3–2.1</td>
<td>0.04</td>
</tr>
<tr>
<td>New Jersey</td>
<td></td>
<td></td>
<td></td>
<td>0.03</td>
</tr>
<tr>
<td>New York</td>
<td></td>
<td></td>
<td></td>
<td>0.044</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>2.5</td>
<td>3.3</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Vermont</td>
<td></td>
<td></td>
<td></td>
<td>0.03</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>3.0</td>
<td>2.0</td>
<td>4.3</td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>2.1–2.5</td>
<td>2.5–2.6</td>
<td>1.6–1.7</td>
<td>0.03</td>
</tr>
</tbody>
</table>

**Notes:** Median value for the "all programs" column was estimated using assumed value of 2.0 for Connecticut and reported data for Massachusetts, Rhode Island, and Wisconsin. Maine is not included in this estimate because of the wide range of individual program values. Median value for the C/I programs column was estimated using assumed values of 2.5 for Connecticut and 2.6 for Massachusetts. Median value for the residential programs column was estimated using assumed values of 1.6 for Connecticut and 1.7 for Massachusetts. (Those two states did not report point estimate values for those variables, just the ranges shown.) We developed the median range estimates shown in the last row of the table in order to give a rough indication of overall program cost-effectiveness across this set of states. Readers are advised not to put too much emphasis on these exact figures, but regard them as broad indicators.

COST OF CONSERVED ENERGY ACHIEVED[1]  
[from states with high quality evaluation data]

| State          | Cost (cents/kWh) | Currency 
|----------------|------------------|---------
| California     | 1.6 to 2.9       | U.S. $  
| Connecticut    | 2.3              |         
| Massachusetts  | 3.2              |         
| Minnesota      | 1.3              |         
| Mich CPCo      | 2.6              |         
| Mich DECo      | 1.5              |         
| Vermont        | 2.6              |         

Typical current market cost, generation only: 5.0 cents/kWh  
Fully loaded costs, incl. generation, transmission, distribution:  
6.0 to 10.0 cents/kWh  

[1] Levelized cost of saving electricity, over the useful lifetimes of the measures installed.  
As reported in various forums since the mid-1990’s.

ATTACHMENT B

[Please refer to report entitled *Funding and Savings for Energy Efficiency Programs for Program Years 2000 Through 2004*, which I had previously sent over as a pdf file.]
ABATE’s response, pages 40 - 49
TO: George Stojic  
FROM: Robert A. W. Strong  
DATE: September 30, 2005  
SUBJECT: ABATE Comments on Staff Proposal

**LEGAL ISSUES**

ABATE relies on its earlier Memorandum dated June 16, 2005 for a discussion of the applicable legal issues and the scope of Commission authority. By way of supplement, the Commission issued in the early 1990s several orders requiring Consumers Energy Company ("Consumers") and The Detroit Edison Company ("Edison") to acquire new capacity through competitive bid solicitations. (Case Nos. U-9586 and U-8869-DE; Case U-9798). Whether the Commission can require a utility to acquire new capacity through a competitive bid solicitation has not been tested in the courts and is probably doubtful given the holdings in the Union Carbide case and in the Consumers case to the effect that the Commission essentially has the ability to economically regulate utilities and set terms of service, but cannot interfere with management prerogative. From ABATE's viewpoint, under current law the decision to build, the type of plant to build, the specifications of the plant, the timeline, etc., are matters all within the purview of utility management. However, until the Court of Appeals or the Michigan Supreme Court holds otherwise, the Commission thinks it has the authority to impose a competitive bidding requirement on regulated utilities at least as it relates to the determination of a utility's
avoided cost under PURPA. Thus, competitive bidding falls within the current regulatory framework, dubious legality or not.

The Staff's proposal also eliminates the used and useful test required by law. See MCL 460.557(2). Michigan law currently requires an after the fact review of both the just and reasonableness of a utility's building expenditures (i.e., "prudence review") and whether the plant is, in fact, used and useful in providing utility service.

In Attorney General v MPSC, 412 Mich 385 (1982), the Michigan Attorney General ("AG") and the Michigan Citizens' Lobby ("MCL"), asked the Michigan Supreme Court to interpret the scope of the review under the utility securities act which has subsequently been repealed. The AG and MCL claimed that the scope of the review of an application to sell securities included a determination of whether the project to be financed by the issuance of securities was reasonable. The Supreme Court held that under the utility securities act the inquiry is limited to whether there is a need to issue securities to obtain funds for a lawful utility purpose and does not extend to whether, to accomplish that purpose, there is a need for the project to which the funds will be devoted. Id. at 396. The Supreme Court stated that whether the utility needs the additional generating capacity and whether the additional generating capacity should be fossil- or nuclear-fueled, or whether the plant is cost efficient are separate questions not covered by the utility securities act:

"It is a separate question whether the utility needs the additional generating capacity, as is whether that additional generating capacity should be fossil- or nuclear-fueled, or whether the proposed plant is cost-efficient or 'reasonable'. We have already stated our conclusion that these separate questions cannot be raised in a utility securities act proceeding."
Id., at 400-401.

The utility securities act was the only arguable basis to conduct a review of whether a particular plant was cost effective and whether it should be fueled by a particular type of fuel, since the general statutes certainly do not give the Commission this type of authority. Consequently, Staff's proposal is well beyond the authority conferred upon the Commission.

The Court of Appeals, in reviewing issues arising under PURPA, held that the Commission did not have the authority to limit the size of any one qualifying facility dealing with Consumers or to limit the total capacity which may be supplied by any one type of fuel. The Court of Appeals held:

"There is no state or federal authority, however, for the PSC's attempt in its interim order to limit the size of any one QF dealing with Consumers or its final decision to limit the total capacity which may be supplied by any one type of fuel. Congress could have limited the absolute size of a qualifying cogenerating facility. It did not. Congress could have required that capacity from QFS be accepted in some manner which would allocate among fuel sources the capacity supplied. It did not. Although the PSC's stated goal of encouraging a diversity of QFS with a variety of fuel types is laudable, as is its concern that the MCV facility is so large as to crowd out other potential applicants, it is not for the PSC to determine questions of public policy. As noted above, the PSC is entirely a creature of statute and must find its powers and purposes under those statutes. In this case, the PSC is operating under both state and federal statutory and regulatory authority. That authority does not grant the PSC the sweeping powers it claims to possess in this case."


From these cases, it is clear that the Staff's proposal is not within the bounds of the Commission's authority and, in fact, violates MCL 460.557. The Commission simply cannot
engage in a pre-approval of a particular project and fuel source among competing projects and fuel sources and cannot require ratepayers to pay for a generating unit before it is used and useful.

The Staff’s proposal would shift all risk from shareholders to ratepayers that the plant, when finished would actually be used for public utility service. For example, assume a utility builds an IGCC electricity plant over the course of six years at a cost of $1.5 billion and that CWIP has been included in rate base, but the plant under-performs or does not perform at all. What protections could the Commission put in place to safeguard ratepayers' investment? Obviously, the Commission could order that all future collections for the IGCC plant should cease, but what about all of the dollars that had been previously collected from ratepayers under the assumption that the plant would be used and useful to them? One way to partially protect ratepayers in the event the plant under-performed or did not work at all would be to collect the rates under bond and subject to refund as such is done in connection with an order granting partial and immediate rate relief.\(^1\) However, this is not total protection as the Commission lacks the power to award appropriate damages. There is no general section similar to MCL 460.6j(16) which states explicitly what the interest rate should be for over recoveries. On the other hand, the Staff proposal may be a flat out guarantee regardless of whether the plant performs as initially projected but this would be totally unfair.

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\(^1\) Collecting rates under bond and subject to refund will probably add risk to the project in the eyes of the parties financing a generating plant. However, this method has been used extensively in the past without controversy but has not been tested in the courts. There is no specific provision in MCL 460.6a or elsewhere addressing a bonding and refund requirement.
If the Staff proposal is that there should be performance and price guarantees then under what statute would the Commission operate to enforce those guarantees? There is no such statute that would provide the Commission with the necessary powers, so the Staff proposal really does not provide any real benefits to ratepayers. It does shift substantial risk to ratepayers with no effective protections.

There is a legal doctrine that if the Legislature intended to confer a power onto an administrative agency such as the Commission, then it must be directly addressed or there is an implied exclusion of that power. The Michigan Supreme Court held:

"Expressio unius est exclusio alterius. Express mention in the statute of one thing implies the exclusion of similar things. Perry v. Village of Cheboygan, 55 Mich 250; Weinberg v. Regents of the University of Michigan, 97 Mich 246; Marshall v. Wabash Railway Co., 201 Mich 167 (8 ALR 435); Taylor v. Public Utilities Commission, supra; Van Sweden v. Van Sweden, 250 Mich 238. When a statute creates an entity, grants it powers and prescribes the mode of their exercise, that mode must be followed and none other. Taylor v. Public Utilities Commission, supra (4 Justices); (2 Lewis' Sutherland Statutory Construction [2d ed], §§ 491-493). When powers are granted by statute to its creature the enumeration thereof in a particular field must be deemed to exclude all others of a similar nature in that same field. So held in Bank of Michigan v Niles, 1 Doug (Mich) 401 (41 Am Dec 575), in which this Court, in considering powers conferred upon a bank by its charter, said:

'The very grant of specified power under restrictions, is an exclusion of other powers in reference to the same subject matter, not granted by the charter.'

Similarly as it relates to the powers of a corporation created under a general statute, 4 members of this Court, speaking in People v Gansley, 191 Mich 357 (Ann Cas 1918E, 165), said:
'It has been held that the powers are simply such as the statute confers, and that the enumeration of them implies exclusion of all others. Thomas v Railroad Co., 101 US 71 (25 L Ed 950); Pennsylvania R. Co. v Railroad Co., 118 US 290, 309 (6 Sup Ct 1094, 30 L Ed 83).'"


Therefore, if the Legislature in Act 304 granted the Commission the power to impose interest to compensate for the time value of money in the event of GCR or PSCR over recovery and there is no corresponding general statute that does the same, then the implication is that the Commission does not have the power to award ratepayers interest in the event that the plant under-performs or does not work.

The same principle would also apply to prior approval of capacity additions. MCL 460.6j(13)(b) is the only statutory authorization for prior approval of capacity purchases. This would imply that under only those circumstances recognized in the statute can the Commission give prior approval to capacity additions.

In summary, under the current statutory regime governing what powers the Commission has or does not have, the Commission cannot eliminate the used and useful test and cannot adequately protect ratepayers even if the Commission tried to do so in the event that the new plant under-performed or did not work. Yet, the Commission has already previously held that new QF capacity must be acquired through a competitive bid solicitation.

**POLICY ISSUES**

A fundamental assumption made by the Staff is that the rules need to be changed in order to induce utilities to build new power plants. In doing so, the Staff would ignore the statutory
requirements that have been employed by this Commission for literally decades and ignore the economies available as a result of an integrated dispatch of all generation located in MISO.

There are at least two major incentives that would cause utilities to build new power plants. The first is that securitization has shrunk the size of the utilities and reduced earnings by converting rate base into securitization debt. Utilities want to grow their business and the only way to do that in the traditional sense is to add to rate base.

The second inducement is that the utilities can make wholesale sales in excess of their native load and these sales will settle out at the marginal cost on the MISO system. This means that solid fuel projects with low operating costs can be paid the system marginal cost which should be very high during peak hours. Consequently, there is major reward available to owners of generating equipment with a low marginal running cost.

In theory, customers of utilities which have joined the MISO should see the benefits of joint dispatch of all of the generating plants located in MISO's footprint. This means that the mine mouth pulverized coal unit which does not require expensive transportation of fuel should be able to serve Michigan loads and be more cost effective than a new plant located in Michigan. The Staff's proposal, even though it incorporates a competitive bid, almost seem to rule this option out in favor of building in Michigan. If this is the case, then ratepayers' investment in MISO will not result in the savings that were identified as justification for creating a RTO in the first place.

A second issue is whether there truly is a need to change the rules so that utilities can finance new capacity additions. Based upon the data posted on the Commission's website,
participation in retail open access is clearly in decline. We suspect that is because alternative electric suppliers cannot find power in the wholesale market that is not priced at the margin. Utilities and other owners are clearly unwilling to enter into bilateral transactions for a significant period of time at other than marginal prices. Consequently, there is less risk of lending to a utility even though, on paper, there is the opportunity present for its customers to purchase power from other suppliers. This fact reduces the risk and increases the willingness of lenders to loan money for large capital projects and does not require a change in how capacity additions are treated in Michigan.

If the concern is financing, then the only way that the Staff's proposal would work would be to guarantee cost recovery up to the capped rate. However, who bears the risk if MISO does not dispatch the plant because it is too expensive? Ratepayers should not bear this risk even though there was an upfront assessment which is a very iffy process. One needs only to look at what happened when this Commission established artificially high avoided costs for the two major utilities. Consumers was allowed to collect capacity costs more than three times higher than the cost of a gas plant and then when gas prices rose as predicated at the time, Consumers ran to the Commission for a fundamental change in the way the MCV facility was dispatched. While this saved MCV a ton of money, it deprived ratepayers of the benefits that should have been associated with levelized (instead of backloaded) capacity payments they have been paying since 1989.

The Staff proposal calls for a "comprehensive planning assessment that evaluates the risks and costs of traditional plant, renewable plant, energy efficiency and load management."
This concept seems very similar, if not identical, to integrated resource planning ("IRP") that was once practiced by several utilities. Consumers and Edison have filed IRPs in the past, but only did so under the caveat that this was voluntary effort on their part and not something that the Commission had the power to require. Accordingly, this concept is legally vulnerable as being outside of the authority conferred upon the Commission.

Again, the same issue is present in connection with the concept that the alternate supplier would have a one time opportunity to make a pro-rata investment in the new generation. The Consumers case dealing with PURPA issues clearly held that the Commission did not have power to allocate capacity among the competing parties.

The Staff proposal to require mandatory competitive bidding prior to deciding whether the utility could build a plant is not workable under the current statutory framework. From a public policy perspective, any type of competitive bidding system would have to create the expectation that it would be conducted fairly and that a third-party supplier had a real opportunity to be chosen as the supplier. Once the solicitation is considered less than legitimate then potential suppliers are not going to go through the effort of trying to respond to a Request for Proposal, which is an expensive process. There is also a structural problem with allowing a utility to build its own facility once the results of the competitive bidding solicitation are known. At the very least, a competitive bidding solicitation would have to be structured using a third-party as a bid evaluator and the utility would be treated as simply another bidder. However, one wonders whether the incumbent utility would have such an inherent advantage such that prospective alternative suppliers would not consider submitting a bid. The incumbent utilities
have current locations where generation could be easily expanded and a major financing advantage of having the opportunity to have CWIP included in rate base without an AFUDC offset. That stacks the financing in favor of the incumbent and possibly could eliminate any of the advantages associated with having a competitive bid as a gauge of what is reasonable to pay for new generation in the market place.

In summary, the Staff's goals and objectives are laudable but clearly unworkable under the present statutory framework governing utility regulation. Moreover, changes such as those proposed by the Staff, do not represent good policy because they will effectively eliminate the protections afforded to ratepayers. The Staff proposal would result in the wholesale shift of risk from the utility and its shareholders to ratepayers with no corresponding reductions in rates and no upside return if the plant were successful. Risk and reward go together. Staff's proposal leaves reward with the utility and it should, but moves all risk to ratepayers. These policies could end up making Michigan's retail rates even more uncompetitive than they already are.
EPSA’s response, pages 51-59
Introduction and Summary

The Electric Power Supply Association (EPSA), Energy Michigan and Midwest Independent Power Suppliers (collectively, “Competitive Suppliers”)1 applaud the Michigan Public Service Commission (Commission) for its investigation into Michigan’s future electric capacity requirements through the Capacity Need Forum (CNF) and for providing the opportunity for the competitive sector to participate in Case No. U-14231. As capacity and reserve margins continue to shrink, and as states in every region face the prospect of how to meet future generation needs, it is imperative that proper market mechanisms are in place to ensure that new generation requirements are satisfied in a manner that most efficiently allocates risks, costs and resource adequacy obligations – while maintaining long-term system reliability to the benefit of all customers.

Further, the Commission has the opportunity in this proceeding to make a significant contribution to the economic climate of the state in terms of job creation and retention, infrastructure investment and tax revenues. This is especially true if the Commission maintains its current policy of fostering competition and providing for adequate sources of supply. An open capacity procurement process and a workably competitive market will lead to a secure future with an adequate number of power plants and sufficient supply sources. Providing for a competitive foundation will ensure that Michigan’s citizens and electricity customers receive the most efficient and most reliable supply of electric power.

To move away from an open capacity procurement process would send the Commission and the state on the road to a repeat of what consumers experienced prior to the advent of competition in the mid-1990s. History shows that a high-cost utility structure, cost overruns, unnecessary ratepayer assumption of utility construction and

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1 EPSA is the national trade association representing competitive power suppliers, including generators and marketers. Energy Michigan is a trade group consisting of competitive power suppliers at the retail and wholesale level and end users who support the goal of competitive power markets. MWIPS is a group of leading competitive power suppliers who joined together with a common goal of achieving full and fair competition in the wholesale power industry in the Midwest. These suppliers, who all have members or member affiliates that conduct business in Michigan and elsewhere in the Midwest, are united in their policy preference for satisfying Michigan’s future resource adequacy needs through a Commission-sanctioned open solicitation process that optimizes choices and benefits for consumers. That these suppliers are the parties that would participate in such a solicitation process and ensure Michigan’s future resource adequacy. The comments contained in this filing represent the position of Competitive Suppliers as a filing entity, but not necessarily the view of any particular member with respect to any specific issue.
operational risks, a high level of stranded costs and finally, little to no customer choice in purchasing electricity from anyone other than the monopoly provider. Captive utility customers will not be left to bear those costs if the Commission stays the course on competitive markets and competitive supply.

**Ensuring Benefits for Customers**

The primary method for ensuring optimal benefits for Michigan electricity customers is a well-functioning Midwest ISO wholesale market that provides the necessary incentives for new investments in generation and transmission capacity through timely and transparent pricing signals, working in concert with a robust retail competitive choice program. Under these conditions, alternative electric suppliers compete for all classes of load and the transmission would be controlled by an independent third party. Further, under these conditions, wholesale suppliers and competitive generators compete to furnish electricity supply to not only the alternative electric supplier (AES) community, but, in the interim, also to the state’s utilities who are still serving retail load.

The Midwest ISO already operates an energy market, and is in the process of complying with a Federal Energy Regulatory Commission order to implement a long-term resource adequacy construct. Well-designed protocols for resource adequacy will allow for needed capacity, including renewable sources. These markets, in tandem with competitive suppliers, will work together to ensure that: (1) customers in Michigan have access to generation supply in the long run, and (2) that generation investment for the benefit of Michigan consumers is made when and where it is needed.

Unfortunately, the fact that the state’s utilities still own generation paid for by their jurisdictional customers is a situation that is not conducive to competitive markets. While the operating environment for all plants in the state is similar, the risk and cost-recovery profiles of competitive plants and utility rate-based plants are different. This bifurcated model creates an economic distortion in the energy and capacity markets, and perpetuation of an artificially induced boom-bust construction cycle. In view of this, the PSC should consider the existing industry structure in the state and market design as it determines how best to meet future capacity needs.

Another consequence is that advantages for rate-based plants (e.g., minimal market risk, assured cost recovery) become more pronounced, as do the disadvantages for competitive plants (e.g., greater market risk, no assurance of capital recovery). While such disadvantages can irreparably harm the merchant generation companies and AES community, more disturbing is the fact that consumers are denied the benefits that true competitive markets deliver.

**Specific Comments on the Staff “Reliability Option” Proposal**

The CNF process, thus, makes certain assumptions about the electricity market that are acknowledged for the limited purpose of these comments. In that context, Competitive Suppliers offer the following comments and recommendations in response to the PSC
staff’s “Reliability Option,” presented at the Aug. 25, 2005, Capacity Need Forum policy meeting. These comments and recommendations should not, however, be read as an endorsement of the assumptions made in the staff proposal.

Staff states that reliability is a public good, which means that, as a classical economic public good, reliability is collective in nature. It can be realized and shared by all customers without diminishing access by others. If this is true, all customers must share in the cost of maintaining system reliability. To do this, and avoid cross-subsidization problems and ‘free-rider’ issues, providing for a competitive procurement process for new capacity would minimize this common public good problem.

Fully supporting a competitive market and working with the Midwest ISO and the entire region to help identify the best competitive solution to meet reliability needs should be the policy outcome from this CNF process. Isolating the state from the broader regional market leads to over-cost scenarios and the other problems that states faced prior to competition. Again, a focus only on Michigan supply risks inefficient construction and other states in Midwest ISO “free-riding.”

To the extent that a decision is made to focus on Michigan capacity needs without regard to the regional resource adequacy paradigms of the Midwest ISO, Competitive Suppliers strongly encourage the Commission to direct Michigan’s utilities to hold a transparent fair and conclusive Commission-approved competitive procurement process for any PSC-deemed capacity needs in the context of all available Midwest ISO resources. The competitive procurement, which is open to all potential suppliers, provides, at a minimum, the opportunity to contract for capacity.

To the extent that questions are raised in the CNF to address issues such as financial hedging and risk management, fuel mix, and resource allocation, competitive markets have demonstrated repeatedly that when allowed to function properly, they are the most efficient and most reliable means of managing these tasks. Certainly, PJM today (and the Midwest ISO in the future) is emblematic of this efficiency and reliability, given the largely positive annual reports filed by PJM’s Market Monitoring Unit each year.

A competitive procurement process that results in pay-for performance contracts is much superior and preferred to having a utility build generation on a cost-plus basis or a purchase power agreement (PPA) with a utility affiliate as the only vehicles to satisfy the proposed “Reliability Option” in the Staff CNF Proposal. An MPSC directive on competitive procurement for capacity would ensure that many risks are shifted away from Michigan utility customers to the commercial entity providing the capacity. Further, it would prevent another long-term, burdensome “mortgage” (in the form of new utility generation in base rates for many years), with the attendant risks of stranded investment or non-performance, being placed on Michigan’s manufacturing, commercial, residential and educational sectors.

Competitive Suppliers support a CNF that encourages an efficient, effective capacity market for the reliability region that covers Michigan, as well as an open competitive
procurement process in Michigan that satisfies the objectives of Order U-14231 regarding the inventory of Michigan’s base-load generating capacity. Such an approach achieves the stated PSC Staff core values of: consumers come first; electric reliability is a public good; adherence to the fairness doctrine of allowing all consumers access to the most efficient supply; and, getting the supply and service for which they pay. Competitive Suppliers believe these values should be fulfilled through a process that includes all competitive supply options. There are many reasons for this position, which are incorporated into the observations on the Staff CNF Proposal outlined (by section) below:

- **Background** – Contrary to the assertion that the competitive market cannot provide for electric reliability, the facts speak otherwise. Since enactment of the Customer Choice and Electric Reliability Act in 2000 (MCL 460.10 et seq.), competitive generators have brought on-line approximately 5,000 megawatts (MW) of new generating capacity – all in response to the competitive environment presumed under the Act and under the establishment of the Midwest ISO bid-based markets.

  Nationwide, the competitive sector brought approximately 187,000 MW of generating capacity into operation between 1993 and 2003, and all of those facilities were financed outside of the traditional rate base – either through long-term PPAs, on a non-recourse, project-financed basis, through the balance sheet, or a combination of these and other approaches. An affirmative commitment by the Commission and Michigan utilities to foster and accelerate competitive wholesale and retail market development, as well as the continuing maturation of the Midwest ISO spot energy markets and bilateral forward markets, will result in sufficient supply adequacy in the future. A positive market environment and regulatory certainty attracts the necessary capital for investment, and the market transparency that can be provided by the Commission will ensure that capital is spent in Michigan where and when needed.

  The entire industry, including the competitive sector and the financial community, has learned a great deal from the revenue inadequacies of the mitigated energy markets that occurred in recent years. Among those factors are firm commitments for longer-term supply arrangements, stronger balance sheets in the competitive sector, better market rules, greater market liquidity, better price signals and risk management tools, and more certain opportunities for recovery of invested capital. All of these positive developments mean that competitive generation can continue to fulfill the supply adequacy role it has successfully adopted during the past decade.

  Furthermore, given these improved market circumstances, there is no reason to believe that future generation development and financing should, or will, automatically default back to the utility rate base. The risk and cost implications for captive ratepayers – starting with the unpleasant specter of a new round of stranded costs in the next decade – are just too significant for the competitive option not to continue to flourish. These risks are better managed by competitive power suppliers.
• **Reliability Option** – Competitive Suppliers have several questions and concerns.

1. Does the Reliability Option obviate or circumvent the need for a competitive Request for Proposals (RFP) process?

   Because the staff proposal speaks only to a utility application with an associated contested case hearing, Competitive Suppliers are very concerned that capacity from merchant generating plants would be precluded from consideration as a Reliability Option. The result would be an unproductive retreat from competition. Further, the problem of generation market power already possessed by the public utilities in Michigan would be exacerbated if the Reliability Option means a return to utility self-build generation only. As discussed below, this outcome is neither warranted nor equitable –either for consumers or suppliers in Michigan.

2. Despite the acknowledgement that a utility self-built or owned generating plant is an option “so long as a better alternative is not available,” it appears that this reliability construct is geared toward a utility-sponsored plant. This begs the question: does the Reliability Option serve as an effective default back to re-regulation of generation, where IOU’s are the only option for new generation?

   If so, Competitive Suppliers would respectfully ask the Commission to reconsider the implications of the Staff CNF Proposal in view of the consequences of such an outcome – namely, no choice of supply source, higher cost of new supply and less access to more efficient supply sources, greater risks to consumers as they reassume those business risks previously managed by the competitive sector, and the prospect of a new round of stranded costs that consumers will be obligated to assume.

   Also, given the regulatory difficulties, cost hurdles and delays that have already surfaced with respect to those states that have re-entered rate-based generation (e.g. Wisconsin and Colorado), and the prospect of multiplying these difficulties and delays many times over in the next few years, there is a reliability question associated with utilities being the sole source of future generation. Michigan would be well-served, especially in the current period of declining reserve margins, to ensure that opportunities for all sources of new supply are able to compete to maintain supply adequacy.

3. Can a non-regulated or competitive entity propose a more economic alternative that will serve as a Reliability Option unto itself or as a utility’s Reliability Option through a longer-term PPA offer?

   Competitive Suppliers submit that the reliability option should accommodate both approaches. Also, unlike the recovery of costs for a utility plant put in rate base, the competitive plant and longer-term PPA options are financed outside of the rate base. Therefore, Competitive Suppliers further submit that the Commission can utilize its existing approval process of the Power Supply Cost Recovery
Clause, rather than require a lengthy and costly contested case proceeding for competitive/PPA projects that otherwise satisfy the requirements of the Reliability Option contemplated in the Staff CNF Proposal.

- **Impact of Reliability Option on AES Customers** – In its current form, Staff’s CNF proposal would severely hamper, if not effectively eliminate, electric choice service in Michigan. The proposal calls for both utility and AES customers to pay a “reliability charge” for a utility plant built to satisfy the Reliability Option. Further, the proposal states that all customers would be credited with their pro-rata share of the plant’s “reliability value” (presumably, this is the capacity cost component) and that AES entities will have a one-time opportunity to make a pro-rata investment in the generating station on behalf of their customers.

The problem with this approach is that the utility plant will be designated to serve only its retail customers, not AES customers. Without a competitive resource procurement process, any charge for non-utility customers would have them, in effect, subsidizing the utility-owned plants, while still having to secure their own supply at an additional cost. Obviously, this cross subsidy will eliminate the benefit of having switched to AES in the first place. And the pro-rata investment by AES would not offset this subsidy. Thus, should the utility be allowed, to purchase capacity, it should be paid for by the utility's retail generation customers, not its "wires" customers.

As previously stated, when additional generation is to be built then that capacity should either be built or contracted in the most efficient manner. To guarantee the most efficient means, a market test in the form of a competitive solicitation is needed – even when the utility self-build option is under consideration. Once a competitive procurement process has been completed, the costs associated with that reliability resource should be recovered by those customers served by the decision-maker, the utility's retail customers. Without this safeguard, the benefits of AES service would largely be lost and a migration of approximately 2,500 MW of capacity back to the utilities would occur.

- **Competitive Bidding/Procurement** – Commission staff rightly acknowledged that any self-build proposal “by a utility in a reliability option hearing should be given considerable deference if the utility has undertaken a fair and open competitive bid.”\(^2\) Competitive Suppliers, however, encourage the Commission and Commission staff to take this thought one step further. If a utility that performs a “fair and open competitive bid” deserves “considerable deference” in its resource proposal, why not construct a Commission-approved, reliable, transparent and fair competitive procurement process that would be required for all utility generation additions? The Commission could establish a rebuttable presumption that the result of the competitive procurement process was just and reasonable and allow the utility to fully recover its costs, thus avoiding costly and time-consuming contested cases for every individual utility resource application.

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\(^2\) Background paper of CNF proceedings prepared by George Stojic, Page 2
This would not require new legislation because current Michigan law allows for a utility to recover the full costs of a PPA with a third party; nor, is it a new or untested policy since 15 states and the District of Columbia have competitive power procurement rules or legislation. It is important to note that the procurement rules in many of these states encompass longer-term PPAs that include capacity, energy and ancillary services – not just shorter-term contracts for a specified amount of energy.

A major goal of competitive solicitations is to evaluate a full range of resources in the wholesale marketplace and to obtain the best possible deal for all electric utility retail customers. In this specific sense, competitive solicitations, when conducted in a fair, accurate and transparent manner, are an important tool at both the state and federal levels for determining the prudence of utility purchases and investment decisions and allaying concerns about affiliate bias.

To help regulators form a credible competitive process, EPSA published “Getting the Best Deal for Electric Utility Customers: A Concise Guidebook for the Design, Implementation and Monitoring of Competitive Power Supply Solicitations.” This guidebook was prepared by the Boston Pacific Company, Inc., which has served as the independent third-party evaluator (IE) for competitive solicitations in other states and currently is the market monitor for the Southwest Power Pool (SPP) regional transmission organization (RTO). The guidebook, along with a follow-up booklet on resource procurement and debt-equivalency, has been attached to these comments for your reference.

For a credible, competitive solicitation to take place, two main requirements must be fulfilled. The first is the development of a process that will give all market participants the assurance that they will be participating on equal terms. If potential participants feel that they are not playing on a level playing field and have significant hurdles toward securing a successful contract, they will ultimately decide not to participate. The departure of market participants will not only bring the credibility of the solicitation process into question, but in the end, will also harm electricity consumers. Consumers benefit when companies compete against each other on the grounds of price, innovation and service.

Therefore, to ensure that a credible solicitation occurs, it is critical that all parties be aware of and agree on important issues such as the type of product to be procured and the evaluation criteria to be used. Bidders must be aware of exactly what type of

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3 Power Supply Cost Recovery Clause; MCL 460.6j.
4 Arizona, California, Colorado, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, Ohio, Oregon, Pennsylvania, Rhode Island, Utah and Virginia
6 Electric Utility Resource Planning: The Role of Competitive Procurement and Debt Equivalency, GF Energy LLC, 2005
capacity the buyer is seeking so that a true competitive bid can be formulated. In this regard, to the extent the soliciting entity anticipates submission of a self-built alternative; it should be required to identify in the draft RFP, the location of its self-build alternative and the relative size of the facility. In addition, in order to have as successful a process as possible, bidders must be aware of the criteria on which their bids will be judged. By taking these additional steps, the Commission and market participants will have the security of knowing that a credible process was used, which, in the end, will better serve consumers.

The second main requirement is the establishment of an IE that will oversee the process to ensure that there is no bias and that will act as a complement to the Commission’s staff. The benefit of an IE is that the Commission, staff, market participants and customers will have an extra pair of experienced eyes watching over the solicitation process. The IE will know the mistakes that can be made and will possess the technical expertise to delve into the details of the utility’s evaluation to determine any biases. The Commission and the bidders both have a high degree of confidence, knowing that a fair and impartial entity is reviewing the details of the solicitation. One of the main tasks for the IE would be that of a conduit for all communications between the soliciting utility and its bidding affiliate(s).

Although many more details must be examined, with both a strong collaborative stakeholder process and an IE, the Commission can be sure that the groundwork for a reliable competitive bidding process would be laid. Please see the attached guidebook for further discussion on these topics.

The value produced by competitive power suppliers goes beyond the possibility of rate savings. What many consider the greatest benefit of non-utility generation is the transfer of risk from the captive utility customer to the competitive supplier. When a utility builds a plant it sets an initial budget that is approved by the state Commission. Yet if, as is often the case in plant development, there are construction delays or cost-overruns it is the captive utility customer of the utility that pays the price. The utility is often entitled to recoup its construction expenses through rate increases that put a significant burden onto the customer. Even if the Commission staff’s recommendation is accepted and a cost cap proposed by the utility, customers would still be responsible for CWIP without an offset for AFUDC, as well as a reliability charge.

Competitive suppliers on the other hand can offer different types of supply options with fixed prices upfront. These options properly allocate the risks associated with the development, construction, ownership and operation of power generation facilities. Developers and generation owners price these risks into their bids and proposals and at a lower risk-adjusted cost to consumers than would be the case from a utility plant. Some examples of the types of risks that are negotiated features in PPAs are:

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7 Ibid, Pages 7 & 8.
set prices for capacity (which protect against construction, operation or other
cost overruns);
guaranteed completion schedule for new construction;
guaranteed unit availability;
guaranteed reliability related performance measures;
protection against changes in a utility’s cost of capital;
price reductions or liquidated damages if guarantees are not met;
flexible contract terms/duration (e.g., a PPA for five or 10 years may be
preferable under some circumstances to the 30-year commitment associated
with a utility acquisition or construction); and
no residual charge for retirement, demolition or site clean-up.

These risk mitigation measures can result in lower and/or more stable rates for
consumers. Finally, PPAs allow utilities to conserve its capital for other much-
needed infrastructure investments, such as distribution enhancements.  

**Energy Efficiency** – Competitive Suppliers have no comments or suggestions on
this section.

**Construction Partnerships** – Not only can Michigan utilities bring in partners for
their self-build options, but competitive suppliers can also have partners for their
plants.

**Market Power** – There is no question that greater concentration of utility ownership
in generation will exacerbate the market power problem. And more broad-based
partnerships in utility power plant building programs are not likely to mitigate market
power problems. In addition to the reasons cited above to include the competitive
generation sector as a full participant in the reliability option concept, Competitive
Suppliers respectfully suggest that market power concerns are another reason for
the Commission to “hardwire” the competitive procurement option in its final rule in
Case No. U-14231.

**Conclusion**

Competitive Suppliers again applaud the Commission for establishing the CNF and the
Commission staff for the work done in re-examining the state’s electric resource
addition policy. With the inclusion of a transparent and fair competitive procurement
process, and staying the course on fully functioning competitive markets, the
Commission would provide equity, comparability and regulatory certainty in the
development of a workable policy on resource additions – all to the benefit of Michigan’s
retail electricity customers.

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8 EPSA White Paper *Buy or Build? Power Purchases or Power Plant Ownership: Making the Best Choice for Customers*, July 2004, Page 4
Consumers Energy’s response, pages 61-65
CONSUMERS ENERGY RESPONSE
TO MPSC’s CNF POLICY CHANGE PROPOSAL
SEPTEMBER 30, 2005

INTRODUCTION

Consumers Energy commends the Michigan Public Service Commission Staff (Commission staff) for its efforts in evaluating the need for new generation in the State of Michigan.

Consumers Energy remains concerned, however, that the current market structure in Michigan does not create appropriate market incentives to invest in new energy resources, and thus creates doubt about whether those resources can be financed on reasonable, affordable terms for Michigan’s utility customers. Similarly, the current market structure does not adequately recognize the value of supply reliability or the market benefits from adding a new facility that generates low cost energy that keeps energy prices down. Consumers Energy believes that base load generation and fuel diversity (beyond natural gas) provide significant public value in the form of more predictable and stable prices. Long-term reliability, affordability, and price stability should be the focus of the Capacity Need Forum. Sole reliance upon emerging energy-only electricity markets is unwise, because such reliance will not meet these objectives.

Without targeted policy changes that substantially increase revenue certainty and provide cash flow support for the financing of large-scale, long-term power generation, Consumers Energy doubts that new generating facilities will be built in the State of Michigan in the foreseeable future. Michigan’s utilities do not have revenue certainty in the current regulatory model and cannot provide revenue certainty to a potential third-party investor in the form of a long-term PPA.

Given this context, we believe that the Commission staff’s current proposal, although an excellent starting point, does not go far enough in creating the stable and predictable regulatory and financial environment required to permit the financing of new base load generation on reasonable terms. Also, since new base load generation will take a number of years to develop and construct, it is imperative that these policy issues are resolved in a timely manner to meet the State’s increasing electrical demand. We are encouraged by the policies and the broad general direction that the Commission staff has suggested and have included some additional comments on these and other aspects of the current regulatory environment below.

1. The uncertainty of a customer base makes financing a large-scale new generation facility unworkable. Without a firm customer base or cost recovery certainty provided through firm and predictable ratemaking treatment, the potential migration of customers to alternative electric suppliers (AESs) makes new generating facility construction an extraordinarily risky proposition and potentially unfinanceable. Historically, the utility’s customers have paid for both the cost of energy and the
associated costs of reliability. The current market structure encourages reliance on short-term energy transactions, and discourages long-term, reliability-based investments. This will ultimately impact all customers.

2. The current inability to recover construction costs in rates during construction expands already significant cash flow requirements pending project completion, and increases financing costs. A policy of deferring consideration of cost recovery issues until the plant enters commercial operation creates additional financial, regulatory and business risks.

3. A competitive bid process that goes beyond engineering, procurement and construction (EPC) injects further uncertainty into the construction decision and financing process.

4. Any policy revisions must be broad enough to ensure optimal results. Major investments in existing facilities should be treated on terms equal to investments in new generation assets. Thus, any reliability charge should not be restricted to only new generation assets. Extending the life or further reducing the emissions of existing units as technology continues to develop may have greater value than would new construction in some instances. We believe a policy that places a non-bypassable reliability charge only on new generation may have unintended and uneconomical consequences.

**MPSC’s Policy Recommendations**

**Binding Pre-Approval**

The Commission staff has appropriately identified a mechanism that can abate some of the financial risks of new generation. While the Commission has certain authority to adopt the related recommendations, their current decisions regarding ratemaking may not necessarily bind future Commissions, adding to long-term investment uncertainty.

We see a strong, binding formal mechanism administered by the Commission, such as the issuance of a Certificate of Public Convenience and Necessity, as a key aspect in mitigating some of the risk associated with an investment of this magnitude. Consumers Energy further believes that, in light of the long-term nature of the financial commitments at stake, the changes under discussion would ultimately require targeted legislative action.

**Construction Work in Progress**

The Commission staff has recognized the importance of receiving a cash return on Construction Work in Progress (CWIP) during the construction period of the new facility. The time frame for carrying debt of this magnitude is too burdensome for the utility without such a mechanism. Comparable ratemaking treatment would be appropriate for any major energy infrastructure investment, whether new generation or in existing generation assets.
**Competitive Bidding**
A competitive bid process introduces additional uncertainty into the construction decision process. We remain convinced that customer’s interests can be fully protected if competitive bidding is limited to the Engineering, Procurement and Construction (EPC) aspects of the plant development.

**Construction Cost Controls and a Commitment to In-Service Date**
The Staff proposal includes a recommendation that the utility agree to a construction cost cap and commitment to an in-service date. If such commitment is required, the utility should be provided reasonable protection from Force Majeure events, as is typical in any major contract. Additionally, the utility should be provided a margin above the price cap for unanticipated cost changes not associated with Force Majeure events. The utility must be able to petition the Commission for recovery of for-cause prudent expenditures within this margin for rate recovery consideration. The utility would still be subject to a prudency test, but would be allowed latitude for scope changes as could relate to such things as regulatory changes or consequential swings in construction materials availability and price. Additionally, if the Utility it to accept a higher performance-based risk for construction guarantees, then due consideration should be paid to positive performance incentives as well.

**Construction Partnerships**
Since customer choice has established an environment whereby utilities must compete for customers with alternative energy suppliers, Consumers Energy will not accept a forced partnership with its direct competitors. A forced partnership with an AES is wholly inconsistent with such an environment. We would, of course, consider partnering with other load-serving entities with whom we are not competing to serve our customer base. Consumers Energy already has such arrangements and would not be opposed to future arrangements that provide for an equitable allocation of cost and benefits.

**Revenue Certainty**
Significant uncertainty surrounding a utility’s future customer base makes financing a new generation facility extremely difficult. Without a firm customer base and cost recovery certainty provided through long-term, binding ratemaking treatment, the potential migration of customers to alternative electric suppliers makes new generation facility construction an extraordinarily risky proposition.

The Commission staff suggested a mechanism by which both bundled and ROA customers would be required to pay a portion of the plants reliability value. This mechanism includes a dedicated non-bypassable charge assessed to all jurisdictional electric customers designed to provide for recovery of certain costs related to reliability. This would ensure that the cost of carrying reserve capacity is borne equally by all customers that benefit from the additional electric reliability as a public good. This recommendation would also help the State of Michigan to maintain a reasonable reserve margin and reduce dependence on out-of-state generation.
However, Consumers Energy believes that the value of the plant to all customers exceeds the reliability value. The availability of additional base load capacity in the market will also hold down market prices to the benefit of all customers. This value also needs to be recognized in the overall structure of the non-bypassable charge.

Consumers Energy sees value in extending the concept of the non-bypassable charge to all major capital investments. Putting all large investments on an equal footing would avoid encouraging suboptimal capital spending decisions. We would require adequate protection from ROA-related risk in any large-scale investment or long-term commitment.

Given the extensive scope of this charge considerably more attention and discussion will be needed to assure that it is appropriately comprehensive and fair.

**Long-Term PPAs**

Under the current regulatory environment, the utility cannot accept the downside risk of a long-term power purchase commitment (PPA) while having neither revenue certainty from a fixed customer base, nor the opportunity to earn an adequate risk-adjusted return.

Under current accounting rules, a utility that enters into a long-term PPA will likely be required to record the present value of capacity payments over the term of the PPA as debt on the utility's balance sheet. In addition, credit rating agencies have imposed a rating penalty on those utilities that have entered into long-term PPAs to reflect the "debt-like" nature of capacity payments due under such contracts.

If Consumers Energy were to opt to pursue long-term PPAs in lieu of generating plant construction, the company would require the same type and level of revenue certainty for them as would be required for large-scale construction or infrastructure investment. Both PPAs and construction have associated loss of market risk under customer choice. Given the current policy environment Consumers Energy could not accept a long-term PPA obligation without appropriate consideration of equity and an assured return on that equity to offset the debt-like nature of the obligations.

**Energy Efficiency and Conservation**

Consumers Energy strongly believes that energy efficiency and conservation (demand management) should play a role in Michigan's energy future. We recognize, however, that efficiency, conservation and renewables, although important, will only be a portion of the complete picture of energy supply and demand in the State and that new base load generation will be the key element. To the extent that efficiency and conservation are economical choices for demand management, with an appropriate allocation of cost and benefits, then the market will support them. We must remain mindful of the controversy that accompanied the demand side management programs undertaken in the 1990s.
CONCLUSION

We applaud the Commission staff for its work in determining the need for additional base load capacity to be built in Michigan and look forward to working on the implementation of policies to accomplish that objective. While the Commission staff’s proposed policy recommendations address several important regulatory hurdles that need to be overcome before implementation of a capacity addition program can commence, we believe that several enhancements to those recommendations are needed to achieve the desired objectives.

In particular, we believe that it will be necessary to have revenue assurance and cash flow support through binding pre-approval, a secure customer base and a non-bypassable charge for any capacity addition to occur. Consumers Energy deeply appreciates the opportunity to provide these comments and to participate in the Michigan Public Service Commission’s Capacity Need Forum. We look forward to reviewing the Commission staff’s final report and the final results of its capacity modeling efforts.
Wolverine’s response, pages 67-74
MPSC Capacity Need Forum
Wolverine Response

Introduction

Wolverine supports this collaborative effort of the Michigan Public Service Commission (MPSC) to assess the future need for generating capacity in Michigan. Wolverine submits the following comments in response to the August 2005 Capacity Need Forum meeting in which Mr. Stojic, on behalf of MPSC Staff, proposed several policy principles and asked for comments from the participants.

Wolverine’s response is based on several overriding factors in Michigan that cannot be ignored in the context of this debate.

1. Michigan’s economy can only be strong if electric providers in Michigan can produce reliable supply for all consumers at rates that create an incentive for businesses to locate and remain in Michigan in the context of a global economy.

2. Michigan, as a peninsula state with few indigenous fuel choices, has limited options for specific types of base load generation. Michigan relies heavily, and will continue to rely heavily in the future, on major rail and Great Lakes transportation of coal and interstate transportation of natural gas.
3. Michigan currently relies on significant imports of power and thus will benefit from increased availability of interstate transmission and increased import capacity from the lower Midwest, where indigenous fuel options are more available, practical and competitive.

4. Additional base load generation must be built in Michigan. The last major base load coal facility built in Michigan was Belle River (circa 1984-1985). Since the time of its construction, the demand for electricity in lower Michigan has nearly doubled. If design for a new coal plant commenced today, it would not be operational before 2012. Michigan must initiate policy efforts immediately if it is to have any competitive opportunities in the future.

5. The capacity additions of the late 1990s were primarily natural gas-fired peaking and combined-cycle plants. These plants enjoyed fast permitting, short construction periods and relatively easy design specifications. They have provided an enormous benefit to Michigan by improving reliability. These plants cannot compete with coal and nuclear for base load operation however, unless, and until natural gas prices drop below $4.00/mmBTU.

6. While admittedly outside of its direct regulatory authority, MPSC Staff should consider the enormously more difficult challenge that power plant developers have today than existed when the current fleet of base load generation was constructed 20-40 years ago. There are significant and well-organized
opposition groups to nearly all types of generation. Additionally, Michigan has contemplated stricter rules than other parts of the Midwest for water withdrawal and mercury emissions. Lenders are nervous and organized opposition for any proposed site is very strong. Unless Michigan is willing to make development of a coal-fired plant more attractive than neighboring states, those infrastructure dollars will be built outside of Michigan further hindering growth of business in Michigan.

Response to the MPSC Staff Proposal

Core Values

The MPSC Staff put forth three values at the August 2005 Capacity Need Forum meeting:

a. The ratepayers come first
b. Electric reliability is a public good
c. We need to adhere to a fairness doctrine (you get what you pay for)

Wolverine and its members agree that the ratepayers come first. The very nature of a cooperative (the members/ratepayers are the owners) ensures that Wolverine’s members and its member-customers come first. Since Wolverine and its members operate for and on behalf of their ratepayers/owners, the ratepayers and owners are one and the same.
Wolverine agrees that reliability is a public good. The highly interconnected nature of the electrical grid makes it impossible to identify which customer benefits more from a particular generator or networked transmission facility. Electrical reliability is a fundamental service essential to the competitiveness of Michigan businesses and can indeed be categorized as a public good. Reliability can be enhanced in a number of ways through generation and transmission projects, and recognition should go to all entities that enhance reliability without discrimination as to type or owner.

Wolverine acknowledges that MPSC Staff should adhere to a fairness doctrine; the difficulty comes with measuring “fair”. If the MPSC Staff means that if customers who pay a “reliability premium” should get the benefit of that reliability and not have to “pay twice”, then Wolverine agrees. Wolverine feels that the fairness doctrine should also recognize that efforts to stimulate development of generation in Michigan must be available to all interested parties and the extent of the parties’ interests cannot be limited in any fashion. In other words, Consumers Energy and Detroit Edison who currently own and control approximately 90 percent of all base load generation in Michigan, cannot be the sole beneficiaries of revised regulatory policy.

“Reliability Option”

The MPSC Staff presented a concept of a “Reliability Option” that contains several provisions. Wolverine agrees that an “Upfront Regulatory Commitment” will lead to
higher security and lower project financing costs over the long term. Wolverine would like to raise several additional points for consideration in the context of this dialogue:

**Market Power** – The focus of the MPSC Staff proposal seems to be on setting rules for encouraging existing Michigan-regulated utilities to build generation. Wolverine hopes that the final outcome of this process will encourage all entities, whether cooperatives, municipalities, or independent companies, to participate on an equal footing. The fact is that approximately 90 percent of all base load generation in the two Lower Michigan zones contemplated in this collaborative effort is owned and controlled by Consumers Energy and Detroit Edison. Further concentration of this market power reduces wholesale competition. The parties must recognize that Detroit Edison and Consumers Energy will rightfully look to existing sites on which to construct modifications or additions to their generation fleet. All Michigan market participants should be allowed the opportunity to participate in project improvements regardless of location.

**Commitments to Capped Price and Schedule** – This provision makes sense on the surface, especially in light of nuclear plant cost escalations during the late 1970s and 1980s. In practice, however, it will be very difficult and likely very expensive to make commitments to price and schedule at the outset of this process. With seemingly endless appeal opportunities afforded in the Air Quality permitting process, the MPSC Staff may be suggesting schedule guarantees that are impossible for any entity to adhere to in today’s market. Price guarantees can be achieved through Lump Sum Turnkey bidding processes with engineering, procurement and construction contractors. The stark reality,
however, is that the likely size of any one base load project could easily exceed $2 billion. Today, in the United States, there are only two or three companies that have the financial resources to provide a guaranteed Lump Sum Turnkey price for projects this large and, if they do, it may come with a hefty premium.

**Need For a Defined Process** – Wolverine believes that a prescriptive process may be useful in the long run only if it is pre-established and yields some certainty at its conclusion. An exhaustive process that affords an absolute right to develop will speed the construction time and ultimately offer lower rates to Michigan residents. A process that affords delays and endless appeals will only add another layer of risk to an already risky development environment.

**Encouraging Collaboration** – The regulatory process as outlined may discourage entities from working together. The fact is that base load generation is so expensive, so controversial and so financially risky, that all Michigan projects will benefit from a diversity of owners. If each entity attempts to demonstrate its need for capacity in the absence of the other Michigan participants, Michigan customers will, in one form or another, pay higher utility rates in the end. The MPSC Staff proposal can be improved by mandating that the process be collaborative and that all interests are considered. According to early results presented by the Integration Work Group, Michigan needs several thousand MWs of new base load capacity in the next decade. Michigan entities owning pieces of different plants, all working together, will force coordinated planning efforts, lower construction costs and reduce life-cycle operating costs.
**One-time Option To Participate** – The plan outlines a process that would give an AES a “one-time” opportunity to make a pro rata investment in the generating station. Wolverine is concerned that this will disadvantage non-IOU participants from participating in generation development. Other Michigan entities, including large retail customers, should be allowed to participate to the fullest extent of their interest and demonstrated financial capability to do so. How is Michigan and the competitiveness of its manufacturers hurt by having General Motors as an owner of base-load energy capacity?

**Competitive Bidding** – Wolverine as a customer-owned entity is motivated to develop reliable power supply at the lowest possible cost. In this light, a not-for-profit entity may be the ideal ownership structure for new generating plants in Michigan. Based on Wolverine’s experience in other projects, competitive bidding does not necessarily guarantee the lowest price for a plant. Sometimes this structure acts only to delay construction, and creates a circus-like environment for opponents to delay or block the project.

**Energy Efficiency** – Wolverine agrees that energy efficiency programs should be pursued. Wolverine is opposed to the costly, time-consuming and human resource-intensive Integrated Resource Planning programs prevalent in the mid-1990s.
**Construction Partnerships** – Wolverine believes that the MPSC Staff should, to the fullest extent possible, encourage Michigan utilities to work together in construction partnerships. Encouraging standard design and equipment and joint procurement will lead to considerable cost savings during construction, spread financial risk and lower life-cycle costs of the new plants.
Shepherd Advisors’ response, pages 76-78
September 30, 2005

George Stojic  
Michigan Public Service Commission  
6545 Mercantile Way, Suite 7  
Lansing, MI 48911

Dear Mr. Stojic,

I appreciate the opportunity to respond to the Capacity Need Forum Staff Proposal and Policy Discussion of August 25, 2005.

Upon reading the proposal, there appear to be several dynamics at play:

1) The anticipated need to improve the reliability of Michigan’s electrical grid,  
2) The anticipation that new generation capacity will need to be built to improve grid reliability,  
3) The unwillingness or inability of utilities to invest in new generation capacity without risk-free, guaranteed financing provided through rate recovery or other means,  
4) The belief by staff that reliability is a “critical public interest”  
5) Staff’s belief that reliability’s “critical public interest” status could provide an overriding rationale for a “reliability option” that would provide utilities with cost recovery (that utilities could not get otherwise) through a “reliability charge” levied on rate payers1, and  
6) The desire by the Commission to achieve targeted reliability in a least cost manner.2

I appreciate also the challenge of the Commission to balance the need for meet growing electrical demand in a competitive, choice environment, with the desires of utilities to build additional conventional generation in Michigan on a minimal or no risk basis.

If reliability is indeed the primary goal being pursued, there are numerous other strategies that the Commission and Staff should pursue first to can enhance reliability much more effectively and less expensively than the public financing of central power plants.

Power reliability is primarily a function of the frequency and duration of electric outages. Most outages occur at the distribution level, are relatively minor, and are caused by severe weather (lightening, ice, etc.), falling or sagging trees, animal intrusions and other hard-to-control factors. More serious brown outs, black outs, and disruptive voltage fluctuations, however, typically start with minor outages at the distribution level that then “cascade” into systemic (distribution and transmission) failures due to (1) local, regional, or system-wide imbalances and fluctuations between the demand and supply for power, and/or (2) exceeded thermal limitations or voltage capacities of specific transmission/distribution equipment that cause equipment performance to degrade or cease.

Thus, improving grid reliability on a systemic basis is primarily a function of (1) improving transmission and distribution equipment, and (2) reducing instances of large demand/supply imbalances and

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1 In the proposal, Staff states, “If it chooses to do so, a utility can build a new generating plant in the traditional manner, that is it could finance the plant without public involvement and then request rate recovery after the plant is completed. However, the utility could instead seek to build a generating plant under the reliability option discussed herein”

2 The proposal states, “It is crucial for Michigan to secure the right type of power (base load, cycling, peaking, renewable, fossil, etc.) at the lowest possible price.”
fluctuations. Towards this end, I strongly urge Staff and the Commission to address reliability concerns applying the following strategies, ordered in priority:

1. **Reduce demand, particularly at peak times, with robust energy efficiency and demand side management programs.** The most effective way to enhance grid reliability is to enable users to easily demand less power, both in general and particularly at peak times. There are many examples of effective energy efficiency and demand side management programs that work to reduce load, especially peak load, and can be very cost-effectively applied here in Michigan.

2. **Impose Congestion Fees at grid nodes particularly susceptible to reliability problems.** Reliability problems often emerge simply because too many users are drawing more power than local distribution nodes in the grid can handle. The Commission should use the power of the market place to raise local penalties for congestion. Higher congestion costs will both send important price signals to users and will provide financial resources to upgrade transmission/distribution bottle necks.

3. **Selectively upgrade transmission and distribution equipment.** Reliability problems are often caused by single faulty pieces of equipment or systems. Often pinpointing problem equipment and system configurations is difficult. Fortunately, diagnostic tools are improving and can be used to make selected, cost-effective upgrades that can yield significant reliability gains.

It is noteworthy that the Michigan Public Service Commission has provided grant funding to Intellicon Inc., a Michigan company, to developed very sophisticated software to diagnosis grid vulnerabilities. Intellicon has completed extensive analysis of much of Michigan’s transmission and distribution infrastructure, and can provide the Commission with detailed equipment upgrade recommendations.

4. **Promote the robust and wide-spread deployment of distributed generation (DG).** The deployment of DG assets is a well accepted strategy to mitigate fragmented reliability problems. As described in a recent study prepared by Lisa Schwartz of Oregon’s Public Utility Commission Staff 3, distributed generation produces electricity at or near the place where the electricity is used. DG involves the local use of:
   a. Combined heat and power (CHP)
   b. Small engines and turbines that run on diesel or natural gas, and
   c. Renewable energy systems such as solar power, wind power, small hydro, and biogas.

These technologies offer numerous advantages over central-station power generation, particularly coal-fired generation. Benefits for DG result because DG is usually:

- **More energy efficient,** extracting more value out of consumed resources,
- **Cleaner burning,** reducing both the quantity and toxicity of pollution discharges and subsequent health and environmental quality problems,
- **Better able to follow and match electrical load changes,** reducing demand-supply imbalance issues,
- **Provide on site peak power,** reducing grid demand at high-congestion times
- **Lower transmission efficiency losses,** improving costs and power quality
- **Providing power onsite,** reducing the need for transmission and distribution upgrades.

In addition, DG provides customers with abilities to better control electrical costs, have critical supply and back up power in case of grid failure, sell excess power back to the grid (and thereby improving

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economics for the user), and participate in demand response programs that augment supply at critical times.

DG can provide users with power flexibility (primary power, back up power, emergency power, co-generation, and peak shaving) and increase user power reliability and quality. If DG is located where the grid is constrained, it can reduce utility costs by delaying, reducing or even eliminating the need for investments in transmission, distribution, and centralized generation. In addition, DG, especially renewable DG, can significantly reduce the negative environmental impacts of power generation.

Finally, under favorable circumstances, DG can in many cases directly improve the financial performance and energy security of Michigan businesses, and can create significant numbers of Michigan jobs.

In addition to providing reliability benefits to users, DG provides disproportionate reliability benefits to grid reliability. Because most reliability problems occur at the distribution level, a DG in the right spot can have as much as 10x the reliability benefit to central generation. In other words, 100 MW of distributed generation in the right place can provide the reliability improvement of 1000 MW of central generation. At the transmission level, well-placed DG also has shown to have as much as twice the reliability benefit of central generation.

The use of energy efficiency, demand side management, congestion pricing, selected equipment upgrades, and distributed generation are well known and increasingly common strategies to mitigate both reliability and generation concerns. The benefits are well known to DOE\textsuperscript{4} and system operators like PJM are on the forefront of developing and implementing these types of strategies.

Many of these strategies can be encouraged and implemented in Michigan with regulatory and rule changes. Many strategies can be implemented on a cost-share basis with specific users and beneficiaries, reducing costs. Indeed, if aggressively pursued, many of these strategies could, over time, obviate many reliability and generation concerns at relatively little public expense, and significantly decrease the amount of new central generation needed for reliability enhancement.

Finally, if Staff feels that a Reliability Charge is still warranted to improve reliability, a use of these resources to FIRST MAXIMALLY ACHIEVE THE STRATEGIES ABOVE will lead to a far better expenditure of rate payer or public funds to build additional generation needed.

I hope my comments are helpful and will be taken to heart. As a rate payer, I want my energy expenses to be put to the best and highest use possible.

I truly appreciate your consideration.

Sincerely,

Loch McCabe
President

\textsuperscript{4} See for instance, “Distributed Generation: Benefit Values in Hard Numbers.” DOE.
www.eere.energy.gov/de/pdfs/benefit_numbers.pdf
MEGA’s response, pages 80-88
MEGA COMMENTS ON STAFF CNF POLICY PROPOSALS

The Michigan Electric & Gas Association ("MEGA"), a trade association of electric and gas investor-owned public utilities, provides the following informal comments on the Michigan Public Service Commission Staff policy proposals in the Capacity Need Forum ("CNF") circulated on August 23, 2005. These are informal comments offered for the purpose of discussion and do not represent the formal policy position of MEGA or any of its individual member utilities. This disclaimer is included because the policy proposals are a conceptual framework for further discussion and subject to modifications based on input from various interested parties with different perspectives. MEGA understands that the MPSC Staff is considering policy recommendations to adopt and has not formally adopted the August 23, 2005 discussion as its proposal.

Major section headings below (identified by letters) are those used in the Staff proposal and the Staff proposal for each policy section other than the background is included in italics. Other bold headings are used to identify subjects addressed in these comments.

As an overall comment, MEGA expresses its appreciation to the MPSC Commissioners, Staff and participants in the CNF for the work and commitment associated with this project. The coordinators and group leaders have developed an excellent work product to date in this area of vital importance to our state.

Another overall comment arises from the multi-state service of certain MEGA member electric utilities. Some members are constructing or have constructed base load electric generation in other states, under the laws and regulations of those states which may include a process for advance certification. Any new MPSC regulatory policies should have the flexibility to incorporate regulatory approvals and treatments afforded to facilities by the state where a utility provides the bulk of its service, as appropriate.

A. Background

MPSC Jurisdiction: The report urges participants to make policy recommendations within the Commission’s existing jurisdiction. Unfortunately, the boundaries of that jurisdiction are subject to interpretation and the very broad authority apparently granted by some of these laws is limited by later court interpretation. MEGA appreciates the Staff’s desire to develop policies that can be implemented consistent with the existing MPSC jurisdiction. It is important, however, to recognize the limits of that jurisdiction and develop policies that are on firm legal ground.

Regulatory Statutes: Michigan public utility regulation is governed by public acts adopted over the last 100 years, which must be read together but are not written as an integrated code. The major acts establishing MPSC regulation of electric utilities were adopted in 1909, 1919, 1939, 1982 (adjustment clause amendments) and 2000 (retail customer choice amendments). Of particular relevance here are MCL 460.557(2) establishing a list of factors to be considered in setting rates, including a reasonable return on the fair value of all property used in the service; MCL 460.54 granting the
MPSC power to control and regulate all public utilities in the state; MCL 460.6 granting the MPSC broad authority to regulate public utility rates, services and all other necessary and incidental matters; and MCL 460.10b, granting the MPSC authority to establish rates and terms that promote and enhance development of new generating technologies and provide for reliable and lower cost competitive rates for all customers. The last of the above statutes is part of the recent Customer Choice and Electric Reliability Act of 2000 (CCERA) and has not been interpreted in court decisions. Section 13b of 1939 PA 3; MCL 460.6j(13)(b) is relevant to the issue of advance regulatory approval of power supply contracts. In recovering power supply costs through the annual PSCR rate proceedings, in order for a utility to recover capacity charges incurred via a long term power purchase agreement (in excess of 6 months), the utility must obtain prior approval from the MPSC. For certain “qualifying facilities” under federal law, the prior approval of the capacity charge recovery may not be modified during a financing period of 17.5 years.

These statutes appear to grant extremely broad authority to the MPSC; however, they are subject to court interpretations that restrict their meaning as discussed briefly below.

It may be difficult for outsiders, particularly the financial community, to understand the scope of the MPSC's regulatory authority and the risks of adverse regulatory actions affecting the financial viability of a project. The hierarchy of authority is Constitution – Statute – Administrative Rule – MPSC Order. Any regulatory policy changes resulting from the CNF should be expressed clearly in the relevant order, rule or law and should not be in conflict with a higher level of authority.

Court Decisions: Huron Portland Cement Co v Public Service Comm, 351 Mich 255 (1958) holds that MCL 460.6 grants no specific regulatory power to the MPSC but instead is an “outline” of regulatory jurisdiction. Specific authority for MPSC action must be found elsewhere in the statutes. The limitation of this decision has been applied in subsequent cases. Attorney General v Public Service Comm, 412 Mich 385 (1982) holds that the question whether advance MPSC approval of power plant construction should be required is a policy matter for the legislature to decide. The Court recognized that the existing statutes did not provide for advance MPSC certification of power plant construction but only regulatory determination of the appropriate rate recovery after completion. Union Carbide Corp v Public Service Comm, 431 Mich 135 (1988) holds that the manner of operation of electric generating plants is a matter for utility management to determine and the MPSC’s broad ratemaking authority does not authorize the agency to make management decisions (although it can review the rate implications of such decisions). In this case, the Supreme Court likened a review of the regulatory statutes governing the MPSC’s powers to a “journey into the heart of darkness.” The Court was calling for modernization of the statutes, which has not occurred in subsequent years although the CCERA added a new legal framework to be considered along with the earlier laws.
The cases discussed above present a dilemma because they interpret the MPSC regulatory authority narrowly. As applied to the proposals, they indicate a risk in relying on the general, broad authority to support major changes in regulatory policy. At the same time, the Michigan courts tend to apply a “rule of deference” in evaluating MPSC actions, particularly if the subject of review involves rate-setting. Although Michigan does not have a “pre-approval” statute for generation additions, matters such as determination of recoverable costs, CWIP/AFUDC treatment and the role of bidding are matters which arguably fall within the ratemaking authority. Other matters, including market power and energy efficiency, are the subject of newer provisions in the CCERA. Policies should be crafted to minimize the risk of repeating the “experimental retail wheeling” situation, where the regulatory action was eventually overruled by the Supreme Court after several years.

The Staff should not rule out the possibility of legal revisions similar to the approach taken by some other states that have advance certification provisions in the applicable statutes. In Wisconsin, for example, new coal plants have been certified in advance of construction under WS 196.491 and the law provides for advance determination of the rate-making principles for recovery of the capital costs. WS 196.371. In July, State Senator Bruce Patterson held a press conference suggesting the possibility of a state statutory measure regarding energy policy similar to a New York model. Some legislators may believe that policy revisions should be made through statutory changes.

Recommendation on MPSC Jurisdiction: MEGA believes it would be appropriate for the MPSC Staff to consider obtaining legal memoranda from its counsel on policy proposals of this type, to determine the likelihood of an adverse decision if the policy is challenged in the courts. The MPSC has received many comments regarding the need for regulatory certainty for utilities to build and finance large base load generating stations. If new policies are implemented without solid legal authority, the required certainty will be lacking.

B. Reliability Option

If it chooses to do so, a utility can build a new generating plant in the traditional manner, that is it could finance the plant without public involvement and then request rate base recovery after the plant is completed. However, the utility could instead seek to build a generating plant under the reliability option discussed herein.

Under the reliability option, the utility would file an application with the Commission containing the following: (1) details of its proposed plant, including expected cost and anticipated in-service date; (2) an analysis of why the proposed plant is the appropriate resource to meet the expected need and an analysis of the public benefits associated with the plant; (3) if desired, a request for placement of the plant’s construction work in progress (CWIP) in rate base without an offset for allowance for funds used during construction (AFUDC); and (4) if desired, a request for a reliability charge on all customers receiving retail distribution service from the utility. The level and timing of the reliability charge would be designed to be commensurate with the public benefits associated with the plant.

A contested case public hearing would be held on the utility’s application. If the Commission determined that the plant’s expected reliability value warranted it, the Commission would permit CWIP in rate base without an AFUDC offset and would authorize a reliability charge on all distribution customers. In exchange for placing CWIP in rate base without AFUDC, the utility would commit to capping the recoverable value of the plant and an in-service date.

In exchange for paying a reliability charge, all customers would be credited with their pro-rata share of the plant’s reliability value in satisfying any regional reliability standard. Further, if customers of an alternative
As noted, this option is not a matter directly addressed in the regulatory statutes and should be the subject of legal analysis. The underlying concept of reliability as a public good is addressed below.

The CNF needs to consider the rapidly changing environment of the regional wholesale markets and potential changes to reliability and market rules. Significant developments include the following:

- MISO began its “Day 2” market this Spring and will continue to evolve;
- MISO has not finalized its policy for resource adequacy;
- PJM is developing its Reliability Pricing Model;
- Joint and common markets are developing;
- Regional reliability councils are being consolidated;
- The federal Energy Policy Act of 2005 was adopted, with many new measures and creation of an Electric Reliability Organization.

**Economic Concept of Public Good**: The Staff report suggests that electric reliability is a classical economic public good. A public good is something that is difficult or impossible to produce for private profit because the market fails to account for large beneficial externalities. Once produced, everyone can benefit without reducing the enjoyment of others and it is difficult to prevent access to the good. Examples include national defense, a clean environment, law enforcement, lighthouses and street lights. See, Wikipedia internet encyclopedia (“Public Good”).

Under traditional regulation, reliability cost was included in the regulated rate structure, insofar as planning reserve margins were established by voluntary organizations such as NERC and the costs of incremental generating plants built to maintain reliability were recoverable from utility customers. Now, there is a serious “free riders” problem because of the ability of electric customers to avoid incremental costs if there is an AES available to bypass the utility adding a new generating plant. The financial risks associated with this situation are addressed in the Fitch Ratings comments of April 22, 2005 (“Fitch Comments”) provided to the CNF.

**What is Reliability?** Under traditional regulation, reliability is “built in” to the existing system, since an electric utility’s duty to serve encompasses the obligation to construct and maintain a system capable of rendering quality service to its existing customers plus new customers it is obligated to serve as a public utility. Reliability has not been viewed as a tangible asset, but only as an attribute of electric service which is made possible by a multitude of decisions involving the type of system owned and operated by the utility and its acquisition of additional resources. For example, a utility such as Alpena Power can maintain reliability by lining up sufficient capacity through wholesale power purchase agreements and elect to build no new generation. The CNF has considered various options, including demand side programs and renewable energy, in developing the modeling scenarios and MEGA commends the Staff for including these
options. In focusing on the reliability option, the analysis should elaborate on how other options would be included and the degree of flexibility afforded to utilities to develop projects associated with reliability improvements. The proposal is founded on the assumption that the current environment is not providing sufficient incentive to encourage new capacity additions; therefore, regulatory intervention is needed and justified. MEGA agrees with Staff that the policy should provide sufficient revenue certainty to allow projects to be financed and constructed. Flexibility is important – utilities could propose differing solutions based on their individual circumstances. Examples include pre-authorized construction, pre-authorized rate of return, third party lease financing, purchase contracts, demand side programs and others, all contributing to reliability.

The Fitch Comments discussed this type of approach as its “hybrid market structure with a carve-out.” Fitch did not use the “reliability” label although it spoke of socializing the costs of the reserve margin, which is the same thing. The Fitch option contemplated a non-bypassable charge for either: (1) new utility owned generation additions; or (2) long term contracts with independent developers. Ultimately Fitch concluded that the special carve-out for new construction under the current hybrid market structure is not a desirable option because uncertainty about the future market would undermine credit quality of the investor-owned utilities and there would be an eventual need to reform the market structure to remove the financial risk. Fitch preferred a return to a regulated market which would eliminate the risk of load migration (free riders avoiding costs) and provide stability needed for long term power purchase agreements.

**Integrated Resource Planning:** Part 2 of the reliability application calls for analysis of the resource, need and public benefits. The CNF process is examining these items and if the proposal is in accordance with the CNF final report, would that provide the required support? An ongoing or repeated process like the CNF would provide useful information for planning and background purposes.

**Ratemaking Authority:** The proposal to include CWIP in rate base without an AFUDC offset appears to lie solidly within the ratemaking authority and discretion of the MPSC. All utility customers would be charged interest on the expenditures for a new generating plant during the construction period, before the project is operational. This has the advantage of spreading out the rate impact over time and reducing the size of the rate increase, since the construction interest recovered via CWIP is not capitalized. The CWIP policy may reduce project risk and financing costs. In previous cases, the Commission has applied a “used and useful” test from common law and perhaps contained MCL 460.557(2) (return on fair value of property “used” in the business). Opposing parties might argue that the CWIP-without-offset provision is illegal because it allows recovery of costs for non-useful property. The courts have tended to defer to the MPSC on this issue however, for assets such as property held for future use or mothballed plants that might be needed in the future.
Project Risks: It may not be practical to develop an iron-clad rule that caps recoverable value of the plant and establishes a firm in-service date. An alternative would be to approve the targets and require justification of any increases beyond the cap if there are significant changes during the project construction, particularly matters beyond the utility’s reasonable control. Michigan nuclear power projects experienced very large cost increases during the time of construction and multiple delays in the projected service dates. This was a function of the Three Mile Island incident, construction management issues and many other factors which remain as possibilities in the current environment and are difficult to predict. If there is a regulatory guarantee and the asset is needed, what happens if the project experiences overruns and delays and the contractors refuse to finish it without assurance that the additional costs will be paid and the utility balks at completion unless it is assured recovery? Naturally, the financial community prefers as much risk as possible be covered by utility customers. If such risks are not covered under the proposal, the availability and cost of financing may be affected.

Reliability Value Credit: It is unclear what is meant by the term “reliability value” associated with a new power plant. If some sort of financial rights are involved, more explanation is needed. Perhaps this refers to the enhanced reliability which exists because of the plant, due to its availability as a resource. All Michigan residents presumably get the benefit of the reliability, whether or not they use any of the power. The power can flow into the MISO wholesale market or the regulated state market, therefore the AES customers have theoretical availability.

More detail regarding this credit concept is needed to evaluate and comment on the overall reliability option proposal. MEGA recommends addressing the accounting and financial implications of the policy. Further, utilities should have flexibility, with the option of recovering CWIP from system supply customers but not choice customers. In such case, the choice customers would not have the capacity or financial rights contemplated in this proposal.

C. Competitive Bidding

Major plant construction involves large capital costs and financial risks. It is crucial for Michigan to secure the right type of power (base load, cycling, peaking, renewable, fossil, etc.) at the lowest possible costs. Utility construction, ownership, and operation of new generating plant is an option for securing that power so long as a better alternative is not available. That alternative might be a proposal by another entity to build the same plant at a lower cost. Therefore, any cost cap proposed by a utility in a reliability option hearing should be given considerable deference if the utility has undertaken a fair and open competitive bid.

The Staff proposal discusses an alternative whereby a bidding process is developed for the utility seeking a capacity addition to allow independent project developers to build the entire plant instead of utility-managed construction. In exchange, the utility would receive deference in the reliability option process for its proposed cost cap.

It is assumed that project competitive bidding will provide cost benefits. This is open to question and there may be advantages to allowing flexibility in developing projects
rather than establishing a fixed set of bidding requirements. We received an internal comment that competitive bids represent no more than opening gambits in the development process. A second round is needed to really pin down all the details at which point the anticipated leverage of competitive bidding disappears and the advantage turns to the successful bidder. Further, the use of bidding introduces more complexity and delay into the system because it requires policing and there would be many more parties with differing interests.

Astronaut John Glenn reported that his last thought before the first Mercury orbital flight was: "Here I am, sitting on top of the low bidder." This story illustrates the need to keep in mind the ultimate goal of a successful and good quality asset, not just a low cost. There should be some room for pragmatic judgment on non-cost considerations.

The use of competitive bidding in the development of new Michigan base load generation may occur for either: (1) a utility selecting the contractors and suppliers for its own project, or (2) solicitation of proposals from independent turnkey developers (IPPs, conservation projects, etc.) to fill an identified block of capacity. The following areas of potential difficulty should be addressed in the policy discussions of bidding:

- There may be a need for a new bureaucracy to police the bidding and the MPSC may lack statutory powers and resources to handle the task.
- Low-ball bidding could lead to serious problems down the road – the award based on lowest cost could come unraveled if the true costs prove to be higher and there are serious quality issues. You can't start over from scratch midway through the project.
- Disappointed bidders might sue and disrupt the process.
- Least cost bidding might lead to compromises on quality, unknown until some failure arises after the operational date.
- Mandating this type of bidding approach arguably intrudes on the utility's management function, and could lead to “Union Carbide” litigation unless there is a clear statutory provision.
- The MPSC Staff might be lobbied to favor alternate suppliers such as IPPs over the utility.
- Unions may object if the least cost approach favors or requires use of nonunion workers.
- Non-utility bidders may lack sufficient expertise to design their proposals to work well within the utility system.
- The bidding process could be susceptible to unethical practices such as disclosure of inside information and attempts to manipulate the result.
- Bids might be awarded to IPPs which have no public duties comparable to a utility's duty to serve. Also, the generating system becomes more fragmented and harder to manage.
- Bidding may result in a “race to the bottom” where low cost trumps all other considerations (mainly quality as noted above).
The overall point here is not to assume the virtues of competitive bidding without considering the risks. Wisconsin abandoned a former process involving a two-state CPCN and bidding.

Although Wisconsin does not have retail open access, wholesale electric customers have choice of suppliers and utilities gain and lose these wholesale customers. Even with this degree of wholesale choice, both We Energies and WPS have received advance approval from the PSCW to construct new coal-fired base load generating plants. If appropriate rules and frameworks are implemented, customer choice and rate of return regulation may be able to coexist. While the conceptual reliability option developed by the MPSC Staff may be within that framework, MEGA believes there needs to be more development and discussion.

D. Energy Efficiency

None of the parties submitting comments have opposed energy efficiency, and we expect that a demonstration that a proposed plant is the appropriate resource to meet an identified need would include an analysis of cost effective energy efficiency as a resource option.

It is reasonable to allow consideration of demand options in resource planning. Utilities should have the ability to include demand side programs in any RFPs developed under the reliability policy, or in general ratemaking. Flexibility is preferable to mandates in this area. At the same time, technology, options and markets for energy efficiency continue to evolve. Customers should be allowed to react to the changes and be provided price signals that accurately reflect cost and values and do not create or promote subsidization.

E. Construction Partnerships

As method to mitigate the risk of construction, Staff expects that utility proposal made under the reliability option would include an offer to other Michigan load serving entities to become partners in the plant.

In some situations it may be reasonable to seek participation by other LSEs in a generating project. Under the current market structure, the free riders risk is less with LSEs such as cooperatives and municipal utilities that are not full participants in retail open access. The LSEs should be allowed to negotiate the terms of participation in any project. At the same time, developing participation by others can be time consuming, difficult and impractical. Partnerships of competitors can lead to years of strife and eventual separation. Mandates in this area should be avoided.
F. **Market Power**

*Detroit Edison has articulated a concern that any new proposal to construct plant may cause it to violate market power provisions of 2000 PA 141. Other parties have indicated that allowing utilities to build additional generation will cause generation to become more concentrated in a few entities and cause an increase in market power.*

*Encouraging multiple party participation in any new plant construction should help alleviate market power concerns. This is not likely to eliminate those concerns, but allowing a more broad based participation in a construction project should decrease the concentration of ownership and allow parties to secure long-term power at stable prices.*

The market power issue arises from CCERA Section 10f, MCL 460.10f. With the relevant markets being defined as either the entire Lower Peninsula or the entire Upper Peninsula, the market power concerns do not affect Indiana Michigan Power Co or Alpena Power, MEGA’s members in lower Michigan. Market power issues will arise in the Upper Peninsula, because any sizeable generating facility in that small market can reach the 30% threshold and be in excess of the owning utility’s native load. Participation by other LSE’s may spread the risk somewhat; however, such participation is would likely be minor in the Upper Peninsula. This issue does point to the potential need to involve the legislature in policy reforms, if the market power situation becomes an obstacle to needed reliability improvements.

CCERA Section 10f was adopted before the MISO Day 2 market and FERC processes for defining market power. MISO, its market monitor and the FERC may be in the best position to handle market power, which calls into question the very need and relevance of Section 10f.

Respectfully submitted,

Dated: September 30, 2005

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MEC/NWF’s response, pages 90-91
COMMENTS TO THE MICHIGAN CAPACITY NEED FORUM

By

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September 30, 2005

On behalf of the National Wildlife Federation (NWF) and Michigan Environmental Council (MEC), we appreciate the Michigan Public Service Commission’s (MPSC) invitation to participate in the Capacity Need Forum (CNF). The following comments represent a collective NWF-MEC response to the staff proposal received at the August 29 CNF meeting.

- NWF and MEC fully support the MPSC’s conclusion that electric reliability is a public good—exhibiting non-rivalrous and non-excludable economic qualities—and that efficient and fair allocation of public goods across the demand schedule requires the prudent intervention of government and its agencies.

- In this case, the role of government should be to facilitate a dynamic process that ensures the public needs are met at a reasonable cost to both the consumer and the utility.

- Project review should be structured to evaluate the fiscal and reliability parameters of diverse projects (1) under likely future regulatory scenarios, such as the implementation of a renewable portfolio standard (RPS), state/federal mercury or carbon dioxide (CO2) emissions standards; (2) that exhibit the greatest degree of “public benefit”; and (3) seek to minimize disadvantages for smaller firms attempting to enter the power market.

- Full rights of Michigan ratepayers must be protected in any bidding process. Therefore, ratepayers must not be asked to bear any of the financial risk that belongs more appropriately to utility company shareholders. Moreover, it is critical to acknowledge that ratepayers participate in the Michigan economy in a variety of other, equally legitimate roles. As a result, they shoulder external costs of energy generation and delivery that are not captured in the billing process, including but not limited to pollution-related healthcare expenses and an enormous energy trade imbalance due to the state’s heavy reliance on imported fuels.

- In general, NWF and MEC support the Reliability Option detailed in the August 29 proposal. We strongly support the inclusion of “analysis of public benefits” listed under item (2) in this section. The term “public benefit” certainly deserves a lengthy qualification—extending well beyond a simple threshold of lowest cost. The MPSC’s emphasis on Construction Partnerships should reflect an expansive consideration of such benefits. In fact, there are examples of collaborative utility planning, such as in the State...
of Colorado, that involve a wide range of stakeholders early in the utility permit development process. Bringing together industry, public interest advocates and regulators is this way can ultimately lead to better decisions that save time, money and litigation.

- Also pertaining to Reliability Option sub-head, consistent with items (3) and (4), cost-recovery measures for new investments establish a viable means to promote projects that enhance a variety of public benefits and should be explored at length in proposals submitted to the MPSC. This should include incentives that reward proactive investment in new technologies that enhance public benefits.

- U.S. Energy Policy Act of 2005, Subtitle A, Section 215 states, “The term 'reliability standard' … does not include any requirement to enlarge [existing bulk-power system] facilities or to construct new transmission capacity or generation capacity.” NWF and MEC urge the CNF to similarly recognize that non-supply side options, which include energy efficiency and demand side management, should be considered as effective and legitimate means to achieve reliability requirements.

- There is extensive documentation that investments in energy efficiency often result in the cheapest, quickest new energy resource among competing options. The burden should therefore be on a utility making a proposal to demonstrate why energy efficiency is not the first, best option for a new energy resource, particularly since these projects could deliver increased domestic investment in Michigan’s struggling economy. Performance parameters of energy efficiency projects are well understood technically, and therefore can be assigned long-term values with a high degree of confidence. In contrast, future prices for traditional, fossil-based fuels can be highly volatile, and therefore carry greater risk exposure for Michigan’s ratepayers.

- It is vital that utility consumers have access to more information about price signals and a greater range of options in order to enable more nimble adjustments in customer behavior that improve overall market efficiency.

- Finally, in a pure economic sense, competitive bidding (or auctions), are often preferred as an efficient medium for resource allocation. Using this model the problem of asymmetric information over costs between large utilities (private) and governing agents (public) is often less problematic, particularly when evaluating winning bids among similar firms. The result is a cost minimization of something economist’s term “informational rents”. In other words, competitive bidding can prevent price-gouging when an information or resource advantage is present—which is of particular concern when addressing the allocation of public goods. It is important to note, however, that entering firms face significant disadvantages in these auctions due to production uncertainties, lack of bidding experience and incumbent market power. In addition, larger conglomerates possess a clear advantage in their ability to bid below, or short-side, actual project costs in order to win contracts, seeking compensating rents by means of rate recovery at a later date. For these reasons, bidding processes must be developed with clear parameters for contractual obligations and provide fair and equal opportunity to all parties large and small.
Knowledge Works’ response, pages 93 - 98
September 30, 2005

To: Mr. George Stojic  
Michigan Public Service Commission  
Capacity Needs Forum  

From: George Deljevic  

RE: Comments on Staff’s Values and Reliability Option  

Thank you for the opportunity to comment on the issues in front of the Forum. This is important work for each of us individually and certainly for the state as a whole, and your willingness to encourage and entertain diverse viewpoints is appreciated.

We are submitting a set of assertions and ideas that may appear provocative and that could be interpreted as lying outside the scope of the current discussion. However, our intention is not to lay blame or to stir the pot, nor is it to blithely expand the scope of the Forum. Rather, our intention is to add an element to the debate that is currently missing, and to offer some novel proposals for exploring alternative avenues for the achievement of energy policy objectives that serve the state as a whole. It is therefore our belief that we can best contribute to the discussion by proffering assessments and ideas that lie a bit outside of the mainstream of what has been posited to now. That said, we respectfully submit our views for your consideration.

**Overview and Commentary**

In our view, the discussion around electric industry structure to this point has been excessively dogmatic and lacking the blending and balancing of views and possibilities that is necessary for a breakthrough solution that works for everyone. Over the past two years, we have seen the utilities work to undermine forces of choice and competition, and we have seen the competitive forces work to undermine the utilities. In the meantime, the Commission has been forced into split-the-baby type comprises that don’t really work for anyone in the long term, and the Legislature has made an effort at reconciling these polar positions, understandably without great result.

It doesn’t have to be this way – there are certainly alternative, creative structures that provide the benefits of choice and competition and fair outcomes for the utilities and reliability. The key is to ensure that the opposite polarity between stranded cost recovery and viable choice and competition based market structures is dissipated, so that both may survive together. We also must ensure that reliability is not sacrificed at the altar of free markets - and vice versa – that the mantra of reliability is not used to as a stake to be driven into the noble heart of customer choice and supplier competition. Both sides – the utilities with their desire to return to the monopoly days of guaranteed returns and low accountability, and the free-marketeers with their assault on utility stranded costs and faith in the market to provide for long term investment and reliability – are tending towards extremes and missing opportunities for innovative solutions.
Values and Policy Objectives

We hope that the industry and policy makers can find a different track that will lead to a more balanced and effective approach towards achieving the state’s policy goals. With respect to these goals, the Staff has proposed the following values:

- Ratepayers come first
- Electric reliability is a public good
- We need to adhere to a fairness doctrine

These points are indisputable in the major sense, but they may not provide sufficient substance to formulate a truly effective policy regime. Of course ratepayers come first, but without serving the legitimate interests of the industry, neither will ratepayers be served. Taken to its extreme, this position would have suppliers provide energy resources without regard to profit.

The characterization of electric reliability as a public good - while correctly suggesting that market forces alone probably won’t solve reliability issues - connotes a lack of choice and accountability in the system of delivering reliability. If reliability were delivered in the means of other ‘public goods’ like, say, roads and bridges, then fees would be collected from all without regard to impact or use, and there would be little incentive for conservation and proper resource allocation. It is our belief that a more nuanced and comprehensive view of the system for provision of reliability is called for.

Finally, the notion of adhering to a fairness doctrine is of course unobjectionable. However, fairness can be notoriously difficult to define, with each interested party characterizing their claims as legitimate in the name of ‘fairness’. You have provided a skeletal interpretation (you get what you pay for), but we would suggest that the issue of fairness goes far beyond this realm. Is it fair to require all ratepayers to support resources that are chosen by the utilities, or by a government body? Is it fair to lock in a guaranteed rate of return to resource developers? Is it fair to put utilities in the driver’s seat when it comes to the development and/or selection of new resources? Fairness is a wide ranging discussion that is at heart a question of balancing the values and interests of all participants.

We would suggest an alternative set of policy objectives:

- To promote reliable electric service, so that all electric consumers can be assured power supplies that are continuously available, save for interruptions due to acts of God.
  - To promote a measure of electricity price stability, allowing for moderate pricing signals to balance supply and demand, while avoiding the extreme volatility that hinders effective financial planning.
  - To achieve a balance in the allocation of risk and reward between producers and consumers, in the support of the other objectives.
- To conserve the resources used in the production and consumption of energy in the state, including human and material (financial) resources, natural resources, and environmental resources.
- To provide consumers of electricity with a reasonable opportunity to meet their varied needs and desires in the marketplace.
- To account and make provisions for the social issues surrounding the electric industry.
We believe this set of objectives is broad enough to allow a wide frame of debate, while substantial enough to serve as a useful touchstone in the development and evaluation of various policy proposals.

The Staff’s Proposal

If our understanding is correct, the Staff has essentially proposed a utility driven system that would provide for new resources with substantial returns underwritten by ratepayer guarantees. Additionally - and laudably - the Staff has attempted to work in provisions to ensure competitiveness in the resource development and selection process, a doctrine of fairness for opportunities to participate in these developments, and a nod towards conservation.

The chief concern here is that there is a significant difficulty in allowing traditionally entrenched and powerful utilities to drive the resource selection and development process. Despite protective measures, oversight, or any other means to try and check the incumbents’ power here, one can be assured that the utilities will in fact be in control of the process. People and organizations being what they are, they will likely attempt to use this control to their advantage - whether or not it generally serves the state’s policy goals.

This is on the one side an issue of hard power, which can probably be addressed through various measures, but it is also on the other side an issue of soft power, which is much more difficult to contain. The soft power of which we speak is one of control of information, of the influence that comes from being the prime cause in a process, of the force of long reaching tentacles of organizations that have operated in every corner of the state for many decades. This sort of power is only seen behind the scenes and noted widely after the fact, and is therefore very difficult to control through standard policy measures. The best remedy is to break the chain of influence completely, to provide a system of ‘checks and balances’, where no one party, and especially no party that is generally unaccountable, can exert influence over the entire prospective resource base.

The Staff has made a strong effort at introducing a measure of fairness with regard to access to development opportunities and resource rights. Certainly there are aspects to the Staff’s proposal that could serve as useful constructs in a rigorous system of reliability provision. However, when coupled with the power granted to utilities in the process, it is hard to see how things will work out for customers or their chosen suppliers in the long run. Customers will pay reliability charges for resources developed and/or selected by the utilities, which will almost certainly present less than optimal resource selections due to the factors cited above; and suppliers will be forced into a position of negotiating with the local leviathans – not a happy prospect for anyone that understands what this can be like when the utilities hold the cards. We believe some form of the Staff’s proposals would work much better in a setting where the overall resource development and selection process was truly competitive.

Finally, it seems to us that nothing works better to promote conservation than accurate pricing signals, and this is an area where current and proposed Commission/utility policy falls woefully short. To wit, customers receive pricing signals that are average cost based, while the true value of conservation is in incremental cost avoidance. The swiftest and surest way to promote cost-effective conservation is to provide a mechanism that transmits accurate incremental cost pricing signals to those that are making the conservation decisions. (Witness the recent drop in gasoline consumption triggered by price
increases at the pump.) This we see nowhere on the horizon, and indeed, we are in danger of moving ever further from this with the pending utility unbundling and rate re-alignment proceedings. Under these proposals, a typical general service customer will see only about $0.05/kWh of value for each kWh of generation they don’t buy, while the true value of these kWh’s is on the order of $0.07 - $0.08/kWh. If approved, these proposals will put the final nail in the coffin of Michigan’s choice and competition program, and will put a lid on any future customer driven conservation programs.

A Sketch of An Alternative

As stated above, we believe the following objectives provide a useful frame for evaluating policy proposals, namely that any market structure should serve:

- To promote reliable electric service, so that all electric consumers can be assured power supplies that are continuously available, save for interruptions due to acts of God.
  - To promote a measure of electricity price stability, allowing for moderate pricing signals to balance supply and demand, while avoiding the extreme volatility that hinders effective financial planning.
  - To achieve a balance in the allocation of risk and reward between producers and consumers, in the support of the other objectives.
- To conserve the resources used in the production and consumption of energy in the state, including human and material (financial) resources, natural resources, and environmental resources.
- To provide consumers of electricity with a reasonable opportunity to meet their varied needs and desires in the marketplace.
- To account and make provisions for the social issues surrounding the electric industry.

It is our believe that only a market structure based on customer choice and supplier competition can best support the human and material resource conservation goals of point 2 and all of the goals of point 3, and that this assertion is generally self evident. It is also our belief that choice and competition are not incompatible with the other policy objectives (and may even be relatively supportive of these objectives measured against other options), but that certain structures are necessary to support the markets in these areas.

Since we won’t argue the self-evident benefits of choice and competition in holding down costs, promoting efficiency, and meeting varied needs and values of customers, we will offer some ideas on how choice and competition can be structured to serve the other objectives.

First, the foremost criterion for the provision of adequate energy resources is that those that can provide these resources – the industry – be presented with adequate incentive to do so. While of course we clearly don’t believe that a reversion to guaranteed 11% life-of-plant rates of return is reasonable, some form of market shaping is good and necessary. The primary financial risks facing resource developers are an oversupply of competitors, or a scarcity of customers. The first issue can be addressed by establishing a cap on the amount of generation capacity (or total resource availability if you want to include import capability) that may be installed in the state. The limit could be set at, say, 20% reserve margin, which would ensure that the market is at no time flooded, while providing freedom for any competitive developer to build up to this point.
On the customer side, the state may require all load serving entities to back sales to end use customers with two to five year contracts with generators or those ultimately controlling generating assets. This would ensure that signals would be sent for needed generation supplies, without tying retailers/customers into long term ‘marriages’ from which they cannot escape.

Finally, to protect against a general absence of load materialization, i.e., if load shrinks or doesn’t grow as projected, a system of price supports could be established that would provide resource developers with the ability to pay bank debt and return capital to investors without rewarding them with a guaranteed double digit rate of return. To those that scoff at this notion, we would only submit that the system of price supports in food production may well be credited with providing this country with an ample and stable supply efficiently produced at competitive prices.

Summary

In summary, in this paper we have argued the following points:

- In terms of the state of the industry, neither those that seem to want to stifle competitive markets in this state nor those that seem to want to throw the utilities to the wolves and place unquestioning faith in the markets are best serving the policy interests of the state.
- Consequently, policy makers have been forced into futile efforts to split-the-baby and to reconcile opposite polar positions, all with little to show in terms of substantive policy progress.
- It is time for an exploration of alternative and novel approaches that offer reasonable treatment for past investments, a system for the provision of reliability and resource adequacy, an opportunity for customers to choose and a requirement for suppliers to compete, and adequate provision for the social policy goals of the state.
- The Staff’s proposed value system, while generally unobjectionable, may not provide sufficient substance to formulate a truly effective policy regime. We have proposed an alternative set of objectives which do not contradict the Staff’s proposal but attempt to put in place a wider and stronger frame on which to hang various approaches.
- The critical flaw in the Staff’s resource addition proposal is to put utilities in the driver’s seat of the process. While regulatory structures may be able check the ‘hard power’ influence of these giants, it will be much more difficult to counter their ‘soft power’ capabilities.
- The Staff’s intentions with respect to introducing a measure of fairness in access to development opportunities and resource rights would be best served in a setting where the overall resource development and selection process was truly competitive.
- Thought the Staff attempts to address conservation, it is self-evident that the most effective means of conservation is through the transmission of timely and relevant incremental cost price signals to those making the conservation decisions (customers). This doesn’t seem to be on the horizon, and we are in fact in danger of killing conservation efforts through the current rate restructuring proposals before the Commission.
- Finally, we have argued that a market structure with customer choice and supplier competition at its center is, *prima facie*, the best means for meeting the varied needs and values of customers and for ensuring efficient use of resources; and that such a structure is not incompatible with, and can be supportive of, goals for reliability and other public goods.
A system of capacity caps, resource contracting requirements for LSEs, and minimum price supports was proposed as a means to provide resource suppliers with some assurance they won’t lose their shirt investing in the state, while still allowing for competitive forces, accountability, and the absorption of a substantial degree of risk by the suppliers.

We thank you once again for affording us the opportunity to submit our views, and we appreciate your indulgence in reviewing them – we hope that we have added something to your efforts and to the development of the issue at large. Please do not hesitate to contact us if we can be of any service to you.

Best regards,

George Deljevic
President
Knowledge Works, LLC
ITC’s response, pages 100-101
September 30, 2005

Mr. George Stojic  
Director, Engineering and Service Quality Division  
Michigan Public Service Commission  
6545 Mercantile Way, Suite 7  
Lansing, MI 48911

Re: Reliability Option Comments

Dear George:

International Transmission Company (“International Transmission”) is supportive of the efforts of the Michigan Public Service Commission (“MPSC”) to undertake an investigation into reliably meeting the energy needs of the State of Michigan. International Transmission is a stand-alone transmission company independent of market participants and is a member of the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”). International Transmission owns and maintains, but does not functionally control, approximately 2,700 circuit miles of transmission facilities covering approximately 7,600 square miles throughout 13 counties in Southeastern Michigan used for the transmission of electric energy in interstate commerce. International Transmission’s transmission facilities are under the operational control of the Midwest ISO. It indirectly serves a population of approximately 4.9 million in the State of Michigan. International Transmission is solely focused on electric transmission and offers the following limited comments on the Resource Addition Policy.

This letter addresses International Transmission’s comments on the Staff’s Capacity Need Forum reliability option policy proposal. It is International Transmission’s understanding that an applicant seeking the reliability option treatment for proposed generation would be required to include an assessment of transmission alternatives as part of the process. The comments below are directed at this aspect of the proposal.

There is a lot of information and expertise needed to be able to make an accurate assessment of possible transmission capacity expansion projects, and the benefits of those expansion projects for end use customers. Such an assessment is required to accurately compare a transmission expansion project to a generator capacity expansion project as proposed under the Reliability Option. It will be very difficult for any single entity to gather all the information necessary to accurately make such an assessment as the transmission constraints could be spread across many transmission owners who may participate in a variety of regional transmission organizations (“RTO”). The Midwest
ISO is probably the most logical regional transmission expansion planning expert, but they lack the local expertise and system specific knowledge necessary to identify, evaluate, and price out transmission projects and moreover may not even have the required level of familiarity related to transmission constraints that could lie outside of their footprint. In addition to assessing possible transmission projects, such an analysis should include an indication of the availability of generation capacity that could be used to fill the new transmission capacity “pipe.” Like transmission constraints, available resources outside of Michigan that could be brought in through additional transmission capacity may lie in different footprints. It is highly unlikely that anyone applying to add generation capacity via the Reliability Option would have the technical expertise to properly and equitably evaluate transmission capacity alternatives and associated outside generation capacity nor could they hire a true expert in the alternative. Anything they would come up with is likely to be incomplete and potentially incorrect thereby requiring even more verification of the results. Finally, it will not be a simple matter of comparing capacities as consideration would also have to be given to the probabilistic availability of transmission capacity and both inside and outside generation capacity.

Because of these complexities, instead of doing ad hoc studies for each Reliability Option application, perhaps a periodic comprehensive effort, involving the RTO and the affected Transmission Owner(s), along the lines of what is being done in the capacity needs forum might be a better approach. As an alternative, a periodic evaluation of transmission expansion possibilities and available outside resources could be undertaken with any applicants using this as a basis for the transmission “alternative”.

Lastly, we would expect diminishing value and increased difficulty in performing these transmission assessments over time for two main reasons: i) after the “low hanging in-state fruit is picked” the constraints are likely going to be pushed outside of Michigan and potentially even out of the Midwest ISO footprint and less information will be available on what could be done to mitigate these constraints; and ii) entities are likely to tire of this type of required repeated effort and will end up putting less effort into assessing transmission, especially those who don't have a large direct stake in the process.

In sum, making an accurate assessment of possible transmission capacity expansion projects including an indication of the availability of generation capacity that could be used to fill the new transmission capacity “pipe” requires a collaborative effort between transmission owners, RTOs and others. International Transmission recommends the MPSC acknowledge the need for this to be a collaborative effort and the important role and expertise that independent transmission companies bring when evaluating capacity needs.

Respectfully submitted,

Thomas Vitez
Director, System Planning
Energy Michigan’s response, pages 103-108
MEMORANDUM

TO: George Stojic
FROM: Eric J. Schneidewind
RE: Energy Michigan Comments on MPSC Strawman Proposal
DATE: September 16, 2005

Thank you for the opportunity to comment on the MPSC Staff "Reliability Option".

I. The MPSC Staff Proposal

The MPSC Staff "Reliability Option" appears to create a type of certificate of need process to acquire new generation which would be limited to regulated utilities. It is our understanding that hearings would be conducted in which the utility would describe the amount of capacity required, the timeframe of requirement and the type of technology (pulverized coal, IGCC, etc.) which would be utilized. Such a request could be accompanied by further requests for the right to charge customers for the cost of construction without an AFUDC offset and use of a non-bypassable surcharge applicable to all retail and competitive customers which would cover costs of the "reliability" component of the plant. The magnitude or items included in this "reliability" component have not been specified although it is stated that a "reliability credit" would be given for payment of the surcharge. While the MPSC Staff drafts mention the use of competitive bidding, the text of the Position Paper dated August 25, 2005 regarding competitive bidding appears to favor the regulated utility as the supplier of generation if its proposal is at all comparable with competitive bids.
II. Concerns Regarding the Staff Plan

A. The Staff Plan Must Be Coordinated With MISO Reliability Programs.

The Staff Plan attempts to address reliability issues associated with resource adequacy. However, resource adequacy is also an issue within the responsibility of regional transmission organizations such as MISO. There are significant economic risks associated with a failure to coordinate Michigan reliability/resource adequacy initiatives with any plan or approach adopted by MISO. Among these risks are diversion or redirection of power supply and inadequate or reduced dispatch of generating facilities. Energy Michigan urges the MPSC Staff to coordinate any resource adequacy initiative with MISO initiatives covering the same subject matter. Unilateral action by Michigan could result in significant, adverse financial consequences to the State.

B. The Staff Plan Appears To Minimize The Role Of Competition In Providing Michigan's Future Wholesale Power Requirements.

Many of the technologies which are mentioned as part of a solution to Michigan's future power requirements are as yet unproven at utility scale. A recent report issued by Standard & Poor's has highlighted the risks associated with IGCC plants and stated that financial interests either prefer not to finance such projects, will exact a premium to finance or will attempt to transfer performance and cost risks to customers because of the inherent risks of new technology. If the role of supplier is limited to utilities using a risky technology, Michigan loses the ability to force bidders to assume part or all of this risk and will not benefit from the downward pressure on pricing that results from competition to build new power plants. A shift of price and performance risk to customers also minimizes pressure on the utility as an operator which in turn may result in higher prices and worse performance than would be the case where the operator assumed performance
risks. The result of the Staff approach is likely to be power costs which are higher than would be the case using truly competitive bid procedures.

C. The Staff's Framework Ignores Commission Policies Which Are Eliminating Competitive Sources Of Retail Electric Supply.

Both current Commission approved generation related surcharges such as securitization, nuclear decommissioning, transition and the proposed new Regulatory Adjustment Charges and "reliability surcharge" all tend to charge competitive customers for utility generation costs while denying these customers the use of such generation. The magnitude and unpredictability of these charges has reached a point where competitors cannot match utility prices (particularly in a high market) and still stay in business. The magnitude of current charges (5-10% of generation costs) and projected charges (adding an additional 10% or more in the case of Regulatory Adjustment Charges) make it impossible to save money by switching to competitive sources of supply. The result of these unfavorable economics could be a massive transfer of competitor load back to utilities thereby aggravating the alleged supply problem and forcing acquisition by regulated utilities of even greater amounts of expensive new capacity. The Commission clearly has the power to reject new utility proposals to collect generation related charges from competitive customers who do not benefit from utility generation. Staff's proposal appears to worsen this situation rather than address the problem.

Forcing competitive customers to pay the costs of a new utility power plant is particularly unfair considering that such plants are likely to be the most expensive resource operated by the utility. Thus, competitive customers would be forced to buy into the utility's most expensive power plant while retail customers are allowed to purchase power at rates that average older lower cost plants with new higher cost plants. The result of this unequal treatment will be to further erode the economics of Electric Choice.
D. Legality.

It may be argued that the Commission has authority to allow utilities to collect the cost of construction of power plant from customers before such plants enter service. It has even been said that the Commission has authority to examine utility costs while a power plant is under construction. AG v MPSC, 412 Mich 385.

However, the above referenced Supreme Court interpretation of Michigan's statutory law found no authority for the Commission to grant prior approval of a utility power plant project and commit customers to pay the cost of the plant.

The Michigan regulatory framework does include provisions which allow the Public Service Commission to give prior approval to utility purchases of power and then commit that utility customers will be billed for and pay such costs. That power is specified in PA 304 of 1982.

III. Proposed Revisions to MPSC Staff Reliability Option.

A. Capacity Acquisition.

Energy Michigan recommends that the Commission utilize the PA 304 framework to acquire needed power supplies in Michigan. Under that framework a utility could issue a RFP for power supply specifying amount, timing and a statement of emission compliance that is required. Proposals to provide this power supply at the least cost with the most performance guarantees would be evaluated and a winner selected. The winning bid and underlying power supply agreement could be submitted to the Commission for prior approval with the assurance that the resulting cost would be billed to and collected from retail customers through the PSCR process.
The criteria for just and reasonable rates would be satisfied through the bid process. Use of a bid process would also assure that price, timing and performance risk could be transferred to the maximum degree possible to the winning bidder rather than utility customers. Several jurisdictions offer examples of effective bid processes.

If financial institutions are concerned that the Public Service Commission may alter their approval Order during the term of the contract, amendments to PA 304 of the type adopted for PURPA contracts in 1987 PA 81 could be proposed.

B. Assuring the Role of Competitive Retail Suppliers.

The Staff proposal is eloquent testimony to the fact that the generation fleet of Michigan's regulated utilities is fully utilized and that the market for any excess power is more than adequate to pay the costs of embedded generation. Yet, competitive customers continue to pay securitization, nuclear decommissioning, transition charges, and may pay new Regulatory Adjustment Charges and a new "reliability" charge. Collectively these generation charges are already so burdensome that they cannot be paid in the current market without rendering Choice service uncompetitive. The logical consequence of this situation is that competitors have been priced out of the retail supply equation by Commission policies which are clearly outdated and unsupportable in the current economic environment.

The equitable solution to this situation is to recognize that competitive customer payments for utility generation such as securitization or nuclear decommissioning represent a revenue stream which is paying overall utility costs of generation. Under these circumstances the competitive customers should be entitled to receive an amount of power at average utility rates which is equal to generation related payments to a utility. This proposal would ensure continuation of a revenue stream adequate to fund existing securitization and nuclear decommissioning trust funds and would not result in stranded
costs because power is taken in return for payments made much as is the case with a retail customer.

Continuation of the current MPSC pattern of requiring competitive customers to pay utility generation related costs in addition to the costs of competitive power is unsupportable in a market where all utility generation is either used by retail customers or commands a price in the marketplace that more than offsets existing costs of generation.

Conclusion

Energy Michigan appreciates the opportunity to comment on the Staff proposal and believes that the constructive comments offered above can make the Staff proposal more effective as a power supply mechanism and more equitable to all energy customers in Michigan.
LS Power’s response, pages 110-113
1. TO PERMIT DEVELOPMENT OF NEW ELECTRIC GENERATING CAPACITY IN MICHIGAN, THE STATE NEEDS TO REMOVE REVENUE UNCERTAINTY.

Prospective developers, owners and operators of new generating capacity can attract the equity and debt investment necessary to provide new generating capacity only under circumstances where there are reasonably predictable future revenues from the plant to provide a return of and return on investment. Revenues must be reliable for periods of 20 years or more. The greater the uncertainty of future revenues, the more expensive the capital, and the more expensive the power will be to consumers. There is a point at which uncertainty over future revenues cannot be overcome by increases in required equity returns and interest rates. When Michigan eliminated the legal monopoly on access to retail customers without providing other means of revenue certainty to power plant investors, that point was reached.

2. ANY METHOD OF PROVIDING ASSURED REVENUE, AND THEREFORE FINANCIBILITY, TO POWER PLANT DEVELOPERS AND OWNERS MUST PROVIDE THE MEANS TO MAKE THAT REVENUE ASSURANCE AVAILABLE TO NON-UTILITY PARTICIPANTS.

In the best interest of electricity consumers, the state of Michigan should devise a system which would extend to non-utility developers the same degree of certainty of future revenues that it provides utilities. If this forum succeeds in devising means to eliminate unacceptable revenue uncertainty to utilities, by a process like that described below or some other,
that revenue stream can as easily be used to make payments to a non-utility plant owner for power purchased as it can be used to service utility-incurred debt or provide returns to utility shareholders.

If the Public Service Commission or the legislature resolves the difficulties facing utilities in the development of power plants, and leaves the same issues unresolved for non-utility developers it may exacerbate the problem of the influence of the distribution monopolists over the generation market, which the legislature sought to curtail in section 10(f) of the Customer Choice and Electric Reliability Act of 2000.

3. NON-UTILITY PLANT OWNERS CAN OFFER COMPARABLE OR SUPERIOR OPTIONS TO WHAT UTILITIES MAY OFFER.

The majority of utility-scale power plants constructed in the United States over the past 2 decades have been conceived, developed, permitted, financed, constructed, operated and owned by companies other than regulated utilities. On the other hand, neither of the large investor-owned utilities in Michigan has constructed a new baseload power plant since the 1980's.

In response to requests for proposals to furnish new generating capacity in other states, non-utility developers have offered lower-cost, more reliable options than utilities. This has been possible because each potential new supply resource has different construction costs, site specific costs, and financing costs. In addition, non-utilities have provided unit efficiency and availability guarantees for their generating facilities, insulating ratepayers from performance risks associated the facility. It may be the case that the utility-proposed generating facility is best, or a that non-utility resource may prove to be superior. However, absent an evaluation to determine the lowest-cost, most reliable option, there is no way to credibly determine what option is best for the state’s ratepayers.
4. A PROSPECTIVE POWER PLANT DEVELOPER SHOULD BE ABLE TO OBTAIN A DETERMINATION OF A UTILITY’S NEED FOR CAPACITY AND THE FAIR COST OF POWER.

A process like that proposed in this forum as the Reliability Option can serve several needs, including the need to level the playing field for IPP participants. LS Power suggests that a contested case to determine (1) the capacity needs of a utility and (2) the fair cost to meet such needs should be within the ability of either the utility or a prospective capacity supplier to commence.

If the conclusion from a proceeding commenced by a supplier was that a need for capacity existed at the utility and that the price and terms for the supply of that capacity offered by the proponent were fair, the utility could then elect to enter into a contract for the provision of capacity and energy for substantially the life of the plant. If the utility did elect to contract for capacity on terms found fair by the Commission, recovery of payments made under that contract would thereafter be guaranteed to the utility more or less in the manner provided in Act 81, MCL 460.6(j)(13)(b), except that recovery of both capacity and energy charges would be guaranteed, and the supplying power plant need not be a qualifying facility under PURPA.

If, on the other hand, the utility declined to contract for the purchase of capacity and power on terms found fair by the Commission, it would not thereafter, for the expected life of the proposed plant, be permitted to recover any power cost in excess of that found to be fair but declined by the utility, in any PSCR case, because the decision not to contract for the power would be demonstrably imprudent.

Respectfully submitted,

LS Power Development Corporation
DTE’s response, pages 114-118
The Detroit Edison Company (“Detroit Edison” or “The Company”) commends the Michigan Public Service Commission’s Staff for its efforts in evaluating the need for new generation in the State of Michigan. However, the State of Michigan must act immediately to assure future resource adequacy. At a minimum, the State of Michigan must implement policies that assign (1) clear responsibility for resource adequacy and (2) explicit cost recovery mechanisms together with regulatory certainty to encourage investments in new generating facilities.

As noted in previous comments to the Capacity Needs Forum, Michigan’s hybrid regulatory structure has significantly complicated the capacity addition process. The introduction of Electric Choice has fragmented the responsibility for generation supply between incumbent electric utilities and alternative electricity suppliers. Michigan’s electric utilities no longer have sole responsibility for electric supply in their service territories. Without a certain and defined base of customers and the associated revenue certainty, both Michigan’s electric utilities and independent power suppliers face substantial financial risk associated with the construction of new generating facilities.

1. **Upfront regulatory commitment to new generating plant through formal case process**

   **Detroit Edison Comments:** As noted previously, any policy changes must be codified to insure the Michigan Public Service Commission possesses the unequivocal legal authority to implement such policies. In addition, a future Commission cannot be bound by a decision of the current Commission without modification to existing statutes. Given the tremendous investment required in new and existing generation infrastructure in Michigan, and the long-term financial assurances required by the capital markets, legislation is necessary to ensure that future Commissions could not alter the policies of the current Commission after the investments are made by the electric utilities. Therefore, an “upfront regulatory commitment” does not provide sufficient regulatory and revenue certainty – two key components to any reasonable capacity addition policy involving long lived, base load assets.

   (a) **recognition of need for plant and plant type**

   **Detroit Edison Comments:** The Company supports a legally binding Commission pre-approval process for the construction of new generating facilities. It is important to note that such pre-approval is a necessary, but not sufficient, condition for the construction of new generating facilities in Michigan. A pre-approval process would reduce, but not eliminate, the financial and regulatory risks associated with an after-the-fact review process with respect to capacity needs, fuel source and type of plant, construction cost estimates, and investment type (generation or transmission).

   In its June 16, 2005 comments, ABATE offered its position that the Commission lacks the statutory and common law power to conduct a pre-construction review of either the need or the cost of a new generating plant. Further, ABATE believes there is no revenue certainty surrounding the pre-construction review of plant costs, and that recovery of such cost can only be authorized upon a finding that the completed facility is “used and useful.” While Detroit Edison does not necessarily concur with the ABATE analysis, it illustrates the significant legal differences of opinion concerning the Commission’s powers in this area. Therefore, legislative action will be needed to both clarify and institutionalize the Commission’s powers over the construction of and payment for new generation plant in order to minimize legal challenges that will delay the addition of any such plant.
(b) enforceable commitment to capped price and schedule

Detroit Edison Comments: The Company agrees that the Commission should include a reasonable requirement for both the cost and schedule of construction of any new generating facility in its pre-approval process. However, the Commission should not limit recovery of prudently incurred expenses that may exceed the original estimate.

(c) demonstration that plant is the appropriate resource to meet need and analysis of public benefits, this needs to be demonstrated through a comprehensive planning assessment that evaluates risks and costs of traditional plant, renewable plant, energy efficiency, and load management

Detroit Edison Comments: The Company agrees that a process should include a reasonable analysis of the risks and costs of a traditional plant, renewable plant, energy efficiency, and load management. However, any programs adopted in conjunction with such analysis must be cost competitive with supply options.

(d) utility can request CWIP in rate base without an AFUDC offset

Detroit Edison Comments: The Company agrees with such a policy to allow Construction Work in Progress (CWIP) without the Allowance for Funds Used During Construction (AFUDC) offset as the new base load plant is being constructed. This would reduce the financial uncertainty and overall financing costs of the facility while supplementing cash flow during the construction period. Placing these CWIP rate adjustments into effect throughout the construction cycle has the added benefit of phasing-in the rate impact on customers.

(e) utility can request a reliability charge to be assessed to all distribution customers of the utility

Detroit Edison Comments: The Company generally supports the concept of a wires charge that would be assessed on all distribution customers of the utility for new capacity additions. New base load generating facilities in Michigan will not only increase overall system reliability, they will also likely reduce the market price of power and energy for all customers within Michigan. However, the MPSC must provide further details regarding the specific costs to be recovered by such a charge and the legal authority for the MPSC to impose such a charge on all distribution customers of the utility. In addition, such a charge should also be considered for existing generation that requires upgrades or environmental retrofits to maintain reliability (see further discussion on page 4). The wires charge must provide for sufficient revenue certainty for new generating facilities to be constructed in Michigan; it must also provide sufficient revenues to support the type of generating facility (i.e., base load, intermediate, peaking) required to meet load requirements in a least cost manner.

2. In exchange for paying the reliability charge associated with the plant, customers of an alternate electric supplier would receive a prorated share of the plants reliability value for satisfying any regional reliability standard. If customers of an alternate electric supplier pay the reliability charge, the alternate supplier would have a one time opportunity to make a pro-rata investment in the generating station
Detroit Edison Comments: While the Company generally does not object to the concept of allocating a pro-rated share of a generating facility’s reliability value for satisfying any regional reliability standard to an alternative electric supplier, the details of such an allocation and the process by which such an allocation may occur must be clear and precise prior to the construction of any new facilities.

With respect to the concept of an alternate supplier having a one time opportunity to make a pro-rata investment in the generating station, Detroit Edison does not support such an arrangement. Public Act 141 introduced retail competition to the State of Michigan. To now require incumbent electric utilities to partner with their competitors in the construction, operation and maintenance of new generating facilities is not only inconsistent with Public Act 141, but runs counter to the structure of any reasonable competitive market.

With regard to the issue of “satisfying any regional reliability standard,” it is important to note that load serving entities in Michigan operate under two very distinct reliability standards. Michigan utilities utilize an 11 to 15 percent planning reserve margin while alternative electric suppliers are only required to meet the North American Electric Reliability Council East Central Area Reliability Coordination Agreement’s requirement of a four percent daily operating reserve pursuant to the Midwest Independent System Operator’s tariffs. It is of the utmost importance that all load serving entities within the State of Michigan operate under the same reliability standards. The Commission’s policy should address this inconsistency.

3. Competitive solicitation for new capacity is mandatory through a fair and transparent process. There would be a rebuttal presumption that a cost cap proposed by a utility in a reliability hearing is reasonable if the utility has undertaken a fair and open competitive solicitation.

Detroit Edison Comments: The Company believes that the public interest will be fully protected if competitive bidding is limited to the Engineering, Procurement and Construction (EPC) aspects of generation development. Developing natural gas-fired peaking and combined-cycle plants is characterized by few permitting and siting issues, standardized design specifications and short construction periods. Plant values are in the several hundred million dollar range and the development risks, other than market, are minimal.

On the other hand, coal-fired plants are far more difficult to permit and site, have complex design requirements and involve substantial more time to construct. Plant values are in the several billion dollar range and the development risks, beyond market, are large given the uncertain and evolving environmental compliance regulations and potential climate change requirements.

A turnkey fixed price guarantee for a major coal-fired power plant, which could take seven plus years to complete, would require a considerable risk premium to be included in any firm construction cost guarantee. Competitive bidding does not ensure the lowest possible all-in construction cost and introduces further uncertainty into an already complex permitting and construction process. Other recognized methods are available, such as benchmarking, to establish the reasonability of construction costs.

It is important to note that in any competitive capacity solicitation process, IPPs would likely seek a long-term Purchase Power Agreement (PPA) with the incumbent utility. A long-term PPA is required to provide project revenue certainty in order to finance the generation project. In order not to financially harm Michigan's electric utilities through a long-term PPA, the following two polices must be considered:
First, the current hybrid structure does not provide customer load requirement and regulated revenue certainty for Michigan’s electric utilities. Consequently, a utility’s long-term purchase commitment to an IPP would not be matched by a corresponding long-term purchase commitment from the utility’s customers and the utility would be at risk to recover its PPA costs. Therefore, a regulatory out clause may be a necessary provision in any new PPA.

Second, rating agencies currently recognize PPAs as off-balance sheet debt and impute it into the capital structure. Additional equity capital would be required to maintain the same pre-PPA debt to equity ratio and credit rating. The incumbent utility must be able to earn a return on the additional equity capital required to maintain a balanced capital structure and which would also provide a financial incentive to contract rather than build.

4. A utility proposal made under the reliability option would include an offer to other Michigan load serving entities to become partners in the generating plant.

 Detroit Edison Comments: The Company supports such partnerships with traditional Michigan load serving entities – investor-owned, municipal and cooperative utilities – in future generating facilities.

- Issues Not Addressed in the MPSC Staff’s Proposed “Reliability Option”

Investments in Existing Generation

In Detroit Edison’s original comments to the Capacity Needs Forum, the Company noted that as long as the current hybrid regulatory structure remains in Michigan, investments in base load generation, whether new or existing, are at risk. As new base-load capacity is added in Michigan, the market price for energy will likely decline. This decline in price will only serve to lower the market value of existing generation and increase the prospect of additional stranded cost.

Adopting new regulatory policies to provide revenue certainty to facilitate new generation investment creates substantial economic and financial risk distinctions between new and existing generation with existing generation clearly at risk. Such a policy distinction will likely lead to unintended consequences whereby low cost capacity expansions on existing generating units are forgone for investment in new generating facilities that may be of lower financial risk due to inconsistent regulatory treatment.

It should be noted that for all their shortcomings, RTO-managed capacity markets have not distinguished between new and existing generation when applying capacity charges. The reason is that all capacity is required to provide system reliability. If new generation that provides only a small portion of the total supply reliability is deemed to be a public good, then the same must certainly be true for existing generation.

Michigan electric utilities have and will be required to make massive investments in environmental retrofits at existing coal-fired generating plants. It is not good public policy to treat large generation investments in Michigan differently for regulatory cost recovery purposes simply because one occurs in a new plant and another in an existing plant to preserve its operation. Without preserving existing capacity, Michigan will require much greater investments in new capacity.
Market Power

In Detroit Edison’s original comments to the Capacity Needs Forum, the Company noted that the market power provisions of Public Act 141 appear to conflict with the addition of new generating capacity in Michigan’s hybrid regulatory structure. While the MPSC Staff notes this concern, the MPSC Staff’s proposal does nothing to address the potential conflict.

This is another clear example of the legal ambiguity surrounding the development of new generating facilities in Michigan. Lower cost financing can only be achieved by reducing the regulatory uncertainty relative to future resource additions.

Conclusion

Detroit Edison appreciates the Commission Staff’s efforts to determine the need for new generation and to recommend policies to ensure that needed generation infrastructure investments are made in Michigan. The results from the New Energy Associates modeling efforts clearly show that Michigan may need to install approximately 7,000 MW of new generating resources in the next ten years to provide reliable, least-cost power supply.

The Company believes that the current electric market structure in Michigan will not enable these investments to be made in the absence of significant policy changes. While the Commission Staff has proposed policy recommendations to address several significant investment impediments, these recommendations do not provide the revenue and regulatory certainty, and specificity, commensurate with multi-billion dollar investments in long-life base load generation assets.

Specifically, Michigan’s current hybrid market structure fails to provide a stable customer base and hence creates uncertain customer supply obligation and corresponding regulated revenue stream. It is entirely possible that the customer base that existed at the time development commences for a new coal-fired plant, and created the need for the utility to build the plant in the first place, will not exist when the plant is placed into commercial operation. It is simply not possible to develop and finance long-life, capital intensive investments, or enter into long-term supply agreements (PPAs), in this hybrid market environment.

In addition, developing new power plants is inherently more risky today than it was 20 years ago when the last base load plants in Michigan were placed into commercial operation. This is due to fuel price uncertainty and volatility and uncertain and increasingly more stringent environmental control requirements. Consequently, it is essential to have regulatory and revenue certainty through a legally binding pre-approval process, a certain customer base, and a non-bypassable cost recovery revenue stream in order for any base load generation capacity additions to occur in Michigan.

Michigan’s electric utilities must not be required to do what the wholesale markets have not done, namely develop new capital-intensive merchant base load generation. This is precisely what would occur if Michigan’s electric utilities are required to develop, directly or indirectly through PPAs, new base load generation in the absence of the required policy changes to Michigan’s existing hybrid electric market structure. Achieving these policy changes will be a major challenge, but they must be made if Michigan is to have a long-term, least-cost and environmentally responsible generation portfolio.

The Company looks forward to working with the Commission Staff, and other stakeholders, through the Capacity Need Forum to develop the policy recommendations that will ensure that the needed generation infrastructure investments are made in Michigan.
Lansing Board’s response, pages 120-121
September 16, 2005

Mr. George Stojic
Michigan Public Service Commission
6545 Mercantile Way
PO Box 30221
Lansing, Michigan 48909

Dear Mr. Stojic:

In response to your request, the Lansing Board of Water & Light (BWL) presents the following comments regarding Reliability Options, Competitive Bidding, Energy Efficiency, Construction Partnerships, and Market Power.

Reliability Options

The BWL supports the concept of retaining the traditional method of building a new generating plant and seeking fair and just rate compensation. With respect to the Reliability Option, our understanding is that the BWL’s customers will not be subject to the proposed reliability charges nor the proposed credits so we have adopted a neutral position at this time. However, we do believe that the Commission’s Reliability Option has merit for further consideration as the details of the reliability charges and credits are more fully finalized.

Competitive Bidding

The BWL supports competitive bidding for power plant construction.

Energy Efficiency

The BWL supports the concept of including an analysis of cost effective energy efficiency as a resource option. Energy efficiency is not necessarily always the primary driver of the best resource option but it should be a consideration. As an example, a lower cost peaking plant that is not as efficient as a more expensive peaking plant may be the best value for the industry if the peaking plant is to run only a few hundred hours per year.

Construction Partnerships

The BWL strongly supports the concept of construction partnerships for base load power plants. Smaller load serving entities, such as the BWL, should be allowed to become partners in a base load plant. This partnership should be required before the MPSC will even entertain rate treatment of the proposed base load
plant. In addition, necessary transmission rights for the base plant output needs to be provided to all plant participants.

**Market Power**

The BWL strongly agrees that new base load plant construction should be open to all parties. The statement needs to go further to require contracts that allow access to plant and company information and do not discriminate or create adverse difference to minority partners.

As a municipal electric utility, the BWL puts the welfare of customers first. We feel our positions as discussed above will allow for a positive effect on our customers. Thank you for allowing us the opportunity to provide input and the BWL looks forward to working with the MPSC and others in the future for the betterment of the customers of electric utility businesses in Michigan.

Petc Schimpke

Lansing Board of Water & Light
Manager, Resource & System Planning
730 E. Hazel
PO Box 13007
Lansing, Michigan 48901

CC- Bill Cook –BWL
Doug Wood- BWL
RESA's response, pages 123-124
Retail Energy Supply Association
Post Office Box 6089
Harrisburg, PA 17112

September 26, 2005
Ms. Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

Re: Capacity Needs Forum, Docket No. U-14231
Comments of the Retail Energy Supply Association

Dear Ms. Kunkle:

The Retail Energy Supply Association\(^1\) ("RESA") is a nonprofit organization and trade association that represents the interests of its members in regulatory proceedings and legislative matters in the Mid-Atlantic, New York, and New England regions. RESA is also beginning to participate in matters in the Mid-West that may impact the development of competitive retail electricity markets. Its members include providers of competitive retail energy supply. RESA appreciates the opportunity to submit these comments regarding the Commission Staff's proposal to maintain capacity adequacy being developed in the above referenced docket.

RESA opposes utility ownership of generation. Utility-owned generation undermines competitive markets. This is because utility ownership of generation increases the utility’s incentive to retain customers on utility service in order to create or retain a large base to pay for the costs of the generation. Utilities that own generation are subject to pressure to create barriers to customers exercising choice in their retail supply. Thus, RESA opposes the Commission Staff's comments regarding the "Reliability Option". RESA’s concerns are not allayed by the statement that this option should be pursued only “so long as a better alternative is not available”. Rather, RESA is concerned by Staff’s declaration that “electric reliability is not likely to be provided by a competitive market alone”. Moreover, there is no evidence that supports Staff’s position. Proposals supportive of utility ownership of generation are contrary to the public policies that supported the

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\(^1\) RESA’s members include Amerada Hess Corporation; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Reliant Energy Solutions; Select Energy, Inc.; Sempra Energy Solutions; Strategic Energy, LLC; SUEZ Energy Resources NA, Inc. and US Energy Savings Corp. The opinions expressed in this filing may not represent the view of all members of RESA.
implementation of competitive wholesale and retail electricity markets in Michigan and other markets.

The expansion of utility-owned generation and rate base recovery in Michigan will exacerbate the host of problems already created by the utilities' continuing ownership and operation of generation. Due to a market design that continues to permit heavy utility influence and activity in the competitive market, retail competition has been slow to emerge in Michigan. Creating additional utility-owned generation will hinder further development of the competitive marketplaces, both retail and wholesale. Utilities must exit the competitive segments of the market (i.e., wholesale and retail segments) in order for competition to develop and flourish. A properly functioning retail market requires that the utilities focus on and remain efficient in providing energy distribution services. Utility participation in generation markets will detract from this focus and will be deleterious to the emergence of a competitive retail electric market.

Equally troublesome, utility ownership of generation greatly enhances the potential for subsidies from the distribution business of the utility to its generation business. Such subsidies distort wholesale and retail electric markets. Moreover, these subsidies can cause irreparable damage to market development before they can be discovered, which is a difficult task in and of itself.

Finally, expanding utility ownership of generation carries with it an unacceptable possibility of creating stranded costs that may ultimately have to be passed through to Michigan consumers. The market is capable of producing capacity construction at the proper times in appropriate locations and with the greatest efficiency. Moreover, shareholders—not ratepayers—will bear the risk associated with new non-utility construction.

Fortunately, the Commission has numerous market-based options available to it to address future capacity needs. Staff can and should use market-based mechanisms to employ market forces to address capacity requirements. Staff correctly notes that regional reliability organizations take active roles in promoting reliability. While RTO/ISO markets continue to evolve, it is clear that they are markets, and that reliability concerns can be adequately addressed through these markets. Consequently, RESA recommends that the Commission avail itself of market-based alternatives.

RESA looks forward to working with Staff and other stakeholders to develop market-based mechanisms to ensure continuing reliability. If you have any questions regarding the foregoing, please contact the undersigned.

Very truly yours,

Ms. Tracy McCormick
Executive Director

cc: Hon. J. Peter Lark, Chairman
Hon. Monica Martinez, Commissioner
Hon. Laura Chappelle, Commissioner