

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
CONSUMERS ENERGY COMPANY for)
certification pursuant to Section 32(k)(2) of) Case No. U-11954
the Public Utility Holding Company Act of 1935.)
_____)

At the June 10, 1999 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. David A. Svanda, Commissioner
Hon. Robert B. Nelson, Commissioner

ORDER

On April 6, 1999, Consumers Energy Company (Consumers) filed an application requesting certification pursuant to Section 32(k)(2) of the Public Utility Holding Company Act of 1935 (PUHCA), 15 USC 79z-5a(k)(2). Consumers, a combination electric and gas utility located entirely in the state of Michigan, is a wholly owned subsidiary of CMS Energy Corporation (CMS) and a sister company to CMS Enterprises. CMS Enterprises wholly owns CMS Generation Company, which owns CMS Generation Michigan Power, L.L.C., (Michigan Power).

Consumers represents that Michigan Power is an exempt wholesale generator (EWG) as that term is used in Section 32 of PUHCA, 15 USC 79z-5a. Consumers proposes to enter into certain energy purchase agreements and electric energy call option agreements that it has negotiated with

Michigan Power. Consumers represents that these agreements will assist it in ensuring the availability of sufficient capacity to meet its anticipated peak demand this summer.

Section 32(k)(1) of PUHCA prohibits electric utilities from entering into a contract to purchase electric energy at wholesale from an EWG that is an affiliate or associate company of the utility. However, Section 32(k)(2) provides that a utility may gain an exemption from that prohibition if every state commission that has jurisdiction over the retail rates of the electric utility makes certain specific determinations in advance of the electric utility company entering into the contract:

- (1) A determination that the commission has sufficient regulatory authority, resources, and access to books and records of the electric utility company and any relevant associate, affiliate, or subsidiary company to exercise its duties under this provision.
- (2) A determination that the transaction will benefit consumers, does not violate any state law, would not provide the exempt wholesale generator any unfair competitive advantage by virtue of its affiliation or association with the electric utility company, and is in the public interest.

Consumers states that it is appropriate that the Commission make each of these findings with respect to the contracts that it has negotiated with Michigan Power. It notes that the finding concerning the Commission's authority, resources, and access to books and records is similar to the finding that the Commission has made in connection with applications for certification pursuant to Section 33 of PUHCA, 15 USC 79z-5b, that the Commission has the authority and resources to protect ratepayers subject to its jurisdiction with respect to the utility's investments in foreign utilities. Consumers further argues that the Commission has already established guidelines for transactions between the utility and its affiliates in the December 7, 1989 order in Cases Nos. U-8678, U-8924, and U-9197 (related to Consumers' gas utility) and in the May 7, 1991 order in Case No. U-9346 (related to Consumers' electric utility). Those guidelines include a provision

requiring Consumers to ensure that the Commission has access to relevant books and records of the holding company and each of its affiliates and their joint ventures.

Consumers argues that the transactions will benefit ratepayers because the agreements will provide Consumers with additional electric generating capacity for use during peak demand periods. It says that the transactions do not violate any state law, including any applicable laws concerning least cost planning, because there is no state law prohibiting the transactions. It says that the proposed transactions do not provide the EWG with any unfair competitive advantage because the call option agreements were negotiated and no preference was given Michigan Power. With respect to the energy purchase agreements, it says that the pricing is based on Consumers' incremental energy costs, and thus provides assurance that Michigan Power will be compensated no more than the cost of alternative energy available to Consumers. It further represents that the pricing mechanism in the agreements assures that Michigan Power receives no unfair competitive advantage with respect to the limited, unscheduled energy deliveries to which these agreements apply. Finally, Consumers says that it has entered into comparable agreements with several other nonaffiliated developers of in-state generating capacity that is expected to be available this summer.

On May 13, 1999, the Association of Businesses Advocating Tariff Equity (ABATE) filed a response to the application. ABATE takes the position that unless the Commission makes findings beyond those requested by Consumers, it cannot conclude that the transactions will benefit customers or be in the public interest. It says that there is a strong possibility that the financial terms in the agreements are substantially above market rates. ABATE requests that, if the Commission grants the application, it find that any above market costs will be imputed as revenues to Consumers when establishing just and reasonable rates in Case No. U-11560, a complaint brought by ABATE for a reduction in Consumers' electric rates. ABATE denies Consumers'

assertion that the suspension of its power supply cost recovery clause is sufficient to protect customers from above market rates. It says that the proposed contracts may serve to transfer profits from the utility to an affiliate at a time when the utility's rates are under investigation. ABATE also says that Consumers has entered into these transactions in direct violation of the Commission's June 12, 1992 order in Case No. U-9586, which established a competitive bidding framework for obtaining new capacity. Finally, ABATE says that there is no basis for the Commission to find that Consumers' affiliate did not gain any unfair competitive advantage in the transactions.

On May 17, 1999, Energy Michigan filed a response to the application. It says that Consumers granted its affiliate an unfair competitive advantage by granting terms and conditions that were not made available to others, making plant sites and interconnection facilities available that are unavailable to nonaffiliated competitors, providing its affiliate with assurances that the power will be purchased, and assuring a payment schedule under which approximately 75% of the capital costs will be recovered before January 2002. Energy Michigan requests that the Commission deny the application and order Consumers to comply with the order in Case No. U-9586 or, if the power is needed this summer, limit the payments to a cost-of-service rate and order a competitive solicitation consistent with the order in Case No. U-9586 for future years.

On May 24, 1999, Consumers filed a reply to Energy Michigan. Consumers indicates that the Michigan Power generating facilities, which are the subject of the application, are being tested and will be ready for commercial operation this summer. Consumers states that the Michigan Power contracts are included in the resources that Consumers has identified in its plan for meeting the utility's 1999 summer peak load and Michigan Power is currently evaluating other marketing options for sale of the power. Consumers contends that it did not offer Michigan Power any assurances that its power would be purchased, that the rates in its agreement are lower than the

cost-based rates that Michigan Power has filed with the Federal Energy Regulatory Commission, and that of the two sites purchased by Michigan Power for the generating plants, one was purchased from an unrelated third-party and the other was purchased from Consumers at a price determined by a market appraisal. Furthermore, Consumers contends that it was willing to enter into a ten-year power sales agreement with Nordic Electric (Nordic), an Energy Michigan member, but that Nordic ultimately informed Consumers that it would be unable to proceed with the project. Finally, Consumers argues that its contracts with Michigan Power do not violate the Commission's capacity solicitation order in Case No. U-9586 because that process applies only to long-term capacity arrangements.

On June 1, 1999, Energy Michigan filed a reply to Consumers. According to Energy Michigan, Consumers' response to Nordic's power sales offer indicated that the utility's willingness to enter into an agreement with Nordic was conditioned upon the inclusion of an affiliate of Consumers in the venture and that Consumers' affiliate assisted the utility in responding to Nordic's offer. Furthermore, Energy Michigan claims that Consumers did not respond to Nordic's offer until November 20, 1998, even though Nordic had previously indicated that it would need an answer by October 15, 1998 in order to be able to proceed. Energy Michigan contends that Consumers' arguments regarding a shortage of capacity this summer must be considered in light of Consumers' request to sell 100 megawatts of power to PECO Energy Company (PECO). Finally, according to Energy Michigan, the costs of the Michigan Power generating plants are almost double the amount that a Commission Staff study had found to be reasonable.

Discussion

This is basically a case of first impression. No utility in Michigan has previously requested certification pursuant to Section 32(k)(2). Consumers does not cite any comparable case from another state and the Commission is unaware of any. In reviewing Consumers' request for an exemption, the Commission has considered three important objectives. First, of course, it is necessary to determine whether the statutory prerequisites for an exemption have been met. Second, the impact upon the ability of Consumers to meet its capacity needs for this summer must be considered. Finally, the Commission must evaluate whether granting the exemption will further the development in Michigan of a competitive market for generation.

With respect to the first statutory prerequisite, the Commission has the authority, resources, and access to books and records sufficient to exercise its responsibilities under Section 32(k)(2). The second prerequisite is that the transaction be in the public interest and not confer any unfair competitive advantage upon the EWG by virtue of its affiliation. From the application and responses, it is not clear that this requirement has been met. The Commission has approved a competitive bidding framework for obtaining new capacity in Case No. U-9586. For reasons that have not been adequately explained, Consumers has chosen to enter into agreements with its affiliate rather than complying with the capacity solicitation process approved in Case No. U-9586.¹

¹The Commission is aware that Consumers claims that Case No. U-9586 applies only to long-term power purchase arrangements and cites the Commission's approval of a purchase by The Detroit Edison Company (Detroit Edison) from Ontario Hydro in Case No. U-10939. However, the Commission's order made it clear that the capacity solicitation requirement did not apply in that case because the purchase was intended to be a substitute for capacity from the Ludington Pumped Storage Hydroelectric Plant that Detroit Edison had leased to another utility and hence was not a purchase of additional capacity. Consumers does not claim that the capacity purchase in this proceeding is intended to be a substitute for other capacity that it has sold or leased.

Furthermore, there are claims that Consumers has unfairly delayed negotiations with unaffiliated generators and conditioned its willingness to enter into agreements on the inclusion of Consumers' affiliates in the venture. These claims, coupled with Consumers' unexplained failure to comply with the capacity solicitation requirements, call into serious question whether the agreements provide Consumers' affiliate with an unfair competitive advantage and are in the public interest.

However, Consumers believes that it needs additional capacity to meet its needs for this summer and has made arrangements to purchase that capacity from its affiliate. Clearly it would not be in the public interest to turn down Consumers' requested certification if that action results in a shortage of capacity for Michigan citizens this summer. In the past, the Commission has repeatedly stated in its orders that utilities have an obligation to plan to meet the electricity needs of their customers. In fact, R 460.3503 of the Michigan Administrative Code requires that electric utilities shall have "electric capacity regularly available from all sources [that] shall be large enough to meet all normal demands for service and to provide a reasonable reserve for emergencies." Under the circumstances, the Commission finds that the requested certification should be granted for one year, with conditions necessary to ensure that the statutory prerequisites are met.

ABATE and Energy Michigan suggest that the price that Consumers has agreed to pay its affiliate will prove to be above market rates. To some extent that concern can be alleviated by permitting the parties to Case No. U-11560 to argue that any above-market revenues should be imputed to Consumers in determining just and reasonable rates for its customers. However, that remedy alone would not eliminate any unfair advantage that Consumers' affiliate may have gained over its competitors. To address this concern, the Commission finds that, within 15 days, Consumers should file with the Commission and give broad national publicity to a request for proposals (RFP) offering any non-affiliated generator an opportunity to enter into a comparable three-year agreement

under substantially the same terms and conditions that Consumers offered to its affiliate but at a price lower than Consumers agreed to pay to its affiliate. If no unaffiliated generator is able to beat the affiliate's price, then Consumers may renew its request for an exemption for the remaining two years of its contract. This requirement will address the immediate concern that non-affiliated generators were not provided with an opportunity to fairly compete with Consumers' affiliate to build this capacity.² However, it does not address the longer-term problem that extends beyond this application.

It has become apparent that some Michigan utilities are engaged in a pattern of waiting until the last minute to file applications with the Commission in highly controversial cases and then using the threat of a summer power shortage as an argument for expedited consideration. Last year, Detroit Edison waited until March 31 to file a request in Case No. U-10840 for an exemption from the capacity solicitation requirements so that the utility could restart its mothballed Conners Creek generating plant. This year, Consumers waited until April 6 to file an application for EWG certification even though the utility knew, or should have known, that its request would be highly controversial.³ This pattern of waiting until the last minute to file an application and then demanding expedited consideration is not conducive to setting good public policy or to the development of a fair and competitive market for electricity in Michigan. Furthermore, the potential for power

²The November 25, 1998 RFP issued by Consumers and attached to Energy Michigan's response was not filed with the Commission and did not comply with the requirements of Case No. U-9586. Moreover, the fact that the RFP limited proposals to the summer of 1999, in contrast with the three-year contracts with Michigan Power, is further justification for the one-year limitation on the Commission's approval.

³Similarly, even though Consumers signed an agreement with PECO on March 5, 1999, the utility waited until March 19 to file an application in Case No. U-11941 and then requested that an order be issued by the end of April.

shortages in Michigan can be directly attributed to the utilities' failure to comply in a timely manner with the capacity solicitation requirements of Case No. U-9586.

Accordingly, the Commission finds that, within 30 days, Consumers should be required to commence a capacity solicitation consistent with the June 12, 1992 order in Case No. U-9586⁴ or, in the alternative, file a proposal for a revised capacity solicitation process that will assure a competitive electric power market in Michigan in which all generators have a fair opportunity to participate.⁵ In making this determination, the Commission wishes to emphasize that the Commission's goal is to remove itself from the capacity solicitation process. Having the Commission oversee capacity solicitation is necessary only because existing market power and affiliate relationships make it impossible for a fair, competitive market to exist at the present time.⁶ The Commission remains committed to working towards an open competitive market in which capacity solicitation overseen by the Commission is no longer required.

With the concerns resolved by the conditions discussed above, the Commission concludes that Consumers' proposed transactions will benefit ratepayers, will not violate any state law, will not provide the EWG with an unfair competitive advantage, and will be in the public interest. By

⁴The only proposal for restart specifically addressed in Detroit Edison's 1998 request in Case No. U-10840 was Connors Creek. If Detroit Edison plans to restart or build new plants, either on its own or through affiliates, it should also adhere to existing capacity solicitation requirements.

⁵Of course, the Commission reserves the right to initiate a capacity solicitation process or a revision of such process on its own motion should Consumers' proposal prove to be unsatisfactory.

⁶The Commission notes that the only reason for its involvement in the current proceeding is because Consumers is seeking an exemption from what would otherwise be an absolute statutory prohibition against dealing with its affiliate.

reserving jurisdiction over this matter, the Commission will reevaluate these determinations following a review of the RFP and the capacity solicitation process.

Ex parte approval is appropriate because no customer's rate will be increased.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; MSA 22.151 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; 15 USC 79z-5a; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACCS, R 460.17101 et seq.

b. With respect to the transactions described in Consumers' application, the Commission has the authority, resources, and access to books and records sufficient to exercise its duties under PUHCA.

c. As discussed above, the proposed transactions will benefit ratepayers, will not violate any state law, will not provide the exempt wholesale generator any unfair competitive advantage, and will be in the public interest.

d. The parties to Case No. U-11560 can raise in that case the arguments that the proposed transactions contain financial terms that are above market values and that the difference between the market rates and the contract rates should be imputed as revenues to Consumers for purposes of establishing just and reasonable rates.

e. Consumers should be required to file an RFP consistent with this order.

f. Consumers should be required to commence a competitive capacity solicitation consistent with the June 12, 1992 order in Case No. U-9586 or file a proposal for a revised capacity solicitation process.

g. Ex parte approval is appropriate.

THEREFORE, IT IS ORDERED that:

A. The certification requested by Consumers Energy Company pursuant to Section 32(k)(2) of Public Utility Holding Company Act is granted for one year.

B. Within 15 days, Consumers Energy Company shall file a request for proposals consistent with this order.

C. Within 30 days, Consumers Energy Company shall commence a competitive capacity solicitation consistent with the June 12, 1992 order in Case No. U-9586 or file a proposal for a revised capacity solicitation process.

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

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand
Chairman

(S E A L)

/s/ David A. Svanda
Commissioner

/s/ Robert B. Nelson
Commissioner

By its action of June 10, 1999.

/s/ Dorothy Wideman
Its Executive Secretary

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MICHIGAN PUBLIC SERVICE COMMISSION

Chairman

Commissioner

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By its action of June 10, 1999.

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_____)

Case No. U-11954

Suggested Minute:

“Adopt and issue order dated June 10, 1999 granting partially the request of Consumers Energy Company for certification pursuant to Section 32(k)(2) of the Public Utility Holding Company Act of 1935 with respect to certain proposed transactions with an affiliated exempt wholesale generator, as set forth in the order.”