

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Adrian Energy Associates, LLC
Cadillac Renewable Energy, LLC
Genessee Power Station, LP
Grayling Generating Station, LP
Hillman Power Company, LLC
T.E.S Filer City Station, LP
Viking Energy of Lincoln, Inc.
Viking Energy of McBain, Inc.

Docket No. EL05-85-000

Complainants

Michigan Public Service Commission
Commissioner J. Peter Lark
Commissioner Robert B. Nelson
Commissioner Laura Chapelle

Respondents

**ANSWER OF THE MICHIGAN PUBLIC SERVICE COMMISSION
SEEKING DISMISSAL OF COMPLAINT
AND NOTICE OF INTERVENTION**

INTRODUCTION AND SUMMARY OF POSITION

Pursuant to Rule Nos. 206 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.206 and 385.214, the Michigan Public Service Commission and the named Commissioner Respondents (together, the "MPSC"), hereby answer the Complaint of Adrian Energy Associates, LLC, *et al.*, ("Complainants" or the "QFs"), seeking its dismissal, and provide notice of intervention in this proceeding.

Complainants ask the Commission to reverse an MPSC order interpreting the parties' contractual intent when entering into certain QF agreements under the Public

Utility Regulatory Policies Act of 1978 Act (“PURPA”), 16 U.S.C. § 824a-3, *et seq.*, as long as twenty years ago. The contracts were entered into under long-standing MPSC orders implementing PURPA that are not subject to challenge.

Contrary to PURPA and all applicable precedent, the Complainants' request to overturn the MPSC's order would enmesh the Commission in contract litigation that has not only been fully adjudicated by the MPSC, but is on review in the state court system and is the subject of a separate suit in federal court. Commission precedent has been clear for the past ten, if not twenty, years that actions such as this seeking to interfere with a state's administration of PURPA agreements entered into pursuant to valid state orders implementing PURPA will not be heard by the Commission. The MPSC was well within its authority under PURPA and FERC regulations in holding, after a thorough hearing, that the contractual intent of Complainants and Consumers Energy Company (“Consumers”) in entering into the QF agreements was to calculate avoided energy costs with reference to the cost of coal actually burned by the utility, not a particular type of coal. The Complainants' effort to have this Commission reverse that decision, and their effort thereby to impose higher costs on Michigan consumers, must be dismissed.

**NOTICE OF INTERVENTION, CORRESPONDENCE
AND COMMUNICATIONS**

Pursuant to Rule 214 of the Commission' Rules of Practice and Procedure, the MPSC hereby files its notice of intervention in this proceeding. Correspondence and other communications shall be served upon the following individuals:

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ARGUMENT

1. PURPA AND ALL IMPLEMENTING PRECEDENT CALL FOR DISMISSAL OF THE COMPLAINT

Complainants ask the Commission to adjudicate a contract dispute that has already been fully litigated before the MPSC and is on appeal, by right, in state court. The matter is also the subject of a separate suit in federal district court.¹ That the interpretation of a contract is what is at issue here is not disputed by Complainants. Indeed, Complainants note that they first brought their contract claim in state court, a claim which was referred by the state court to the MPSC for adjudication on grounds of primary jurisdiction.

Highlighting the contractual basis for their complaint throughout the pleading,

Complainants allege:

The PPAs explicitly provide that ‘the capacity and energy payment rates to be paid by Consumers are based on the

¹ Complainants’ have docketed their appeal of the MPSC’s decision in *Adrian Energy Associates LLC v. Michigan Public Service Commission and Consumers Energy Company*, Mich. Ct. App. Case No. 261718. The appeal has been taken as a matter of right under MCL 462.26. A separate suit is pending in the Western District Court of Michigan in *Adrian Energy Associates LLC v. Michigan Public Service Commission, Commissioners J. Peter Lark, Robert Nelson and Laura Chapelle*, Case No. 05-DV-0060.

concept of 'avoided costs' as now described in Section 210 of PURPA...' Consumers Energy Company has admitted that the Michigan QFs never agreed to be paid less than avoided costs."²

The intent of the Power Purchase Agreements is for Consumers to pay the Michigan QFs its avoided costs (*sic*). The PPAs explicitly provide that 'the capacity and energy payment rates to be paid by Consumers are based on the concept of 'avoided costs'....³

While the MPSC agrees that Complainants are entitled to be paid "avoided costs" as described in Section 210 of PURPA, the issue is how the parties to the PPAs intended such avoided costs to be calculated. Acknowledging that "[t]he PPAs do not directly define the term 'avoided costs,'"⁴ Complainants rehash at considerable length hundreds of pages of parol evidence adduced in hearings before the MPSC in an effort to persuade FERC that the QFs', rather than the MPSC's, reading of the contracts is the correct one. The MPSC, of course, disagreed with the QFs' position, finding, as a matter of contract interpretation,

...that the ALJ carefully considered the arguments of all the parties and arrived at a recommendation that is supported by a preponderance of the credible evidence. The QFs agreed to the above-quoted energy charge determination provisions. The Commission finds that those provisions and Consumers' administration of the power purchase agreements reflect the intent of the parties with regard to the payment of avoided energy costs.⁵

² Complaint, pp. 1 - 2.

³ Complaint, p. 8.

⁴ *Id.*

⁵ Opinion and Order in Case No. U-13917; *In the matter of the application of CONSUMERS ENERGY COMPANY for approval of a power supply cost recovery plan and for authorization of monthly power supply cost recovery factors for calendar year 2004*, issued February 28, 2005 ("MPSC Opinion and Order"), *slip op.* at 18.

In a long line of cases endorsed by reviewing courts and reflecting the structure of the statute, this Commission has consistently refused to be dragged into contract disputes under PURPA agreements, matters that involve a state's application of its implementation of FERC's regulatory directive. Reflecting the statute, the Commission and the courts have distinguished between permissible FERC actions addressing a state's failure to "implement" FERC regulations and the case-by-case application of state-based implementation, which is not subject to FERC review. The court in *NYSEG v. FERC*, 117 F.3d 1475 (D.C. Cir. 1995) outlined the Commission's and the States' respective responsibilities to implement PURPA as follows:

The Congress declared with specificity the means by which the ends of the PURPA are to be achieved. The Commission is charged with promulgating regulations designed to encourage cogeneration, 16 U.S.C. § 824a-3(a), which each state regulatory authority must then implement. § 824a-3(f). The Commission may bring an enforcement action in federal district court against any state authority that fails to do so, § 824a-3(h)(2)(A); alternatively, a utility or cogenerator may petition the FERC to bring such an action and, if the agency declines, may itself sue the state regulatory authority in district court. § 824a-3(h)(2)(B).⁶

After a state has implemented PURPA, the application of such implementation is not a matter with which the Commission is properly concerned. In its 1983 Policy Statement outlining its enforcement responsibilities under PURPA, the Commission stated as follows:

The Commission perceives that its primary role in the statutory scheme of review and enforcement is to ensure that the State regulatory authorities and nonregulated electric utilities implement regulations under section 210(f) which are consistent with the regulations established by the Commission under section 210(a) of PURPA. However, once the State regulatory authorities and nonregulated

⁶ *Id.* at 1476.

electric utilities have appropriately implemented the Commission's regulations, the Commission's role is limited regarding questions of the proper application of these rules on a case-by-case basis.*

* In fact, the only area in which the Commission may get involved in questions regarding the application of rules is with regard to 30 to 80 megawatt small power production facilities.⁷

Consistent with these boundaries, in *West Penn Power Company*, 71 FERC ¶ 61,153 (1995), the Commission specifically rejected the petitioner's request for modification of an existing QF power purchase agreement "fully litigated in another forum." Holding that "[t]he Pennsylvania Commission's modifications to the Purchase Agreement involve fact-based determinations and PURPA enforcement issues that we have consistently regarded as the province of the States," the Commission concluded that:

It is up to the States, not this Commission, to determine the specific parameters of individual QF power purchase agreements....This Commission does not intend to adjudicate the specific provisions of individual QF contracts.⁸

Similarly, in *Kawaihae Cogeneration Partners*, 84 FERC ¶ 61,325 (1998), the Commission refused to become involved in a claim that the state's application of PURPA rules required it to compel the formation of a QF agreement according to the QF's specifications, holding:

The Commission's established policy is to leave to the states and to appropriate judicial fora issues relating to the

⁷ *Policy Statement Regarding the Commission's Enforcement Role Under Section 210 of the Public Utility Regulatory Policies Act of 1978*, 23 F.E.R.C. ¶ 61,304 at 61,645 (1983).

⁸ *Id.* at 61,494-61,495 (emphasis added).

specific application of PURPA requirements to the circumstances of individual QFs. We will decline to arbitrate disputes under PURPA....⁹

Complainants' position in this case is indistinguishable from the complainants' posture in *West Penn* and *Kawaihae*. In each of these cases, the underlying matter was fully litigated before the state commission. In each of these cases, the complainants asked this Commission to intervene in adjudicating contractual relationships governed by lawful state implementation plans long in place and not subject to challenge. And here, as was the case in *West Penn* and *Kawaihae*, it is clear that complainants' recourse is to a state court on appeal under Section 210(g)(1) of the Act, not to FERC.

Federal district courts, to which recourse may be taken under PURPA Section 210(h)(2)(B) when the Commission refuses to bring an enforcement action, have similarly refused to entertain enforcement actions addressing case-specific state application of state-based PURPA regulations. *See, e.g., Greensboro Lumber Co. v. Georgia Power*, 643 F. Supp. 1345, 1374 (N.D. Georgia, 1986); *Massachusetts Institute of Technology v. Massachusetts Department of Public Utilities*, 941 F. Supp. 233 (D. Mass. 1996) ("*MIT*"). The court in *MIT* dismissed a QF's complaint, "mindful of the dichotomy between implementation claims and "as-applied: claims" under Section 210(h) of PURPA. As the court explained:

An implementation claim...involves a contention that a state agency has failed to implement a lawful implementation plan under § 210(f) of PURPA. An as-applied claim, in contrast, involves a contention that the

⁹*Id.* at 62,458, *citing inter alia, Tennessee Power Company*, 77 FERC ¶ 61,125 (1996); *Metropolitan Edison Company*, 72 FERC ¶ 61,015 (1995); *West Penn Power Company*, *supra*.

agency's implementation plan is unlawful, as it applies to or affects an individual petitioner.¹⁰

It is entirely clear that in this case Complainants have asked FERC to adjudicate their rights "as applied" by the MPSC under state regulation implementing FERC regulations. While Complainants baldly assert that their challenge is to the MPSC's alleged "implementation" of FERC regulations, the facts make it absolutely plain that the gravamen of the Complaint is for case-specific contract adjudication of agreements approved pursuant to lawful state orders implementing PURPA that are not challenged by Complainants.

It is worth noting that in certain cases preceding the *West Penn* decision, the Commission entertained several petitions for declaratory orders in which the Commission was asked to hold that specific contracts mandated by state authorities may reflect unlawful implementation. Yet, the Commission specifically confined such consideration to contracts over which there was a continuous and pending challenge brought *prior to execution of the contract and not subsequently abandoned*. As the Commission put it in *West Penn*, "...we will not accept challenges to State-approved avoided-cost rates unless the rates were challenged prior to the execution of the contract and the challenge is pending."¹¹ Complainants in this case, of course, do not even attempt to claim that they have mounted a continuous challenge to the contracts at issue. Nor could such a claim

¹⁰ *MIT*, 941 F. Supp. at 237.

¹¹ *West Penn*, 71 FERC, at 61,495, citing, *inter alia*, *New York State Electric & Gas Corporation*, 71 FERC ¶ 61,027 (1995); appeal dismissed, *NYSEG v. FERC*, 117 F.3d 1473 (D.C. Cir. 1997); connected district court action dismissed, *NYSEG v. Saranac Partners, et al.*, 117 F.Supp.2d 211 (N.D.N.Y., 2000); *aff'd* 267 F.3d 128 (2nd Circuit, 2001).

be supported. The PPAs at issue were approved by the MPSC as much as twenty years ago, in a process that is no longer subject to challenge.

2. MPSC WAS WELL WITHIN ITS AUTHORITY UNDER PURPA TO FIND THAT THE COMPLAINANTS' POSITION ON ENERGY PAYMENTS IS NOT CONSISTENT WITH THE AVOIDED COST PROVISIONS OF THE PPAs.

As made clear above, the dispute in which Complainants seek to embroil the Commission is a matter of contract interpretation. In extensive litigation before the MPSC, the claim made by the Complainants, identical to the one pressed here, is that their QF agreements locked in energy costs derived from the cost of high-priced bituminous coal, and that Consumers Energy violated this agreement by using the actual cost of sub-bituminous utilized by Consumers Energy to fuel its coal generation.

The contracts simply do not specify a hypothetical bituminous coal plant as the basis for calculating energy costs. Moreover, the Complainants concede here that: (1) “the PPAs do not directly define the term ‘avoided costs’”;¹² and (2) “...the Michigan QFs did not lock in a particular energy price per kwh.”¹³ In the MPSC litigation, Complainants attempted to prove their claim with extensive parol evidence regarding the parties’ and the MPSC’s assumptions at the time the contracts were finalized. The MPSC provided the Complainants ample opportunity to prove their contract claim with such evidence, and simply decided against them. With that, the MPSC has fulfilled its responsibility and the Complainants’ recourse should be only to state court, as prescribed by PURPA Section 210(g).

¹² Complaint, p. 8.

¹³ Complaint, p. 26.

In an effort to fashion a statutory basis for their claim here, Complainants now claim that their payment stream does not reflect avoided cost, and that it violates the right they are alleged to have exercised to lock in an avoided cost payment stream under 18 C.F.R. § 292.304(d)(2)(ii).¹⁴ These claims are baseless.

Of course, locking in avoided energy costs at the outset of their agreement is something the QFs might have done. Section 292.304(d)(2) of the Commission's regulations does provide a QF with the option, when entering into a QF agreement, to have avoided costs calculated either at the time of delivery or at the time the obligation is incurred (the so-called "lock-in" option). But it is quite clear is that the Complainants simply did not lock in a particular stream of avoided energy payments. Instead, they agreed to track the actual price of coal as it changed over time. Try as they might to say otherwise, the Complainants admit this, although they gamely argue that the contracts locked in as-delivered energy prices from a particular type of coal, rather than the type of coal actually burned by Consumers. Repeating matters earlier litigated before the MPSC, the Complainants argue:

Consumers apparently contends that the Michigan QFs locked in avoided costs but did not lock in the corresponding avoided energy costs. This argument is clearly wrong. Despite the fact that the energy payment may vary with the market price of bituminous coal, the Michigan QFs locked in the right to be paid avoided costs and, therefore, capacity and energy rates based upon the cost of a bituminous coal-fired electric generating plant and its associated fuel costs.¹⁵

Since FERC regulations obviously do not mandate QF agreements in which avoided energy costs are locked in at the outset of an agreement, and with the

¹⁴ Complaint, pp. 2 – 3, 26-27.

¹⁵ Complaint, p. 27.

Complainants having conceded that their contract did not include such a lock-in provision, the only remaining question is whether, as a matter of contract law, the QFs secured the right to calculate avoided energy costs with reference to a specific type of coal. But one will search the Complaint in vain for contractual language which supports the QF position. And with the MPSC, following its review of the extensive evidence of the parties' contractual intent, having rejected the Complainants' argument that their professed intent can be inferred in the agreements, this matter should now be at an end.

It bears pointing out, in passing, that there is absolutely no support for Complainants' related claim (p. 22) that there is something unlawful about a QF agreement that calculates capacity costs on the basis of a plant hypothesized at the time the contract was entered into, while energy costs are calculated on a current basis. Nothing in PURPA precludes this result, there is nothing relevant in the regulations, and Complainants cite no supporting precedent or applicable law. Once again, the salient issue is one of contractual intent, and the MPSC's extensive consideration is conclusive.

3. COMPLAINANTS ARE WRONG IN CLAIMING THAT THE MPSC DECISION VIOLATES PURPA SECTION 210(e) OR THAT THE MPSC'S DECISION SOMEHOW DISCRIMINATES AGAINST THE MICHIGAN QFS.

Complainants provide no support for their claim (pp. 52-53) that the MPSC's action violates PURPA Section 210(e), pursuant to which QFs are exempt from "state laws and regulations respecting the rates, or respecting the financial or organizational regulation." Complainants cite *Smith Cogeneration Management Inc.,v. Corp. Comm'n*, 863 P. 2d. 1227 at 1240-41 (Okla 1993) for the proposition that "[r]econsideration of long-term contracts with established estimated avoided costs imposes utility-type regulation over

QFs.” Complainants argue that a decision reopening an existing QF agreement as a matter of ongoing regulatory oversight would involve impermissible “utility-type” regulation. Yet, the MPSC did not reopen or reconsider its prior approval of the PPAs at issue here. To the contrary, following referral of the matter by state court, the MPSC in its Opinion and Order found that the energy rates paid by Consumers Energy to the Complainants are consistent with their QF agreements. The agreements have certainly not been “reconsidered,” leaving Complainants’ argument lacking for its essential factual predicate. In fact, it is the QFs that sought a declaratory ruling in state circuit court and a the MPSC regarding the proper meaning of the energy payment provisions in their PPAs, a request with which MSPC complied.

Complainants' further assertion (p. 54) that the MPSC Opinion and Order discriminates against the QFs in violation of PURPA Section 210(b) is nearly too inchoate to warrant a response. Complainants appear to argue that the alleged mismatch between capacity payments based on the avoided cost of a hypothetical bituminous coal burning plant, and current energy payments based on current actual costs, constitutes discrimination under the statute. The fact that Complainants cite no law or precedent for the view that this so-called mismatch is prohibited by PURPA is addressed above. It is underscored here that Complainants’ loose reference to the prohibition against discrimination under the statute provides no help for their cause. The concept of “discrimination” in a rate setting context is not an empty vessel into which the Complainants can pour any desired meaning. The law against discrimination, in a regulatory setting, prohibits practices that would treat similarly situated purchasers or sellers differently, without a justification geared toward achieving a legitimate regulatory

goal.¹⁶ As used in PURPA Section 210(b), proscribing utility discrimination against QFs in the purchase of their power, the term is clearly aimed at prohibiting rates that would provide non-QF suppliers an advantage when selling power to a utility. That concept has absolutely no relation to the QFs' complaint in this proceeding.

4. COMPLAINANTS' CLAIM THAT THERE IS A FERC-JURISDICTIONAL ISSUE REGARDING MICHIGAN'S RATE FREEZE DISPUTE IS FRIVOLOUS.

Complainants' assert (p. 55-56; 30-32) that a violation of the Federal Power Act somehow lies in the establishment of bundled retail rates that provide alleged overcompensation to Consumers Energy. It seems nearly self-evident that the basis on which bundled retail rates have been established is a matter exclusively before the MPSC, and Complainants cite absolutely no authority for the proposition that this matter involves FERC-jurisdictional wholesale sales or transmission rates. Absent even an arguable nexus to the Commission's statutory responsibility, the claim must be summarily dismissed.

¹⁶ See, e.g., *Fort Pierce Utilities Authority of City of Fort Pierce v. FERC*, 730 F.2d 778 (D.C. Cir. 1984); *Alabama Elec. Co-op., Inc. v. FERC*, 684 F.2d 20 (D.C. Cir. 1982); *St. Michaels Utilities Commission v. FPC*, 377 F.2d 912 (4th Cir. 1967).

CONCLUSION

For the reasons articulated above, the MPSC asks that the Complaint be dismissed and that MPSC's Motion to Intervene be granted.

Respectfully submitted,

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April 20, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing pleading upon the parties on the service list in this case compiled by the Secretary of the Federal Energy Regulatory Commission, consistent with the Commission's Rules or Practice and Procedure.

/s/
Jonathan D. Schneider

April 20, 2005