

Response from Consumers Energy

Electric Choice Question #8: What market forces, policy or other factors could change the current market dynamic for choice? How many of these factors affect the viability of choice in Michigan?

Electric Choice Question #10: What kind of future changes could have a strong effect on affordability, reliability, and environmental protection under different regimes?

Executive summary

There are a number of market forces that could impact the current dynamic for electric deregulation, including:

1. Environmental regulations may force retirement of older coal fueled generating units. The amount of coal fueled generation being retired is anticipated to eliminate significant oversupply, or possibly cause a shortage of electric capacity. EPA regulations leading to coal plant retirements and federal carbon legislation would drive market prices much higher in that case, and electric customers currently participating in the Michigan Retail Open Access (“ROA”) program may migrate back to utility bundled electric service.
2. The price of coal and coal transportation, as well as the price of natural gas, impact the utility’s competitive position versus the MISO market.
3. Requirements for renewable energy for utilities are different than those for alternate energy suppliers (AES’s), creating a significant variance in costs incurred per customer to meet renewable standards.

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Utilities have made commitments by way of owned generation resources and power purchase agreements over the past several decades to meet the obligation to serve. The current over-supply of electric generation in the MISO footprint has driven the market price of electric capacity to near historic lows. As a result, Alternative Energy Suppliers (“AES”) enjoy the ability to meet their electric resource plus reserve

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obligations by paying for capacity at substantial discounts compared to the actual fixed costs of the resources they are purchasing.

New environmental rules like the Mercury and Air Toxics Standard (“MATS”) will require coal fueled power plants to install expensive air quality control systems to meet more stringent emissions rules. The industry expects that many smaller, older coal fueled generating units will retire when the MATS rule takes effect in April 2015, or possibly April 2016 if a one year extension for meeting the rule as provided by the rule is obtained by some generators. The amount of coal fueled generation being retired is anticipated to bring the amount of generation within the MISO footprint back into balance with electric demand, or even possibly cause a shortage of electric capacity. At such time, utility power supply resources will once again be economical with options available to AES’s, and electric customers currently participating in the Michigan Retail Open Access (“ROA”) program may migrate back to utility bundled electric service.

2. The price of coal and coal transportation, as well as the price of natural gas, impact the utility’s competitive position versus the MISO market.

Consumers Energy is a party to several thousand megawatts of power purchase agreements (“PPA”). The cost of many of those PPAs is tied to the average cost of coal burned in Consumers Energy’s coal fleet. As a result, a rise in price of the coal commodity or coal transportation would in turn not only increase the cost of the Company’s coal generation, but also some its PPA costs. A decrease in the price of the coal commodity or coal transportation would decrease the cost of the Company’s coal generation and some of its PPA costs. During on-peak hours, however, coal fired units are typically not the marginal unit setting MISO energy market prices.

Even with the recent reduction in the price of natural gas, natural gas fired combined cycle generating units still set the marginal price of energy, or the Locational Marginal Price (“LMP”) of power, for many hours each day in the MISO footprint. History has shown that the MISO LMP has followed the price of natural gas with a high degree of correlation. As a result, if natural gas prices were to rise faster than currently projected, the MISO market energy price would increase faster than expected as well.

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With a significant portion of Michigan utilities energy costs link to the price of coal and nuclear plants, the utilities power supply costs would be considered economical if natural gas prices were to rise. Consequently, ROA requests would be expected to decline and some ROA customers would actually return to utility bundled electric service if natural gas prices were to rise high enough.

3. Requirements for renewable energy for utilities are different than those for alternate energy suppliers (AES's), creating a significant variance in costs incurred per customer to meet renewable standards.

Legislation has different requirements for large utilities such as Consumers Energy and DTE Energy Electric and for AES's. Both utilities and AES's have a requirement based on kWh, but only utilities have a capacity (kW) requirement for new renewable energy resources by 2015. The capacity requirement can only be met by building or causing to build new renewable generation facilities; the kWh requirement can be met through the purchase of REC's in addition to the energy generated by new facilities.

Because the actual energy output of some recent wind farms that have gone into service are higher than were expected, more energy has been generated than was needed to meet requirements (note that the capacity was necessary regardless of the output). The excess energy is therefore being sold through the Renewable Energy Credit ("REC") market. In addition, under the law the large utilities only receive approximately 80% of the REC's generated by existing PURPA facilities. The result is excess REC's pushed to the market annually.

Consequently, the REC market has been flooded and their associated value is low. The difference in requirements means that AES's can meet their requirements for a lower price than utilities can. Ultimately, the regulatory playing field between utilities and Alternate Energy Suppliers should be level.