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RESPONSES OF THE INDEPENDENT POWER PRODUCERS COALITION OF MICHIGAN (IPPC) GROUP TO THE STAFF'S AVOIDED COST STRAWMAN PROPOSAL

The IPPC Group appreciates the effort and thought that went into the Staff Strawman Proposal. While this response includes several suggestions for changes to the Staff model, we nevertheless believe that the Staff proposal is moving in the right direction and is responsive to many of the concerns that IPPC has expressed.

I. THE STAFF'S TRANSFER PRICE SCHEDULE MEETS THE FEDERAL LAW'S REQUIREMENT THAT AVOIDED COSTS BE JUST AND REASONABLE, IN THE PUBLIC INTEREST, AND NOT DISCRIMINATE AGAINST THE STATE'S QUALIFIED FACILITIES.

The IPPC strongly believes that there is no better representation of what a true avoided cost template should look like than that which has been used over the past 9 years by the Commission in its Transfer Price Schedule. As this Commission recently stated in its 2016 Renewable Energy Report, "(t)ransfer price schedules are representative of what a Michigan electric provider would pay had it obtained the energy and capacity (the non-renewable market price component) through a new long term power purchase agreement for traditional fossil fuel electric generation. To best determine the value of the non-renewable component of Act 295 compliant generation, Commission Staff determined, for purposes of developing a uniform

Transfer Price Schedule, that the levelized cost of a new natural gas combined cycle (NGCC) plant would likely be analogous to the market price mentioned above."[1] Use of the Transfer Price Schedule as the proxy for avoided cost, since it is itself based on a NGCC unit – which as we discuss below, is the appropriate proxy for the avoided cost, and would satisfy the obligation under the Public Utility Regulatory Policy Act of 1979 (PURPA) to be just and reasonable and in the public interest. In fact, it has already been found to satisfy those criteria in multiple Commission proceedings. Furthermore, since the Transfer Price Schedule offers a projected cost over a multi-year horizon, it also offers the opportunity to establish an avoided cost schedule that could be the basis of a multi-year power purchase agreement.

II. IPPC'S COMMENTS ON THE STAFF'S STRAWMAN PROPOSED MODEL

IPPC believes that the previous work of the Commission, reflected in dockets U-6798 and U-8871, should be respected; and while it needs to be updated, the essential model adopted there is still appropriate and relevant for establishing avoided costs for Michigan's PURPA Qualifying Facilities (QF). We believe that the Transfer Price Schedule, using as it does a proxy generation unit, is consistent with the approach taken in the previous dockets. We are pleased that the Staff proposal follows the structures embraced by the previous model and does not attempt to establish an entirely new vision of how avoided costs should be set. That said, the IPPC has some suggestions for revision to the Staff proposal as follows.

[1] Report on the Implementation of the P.A. 295 Renewable Energy Standard and the Cost-Effectiveness of the Energy Standards, Michigan Public Service Commission, February 12, 2016 ("2016 Renewable Energy Report"), at pp. 32-33.

A. Levelized Costs, and not LMP Day Ahead Prices, are the Appropriate Cost Measure

In its proposed calculation of the energy component, Staff provides three options. While the concept of offering options is not itself objectionable, IPPC is concerned that the options provided are so far away from each other in methodology and result that they are likely to be a continuing source of controversy that could lead to further proceedings before the Commission to settle disputes over them.

First of all, IPPC believes that the MISO Locational Marginal Price (LMP) at the appropriate node is not a reasonable proxy for avoided energy costs of the utility. For one thing, QF contracts in Michigan have traditionally been long-term contracts, and the LMP does not reflect any long-term forecast of energy costs. Staff's second option, the levelization of projected LMP over the contract term, at least has the benefit of attempting to account for the value over time of the energy being provided. That being said, the LMP, even levelized over time, does not capture the true avoided costs, as required by PURPA.

IPPC believes that the most appropriate and reasonable manner to address the energy component is to use the third option the Staff has provided – the levelized variable costs of a combined cycle natural gas plant over the contract term, consistent with how the Commission utilizes this proxy for its Transfer Price Schedule. As IPPC believes that such a plant should be the basis for the capacity calculation (see below), this would have the virtue of being a consistent application of the proxy model across all costs, which is the most reasonable way to apply the model.

Using a levelized cost rather than spot market costs better reflects the utility's long-range planning horizon. It would not be prudent operation for any utility to base its determinations about making long-term purchases of energy, or about building more generation, on spot market

prices. Instead, any prudent utility looks at long-term trends in fuel costs, load growth, and other factors. None of these factors is reflected in the spot market price, and so that price does not satisfy the federal requirement that the avoided cost must reflect the costs that the utility is avoiding by not having to generate itself or purchase from another source because of the (long-term) contracts that it has entered into with QFs. See 18 CFR 292.101(b)(6).

Use of levelized costs and long-term contracts also provides a hedge for the utility against fuel and generation cost increases over the planning horizon. Again, this is not a benefit that can be reflected in the spot market cost, but which the avoided cost rate should reflect.

B. PURPA Imposes Legal Obligations on the Regulated Utility

PURPA imposes a number of legal obligations on regulated utilities. In the PURPA – TAC meetings we have heard representatives of Michigan's two largest regulated utilities question this and whether if others should be bearing those obligations, such as Alternative Electric Suppliers (AESs) and transmission owners. As Staff knows, PURPA imposes a mandatory purchase obligation on each "electric utility," as that term is defined by federal rules and law, which is broadly defined as "any person, State agency, or Federal agency, which sells electric energy.[2] AESs, of course, are not defined as utilities in this state. And federal law remains clear that it is the electric utilities that must offer to purchase electric energy from any QF that can deliver power to the utility.[3] At the very least, we are pleased that the Staff has not let itself be distracted by these red herrings. If the utilities have complaints to make about the functioning of federal law, this workgroup is not the place to try to address them.

[2] PURPA §3(4), 16 U.S.C. §2602(4); in essence, the requirement rests on the local distribution company.

[3] PURPA §210(a).

That said, PURPA requires that purchases by electric utilities from QFs subject to the "must purchase" obligation be 1) "just and reasonable to the electric consumers of the electric utility and in the public interest," 2) non-discriminatory "against qualifying generators or qualifying small power producers," and 3) that federal rules shall not require "a rate which exceeds the incremental cost to the electric utility of alternative electric energy" or its "avoided cost." See 16 U.S.C. § 824a-3(b) and 18 CFR 292.101 *et seq*.

We have heard representatives from the utilities arguing in the workgroup meetings that it would be somehow unfair or unreasonable if satisfying their federal PURPA obligations causes them to spend more than they would if they just obtained the cheapest energy or capacity they could at the moment. However, that is not what the federal law says. Instead, it requires that the resulting costs to the utility to meet its must purchase obligations be "just and reasonable to the electric consumers" and "in the public interest," not that it be the cheapest source available. Conversely, it would also not meet the federal law's standards if the QFs proposed a cost that was the highest cost available. The Commission must find that balance that meets a just and reasonable cost to the utility's customers and is in the public interest – and is non-discriminatory to the QF. Simply finding "the lowest incremental cost" possible would violate PURPA's requirement of a just and reasonable rate to the QF.

As the IPPC group presentations illustrated, there are a number of public interests involved in continuing the operations of these QFs besides the obtaining of cost-effective capacity and energy. It is consistent with federal law for the avoided cost determination to reflect such public interests. Furthermore, as Ken Rose noted in his presentation, avoided cost means "the incremental cost of the utility to generate or purchase itself without the QF or QFs – over the relevant utility planning horizon." And he added, "that is, long term that takes into

account capital expenditures." See Ken Rose presentation to PURPA – TAC, 02-03-2016, slide 8.

C. Staff's Capacity Payment Component Should be Consistent with the Energy Component.

Staff's proposal for capacity payment used a combustion turbine natural gas plant (simple cycle, or CT) as the proxy. This is problematic as it is widely acknowledged that the next build – if new generation is required – is most likely to be a combined cycle gas plant (NGCC). The only basis provided for this choice in Staff's proposal is that it "[r]epresents the most cost-effective new entry into the energy market." The problem with that rationale is that it is not a reasonable basis for the proxy choice under federal law or the proxy method, which require not the lowest cost choice, but the one that the utility itself would build if it were not for the presence of the QFs. See, *PURPA Title II Compliance Manual*, "Proxy resource method," p. 35. Consumers Energy recently demonstrated what its choice for its next planned addition would be when it proposed the combined cycle natural gas plant at Thetford (see Case No. U-17429). There has been nothing presented to the workgroup that would make a compelling case for anything different as the proxy unit.

D. Intermittent and Baseload Generation Technologies Need Different Proxies to Reflect Differences in Benefits to the System and Costs Avoided.

IPPC understands from the workgroup discussion on February 10, 2016, that Staff provided the "NGCC Energy Adjustment" in an effort to counter the concerns expressed above regarding using CT as the capacity measure, and that by shifting the costs from capacity to energy via that Adjustment there was an intent to account for differences between intermittent

and baseload technologies. IPPC nevertheless believes that this can be accomplished more cleanly, simply, and accurately by establishing different proxies for intermittent and baseload technologies. Thus, solar and wind, to take two examples, as intermittent technologies might have a CT proxy for capacity and energy, while the IPPC member units, which are all baseload units, would have a NGCC proxy for capacity and energy.

Such a distinction is anticipated in the Federal rules, which state that "[t]he standard rates for purchases under this paragraph . . . [m]ay differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies." 18 CFR 292.304(c)(3). This is a more reasonable way to address the fundamental difference between baseload and intermittent technologies than the method proposed in the Staff's February 10, 2016 proposal.

E. The Utility's Long-Range Planning Includes the Existing Capacity from QFs Under Contract

While Staff's proposal covered payment for capacity, it did not address the issue of when a utility is obligated to purchase capacity from a QF. As the utilities' obligation to purchase energy and capacity from QFs has existed for over 25 years, those facilities that have long been part of a utility's long-range planning for capacity and energy should enjoy a presumption, when their contracts are due for replacement or renewal, that the utility will continue to be obligated to purchase their capacity going forward. This presumption simply recognizes that the utility has a continuing federal legal obligation to purchase capacity and energy from the QF so long as the QF continues to offer it, even upon termination of the existing contract. A utility should not be able to claim that it no longer needs the QF's capacity (perhaps in the hope that it will be able to

build and rate base a new generation source itself) unless there is some extraordinary reason, such that the continued purchase of the QF's capacity is no longer in the public interest.

F. PURPA QFs Should Retain the Renewable Credits

Because the proxy that Staff is proposing is based on a fossil fuel fired generation source, and so does not account for any of the renewable benefits of the QFs, those renewable benefits should belong to the QF unless they are otherwise contracted for between the QF and the utility. To do otherwise is to arbitrarily take value provided by the QF and give the utility the benefit of that value without concomitant payment to the QF. IPPC recognizes that the value of RECs and other means of measuring the renewable benefits provided by QF generation are difficult to project and subject to dispute, and so we propose that rather than trying to assign these a value they be left with the QF, unless the utility wishes to acquire them, in which case their value will be determined in arms-length negotiation between the parties.

III. SOURCES OF COST DATA

The IPPC has identified several possible sources of cost data that the Staff could use, all of which have been used in one way or another in MPSC cases recently, or are otherwise government-authorized numbers and so are less likely to be subject to accusations of bias in their derivation. If not used directly, these data at a minimum should be used to verify the reasonableness of the avoided cost derived through the MPSC prescribed methodology.

A. Transfer Price Schedule

As discussed above, this schedule, which provides yearly and forecasted costs, would make an excellent proxy to establish the avoided costs of the utility. Attached is the schedule recently supported by Consumers Energy in Case No. U-17792, as Exhibit A-17.

B. EIA Data

In its Annual Energy Outlook 2015, EIA provided levelized costs and avoided costs for new generation both nationally and on a regional level. These numbers are updated annually. http://www.eia.gov/forecasts/aeo/electricity_generation.cfm

C. Thetford Filing Data

Consumers provided what it at the time argued were its just and reasonable costs for its next source of generation in the Certificate of Necessity docket, U-17429. Consumers provided levelized cost of generation in Exhibit A-35: $100.89 – 125.05 / MWH.