Consumers Energy
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A CMS Energy Company

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Michigan Public Service Commission
Attn: Mr. Paul Proudfoot, Director – Electric Reliability Division
7109 W. Saginaw Highway
Lansing, MI 48917

Dear Mr. Proudfoot,

On February 10, 2016, the Michigan Public Service Commission (MPSC) Staff conducted a meeting to discuss a proposed methodology for the calculation of utility avoided cost as part of the Public Utility Regulatory Policies Act of 1978 (PURPA) technical advisory committee. At the conclusion of the meeting you requested that all interested parties provide comments on the proposed methodology in writing by February 24, 2016. In addition to comments on the proposed methodology, Consumers Energy provides responses to several questions and discussions that arose at the February 10, 2016 meeting.

MPSC Staff's Proposed Methodology:
MPSC Staff proposed a standard methodology to establish the avoided cost to be paid to a Qualifying Facility (QF) based on the Capacity Cost associated with a Combustion Turbine (CT) and the Energy Cost resulting from: (a) either: (i) the Locational Marginal Price (LMP) as determined by Midcontinent Independent System Operator, Inc. (MISO); (ii) levelized LMP; or (iii) levelized Natural Gas Combined Cycle (NGCC) plant variable costs; and (b) a NGCC Energy Price Adjustment. MPSC Staff's proposed method incorporates several concepts that the Company supports. However, MPSC Staff's proposal is unlikely to adequately reflect a utility's avoided cost at all times and requires additional flexibility to accommodate the different planning horizons ahead. The following comments are provided to assist in modifying MPSC Staff's proposal to provide that flexibility.

Identifying Need:
A utility's avoided cost is highly dependent on the utility's capacity need. At Consumers Energy we put a significant emphasis on meeting customer demands using the lowest cost resources available. In support of this endeavor, Consumers Energy has different strategies for meeting capacity shortfalls depending on the size of the shortfall. As a result, the method used to determine the avoided costs that should be paid to a QF will vary significantly depending on the capacity need in a given year. Consumers Energy proposes the following tiered approach to determining avoided costs based on the utility's need for capacity over the planning horizon:

1) For those periods when the Capacity Need is expected to be less than zero (0) Zonal Resource Credits (ZRCs), we propose that the methodology recognize that no capacity payment is avoided and that the avoided energy payment is equal to LMP.
2) For those periods when the Capacity Need is greater than zero (0) ZRCs but less than 200 ZRCs the avoided capacity cost should be based on MISO's Planning Resource Auction (PRA) and the avoided energy payment should be equal to LMP.
3) For those periods when the Capacity Need is greater than 200 ZRCs but less than1000 ZRCs the avoided Capacity Payment should be based on CT fixed costs, and the avoided energy payment equal to lesser of CT variable cost and LMP.
4) For those periods when the Capacity Need is greater than 1000 ZRCs the avoided Capacity Payment should be based on NGCC fixed costs, and the avoided energy payment equal to lesser of NGCC variable costs and LMP.

Capacity Component:
First, in order to consider various capacity options on a comparable basis and allow for the tiered capacity payments discussed above, MPSC Staff's methodology should consider the economic carrying charge associated

with the avoided proxy plant. The use of economic carrying charge ensures that payments made in a given year represent the appropriate value received for the capacity in that year. The use of a levelized cost would result in "front loading" compensation. Use of levelized costs require: (i) the same avoided proxy plant is used; (ii) the term of the contract covers the entire life of the proxy plant; and (iii) deliveries commence at the same time for all contracts compensated under those rates, regardless of the utility's need for capacity. Use of the economic carrying charge allows for flexibility in the payments and would enable the tiered approach Consumers Energy is advocating.

Second, Consumers Energy only realizes the benefit of a generator's capacity to the extent that MISO recognizes the resource as capable of delivering capacity directly to the grid or through modification of a market participant's load. To accomplish this, MISO awards ZRCs to all registered generators. Consumers Energy currently receives ZRCs for all existing QFs for which it pays for capacity. These ZRCs are determined through various rules that are established in MISO's Business Practice Manuals (BPMs). Payment for capacity must tie back, in some fashion, to the amount of ZRCs received, or expected to be received, from a given generator. For example, if the avoided plant is considered a CT, the investment is made with an expectation of a given performance and resulting ZRCs. Using MISO's current rules, Consumers Energy would expect to initially receive 0.9431 ZRCs for every MW of capacity verified through an appropriate capacity test. To the extent that an existing generator receives more or less ZRCs per verified MW of capacity, that should be reflected in the payments to that generator. This is best accomplished by determining the appropriate $/ZRC-Year payment rate for the avoided plant and providing payment to QFs based on the number of ZRCs QF is able to supply through MISO's resource adequacy procedures for determining annual unforced capacity. Annual capacity value should be allocated into monthly payment amounts. That way, customers pay for the capacity commensurate with when it is used and costs are recovered across the two PSCR years in which they occur (since the MISO capacity planning year runs from June 1 through May 31 of the following year).

Energy Component:
Use of the LMP in determining the energy component is critical.

First, the LMP truly represents the avoided cost of energy to the utility. Absent the delivery of energy from a QF, Consumers Energy would either (i) lose the revenue associated with a sale occurring at the LMP, (ii) increase purchases being made at the LMP, or (iii) some combination of both. If Consumers Energy actually built the avoided plant, its customers would receive the net energy value (NEV) associated with operation of the plant in the market. Therefore, it is important that the energy component be modified appropriately to reflect the NEV that would have been received if the utility had constructed the avoided plant.

Second, the use of actual LMP, capped at the appropriate avoided plant variable cost, ensures that QFs receive the appropriate economic signals. Consumers Energy's participation in MISO gives our customers access to the lowest cost generation resources in the midcontinent region. Consumers Energy identifies the costs for generating electricity at its facilities and offers those costs in the form of an asking price into to the MISO energy market. To the extent that lower cost options are available, MISO provides signals to have the lower cost generator produce energy and reduces the output from Consumers Energy's generators. The MISO energy market relies on the LMP to provide these signals. By leveraging the LMP for avoided cost payments, Consumers Energy's customers are ensured that QFs are incented to produce the maximum amount of energy possible when it produces the most value and the minimum amount of energy possible when it produces the least value.

Some QFs may assert that they cannot be dispatched to higher and lower output levels due to the technology of their facility. Paying the QF the lower of the avoided plant's cost of production or the MISO LMP takes this factor into account so that the cost to customers is effectively the same as it would have been had the utility constructed the plant and fully dispatched it according to MISO energy market price signals. The QF can run as much as or as little as it wants, getting paid based on the energy it produces at the prices determined through this guideline.

NGCC Energy Adjustment:

For the same reasons discussed above, there is no need for the NGCC Energy Adjustment payment as it is included, if justified, in the payments made based on the capacity need. The NGCC Energy Adjustment, therefore, should be eliminated. This simplifies the calculation of avoided costs significantly. First, it eliminates the need to use the fixed costs for two different generation technologies in determining avoided costs for a given year. Second, there is no need to convert fixed costs into a volumetric value. Conversion of fixed costs to volumetric costs would be highly dependent on the assumed operating characteristics of the NGCC plant and market price forecasts. Relying on the appropriate fixed costs and the lesser of actual LMP and avoided variable costs is much simpler and will deliver the same value as using an NGCC energy adjustment payment. Additionally, using actual LMP will take forecasting the future out of the equation, and ensure customers only pay for actual avoided energy costs.

General Comments:

Consumers Energy has concerns regarding the table provided on the last page of MPSC Staff's avoided cost presentation. The presentation of the proposed methodology in that table creates the impression that a fixed $/MWh amount will be agreed to and paid to QFs for each MWh of energy produced. Avoided costs should be presented as they will be paid, based on a combination of capacity (a fixed monthly payment based on the ZRCs supplied by the QF) and energy (a volumetric monthly payment based on actual energy delivered). If illustrations are necessary to ensure all parties understand the proposal, it should be clearly laid out using a series of hypothetical scenarios based on real world data for various generators.

Questions to Consider:

On February 10, 2016, MPSC Staff presented several "Questions to consider." Consumers Energy offers the following responses:

1. Q: Should capacity be paid hourly, monthly, yearly and if the latter two, should there be a true up?
   A: Capacity can be paid on any mutually agreed upon time frame (although a monthly settlement would be the most appropriate), but should be based on the ZRCs received within the MISO construct. The use of a payment(s) based on ZRCs would eliminate the need for any true up because they are awarded, based on the MISO rules, in advance of and for the entire capacity season.

2. Q: Should capacity be discounted by ELCC?
   A: Capacity should be reflective of the Effective Load Carrying Capability (ELCC) of the resource. By basing payments on ZRCs received, ELCC is applied as appropriate for all technologies.

3. Q: Should capacity be reduced to 75% of the full amount to account for "all or nothing" capacity need cycles?
   A: Given that the proposed methodology is not attempting to represent the MISO capacity market construct, it would be inappropriate to apply the 75% concept. If the intent were to reflect a forecast of the MISO market value of capacity, then applying the 75% concept to the calculated Cost of New Entry (CONE) would be an approach to capture the "all or nothing" nature of the MISO market construct.

4. Q: Should LMPs be actual average hourly/monthly or should a projection be used and should there be a true up?
   A: As discussed above, the use of actual LMPs (capped at the variable cost of a CT or NGCC plant, if and as applicable) would represent the best avoided cost and provide the appropriate market signals to the QFs. Projected costs carry significant risk for both customers and the QF. A true up mechanism could be used in concert with projected costs; however using actual LMPs would probably be just as efficient. We should all remember that it is the customer that pays for these costs. Using actual LMPs ensures customers pay no more and no less than the true avoided cost of energy for the utility.

5. Q: Who should own the RECs/CO2 attributes and if IPPs own RECs/CO2 attributes should there be a utility obligation to purchase?

A: RECs should belong to the utility. The reason a utility has a must purchase obligation is because of the use of "qualifying" technology. To the extent that a facility qualifies because it is renewable, the utility should receive the RECs. Regarding CO2 attributes, there is substantial uncertainty how current proposed rules will be implemented, therefore, to the extent that the utility's purchase from a QF results in additional carbon emissions that the utility would otherwise avoid or additional energy expense, the utility should be awarded the carbon allowances.

Term:
It is impossible to understand what the future may hold. Changes in regulation, technology, economic development, and many other factors drive our business and the cost of producing energy. Changes in any of these factors can quickly make the terms of a very appealing contract turn sour. In order to minimize the risk to our customers of significantly over-market obligations, we must limit the term-length of all PURPA avoided cost contracts. The more market based the methodology, the more comfortable Consumers Energy is with longer-term agreements. For example, under a methodology that simply passed actual market rates for energy and capacity onto QFs, a long-term contract would be acceptable. Under a methodology where compensation rates must be fixed at the time of contract execution, Consumers Energy advocates for terms of 5 years or less in length.

Administrative Process:
During the February 10, 2016 meeting, discussion arose regarding the necessity of having separate contested case proceedings for approval of each PPA entered into between the utility and a QF. Consumers Energy recommends that the Commission approve these contracts on an *ex parte* basis. Since each utility's avoided costs will be determined in a contested case before the MPSC, it would be an inefficient use of the MPSC's resources to re-litigate the utility's previously established avoided costs when reviewing and approving the PPA. This is a similar approach to the approval of Renewable Energy Purchase Agreements under 2008 PA 295.

Conclusion:
Under MPSC Staff's proposed avoided cost methodology as modified by these comments, ratepayers are ensured costs will never exceed those that would be incurred if the utility did not purchase the energy and capacity produced by a QF. This is in perfect harmony with PURPA. Regular filing with the MPSC on capacity needs and avoided costs will ensure that the appropriate payments are made to all QFs.

Respectfully,

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