STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter, of the application of CONSUMERS ENERGY COMPANY for authority to recover implementation costs, for approval of stranded cost true-up methodology, and for other relief	)))))	Case No. U-l 1955
In the matter, of the application of THE DETROIT EDISON COMPANY for authority to recover retail access program implementation costs and for approval of a true-up mechanism in connection with the recovery of stranded costs	))))))	Case No. U-l 1956

REPLY-BRIEF OF THE MICHIGAN INDEPENDENT POWER PRODUCERS ASSOCIATION

The Michigan Independent Power Producers Association (MIPPA) responds ad seriatim to: Detroit Edison, Consumers Energy, Energy Michigan, Attorney General and the MPSC Staff

MIPPA RESPONDS TO DETROIT EDISON

Detroit Edison in its Initial Brief (at pages 64-67) state how Detroit Edison treats and proposes to treat QF purchase power contracts in the True-up process. Detroit Edison states:

> B. Edison's Revenue Requirement for the Stranded Costs of Purchased Power Contracts.
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> Mr. Loeher calculated the revenue requirements for the recovery of stranded costs related to PURPA purchased power contracts (including all "PA 2" contracts) by subtracting forecasted market value (revenues) for the power associated with these contracts from the forecasted energy costs plus contract capacity charges. Mr. Padgett proposed an auction mechanism that will help establish these market values more accurately. Mr. Loeher estimated these stranded costs for the period 1999 through 2007. The true-up process will consider these costs on a year-by-year basis (4T 223).
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> Mr. Loeher's calculation differs from the calculation used to derive stranded costs for PURPA purchased power contracts that were included in the Commission's Order in Case Nos. U-l 1290 et.. al, dated January 14, 1998. His calculation is simply a year-by-year

analysis. The Commission's order calculated stranded costs by adjusting a calculation performed by the Company in its March 7, 1997 informational filing. In that informational filing, stranded costs for PURPA purchased power contracts were calculated as the present value of above-market capacity costs related to the contracts for the duration of the contracts. The above market capacity costs were calculated on a present worth basis as the contract capacity costs less an assumed market price for capacity of 0.5 cent/kWh multiplied by the forecast output. The Commission Order adjusted the Company's calculation by (1) removing costs beyond 2007 and (2) removing costs associated with customers who remain on bundled rates (4T 223-24).

Mr. Loeher explained that the collection of stranded costs for the PURPA contracts differs from the collection of stranded costs for Fermi 2 and other regulatory assets mainly because there is not a defined amount to be collected. Instead, the stranded amounts for the PURPA contracts vary from year to year based upon the level of energy Edison must purchase per the particular contract. So that even in 2007, the last year to collect stranded costs, the costs can only be estimated for the ensuing years (4T 224).

He added, however, that nothing needs to be done now with above-market capacity costs forecasted after 2007, the last year to collect stranded costs, even though these contract terms extend beyond 2007. The above-market capacity component of these contracts is expected to decline over time, so the need to include further stranded costs for years beyond 2007 will lessen from the current level. For instance, Mr. Loeher forecasts a total amount of about $18 million in the year 2000, which then declines to about $8 million in 2008. If 50% of customers select Electric Choice in 2008, then the stranded revenue requirement is $4 million for 2008. Further, if at that time there is a crossover forecasted shortly after 2008, the Commission may decide that the levelized values of the contracts at that time no longer represent above-market costs. Due to the uncertainty in forecasting the level of market values in the future, it is of little value to forecast the level of the above-market capacity costs post-2007 at this time. The amount with which Edison is concerned will be smaller than other items of stranded costs, and the Commission has sufficient time to deal with it in future true-up proceedings. The Commission should monitor the status of these contracts in the annual true-up proceeding. The Commission can deal with recovery of these costs as 2007 approaches and the level of these costs are better known. <u>One option to recover any post-2007 remaining costs would be to have a small continuing charge to all customers (4T 225).</u> (Emphasis added) The payments to PURPA projects beyond 2007 are not in jeopardy if the Commission does not take action now (4T 225-26). DECO Initial Brief 65-57

MIPPA agrees with Detroit Edison when it suggests that the MPSC could now institute a continuing charge to cover purchase power costs after 2007. The MPSC certainly has the ability to treat above market payments to QFs in the same manner as it has for all of Detroit Edison's other stranded costs. MIPPA strongly disagrees with the contention of Mr. Loeher that nothing needs to be done now regarding recovery of stranded costs associated with payments to QFs after 2007. MIPPA continues to be concerned with the failure to date of the MPSC to identify a reasonable method of recovery of above-market purchase power costs for that period.

Detroit Edison argues that purchase power costs will get smaller after 2007 may cross over and even be below the market clearing price sometime around or about 2008. That may or may not be true, but that is not the issue. MIPPA, argues that now is the appropriate time to state how the MPSC will provide for recovery if purchase power costs do not cross-over. Otherwise, by ignoring the possibility that a cross-over may not take place until years later as had been forecast in prior proceedings, the Commission leaves itself with no options and QFs ultimately at risk. This is the same risk this Commission has already found to exist in costs associated with Detroit Edison's Fermi II plant in Case U-11726. If it does not identify a method of recovery for this possibility, the Commission will be defeating one of its'premises that all customer should pay their fair share and is defeating the basis for which it granted both Consumers Energy and Detroit Edison their stranded cost concessions. By not identifying a method of recovery for this possibility, the Commission will also place a cloud over PPAs and decrease the value of the assets that are tied to the revenue generated under theses PPAs.

The Commission will be encumbering MIPPA's contracts by its' inaction. Such an encumbering results in a confiscation of property without just compensation, exactly the opposite of what PURPA and Act 81 were designed to encourage. Detroit Edison's position on this issue is self-serving. It isn't Detroit Edison's revenue stream that is being impaired. When its' own revenue stream is threatened then its viewpoint changes dramatically. MIPPA submits this Commission should stop side stepping this issue and do what is fair and just.

MIPPA RESPONDS TO CONSUMERS ENERGY

Consumers Energy in their Initial Brief (at pages 27-28) also state how it treats and proposes to treat MCV purchase power contracts. Detroit Edison states:

> **Exhibit ACE-21** shows how this calculation would be performed.
>
> Mr. Ernst explained that, in light of the Commission's orders in Cases U-l 1180R and U-l 1941, the aspect of the true-up mechanism shown in Exhibit ACE-21 would apply only to nuclear plant and regulatory assets. 4 Tr 433,436. This is because, in those orders, the Commission adopted a different true-up mechanism for the MCV PPA capacity costs. Beginning with the true-yp conducted for 2002, the revenues collected from full service (bundled) customers via a separate per kWh rate for MCV PPA capacity costs will be determined, and then compared against actual MCV PPA capacity costs. To the extent the

revenues collected from bundled service customers exceed the actual costs, the difference will be treated as a decrease in stranded costs; if the bundled service customer revenues are less than actual costs, the difference will be an increase in stranded costs.[3] 4 Tr 436-437. **Exhibit ACE-22** illustrates the mechanics of this aspect of the true-up mechanism.

Exhibit ACE-23 provides an example of how the true-up mechanism will adjust for variations in the actual market clearing price from the estimated market price used in the original $1.755 billion stranded cost calculation. This operates as the Commission described it in the January 14, 1998 U-l 1290 et al Order; i.e., "the product of(i) open access load and (ii) the difference between original estimated market clearing price and the actual market clearing price." 4 Tr 438. Mr. Ernst explained that, while this type of adjustment is, in theory, appropriate, 4 Tr 438, it is critical that the actual market clearing price be determined in a manner which reflects what Consumers Energy can actually realize from the sale of the displaced power into the marketplace. 4 Tr 439. For example, using a retail market price has numerous problems: (1) it would imply that all of the displaced power could be sold into the retail market, an assumption that is wholly unrealistic; (2) retail power transactions may include products or services other than electric capacity and energy that are not separately identified and priced, making it difficult, if not impossible, to identify the price for the power; (3) promotional practices followed by retail marketers (e.g., "free" first month supply) will make reliance upon retail prices problematic; (4) using retail prices would require access to the pricing details of hundreds or thousands of retail transactions, with associated administrative problems. In light of these problems, the average wholesale price should be the basis for determining market price for true-up purposes. 4 Tr 439.

[3] The cost of purchases made to serve incremental bundled service load, calculated at market prices, must also be factored into this calculation. See 4 Tr 437.[4]

MIPPA agrees with Consumers Energy when it suggests that using retail market prices as a template for market clearing prices has problems. In fact, MIPPA witness Mr. Johns along with various other witnesses, presented evidence that it will prove difficult, cumbersome and inaccurate. MIPPA does not support using the average ***wholesale price*** as a market clearing price determinant as proposed by Consumers Energy. MIPPA suggests that known indices for ascertaining market clearing price such as NYMEX or some other index is the only practical yet objective means available to track changes in the value of wholesale power.

MIPPA RESPONDS TO ENERGY MICHIGAN

MIPPA points to Energy Michigan's argument to show the difficulty in calculating market clearing price for the very reasons discussed in Energy Michigan's brief. Energy Michigan states in it's Initial Brief at Page 23:

> ii. The assumed market value of capacity from Power Purchase Agreements is understated in Exhibit A-CE-20.
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> Mr. Ernst's Exhibit A-CE-20 assumes that the total capacity costs of Power Purchase Agreements (stated on lines 53 of A-CE-20) are offset by an assumed market value of .9 ¢ /kWh times generation output of roughly 8.6-9.4 million Mwh of output each year.
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> 1) The output of PPA capacity is understated or the value of PPA QF capacity which is economically dispatched is understated.
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> Exhibit I-32 contains the work papers of Mr. Ernst related to QF output. ***Brief Exhibit*** 5 ***a-d.)*** Exhibit I-32, page 1 is Mr. Ernst's work paper WP-2C which shows that QF output during 1997 was approximately 13 million Mwh with the MCV producing about 10 million of these Mwh. 4 *T* 448. Total average cost of the output was about $57.34 / Mwh for the MCV and the capacity portion was about $40.00/Mwh subtracting variable cost from total costs. I-32, *p. 1.*
>
> Mr. Ernst admitted that in A-CE-20, he projected reduced output for the MCV in 1999-2007 of between 8.6 and 9.4 million Mwh per year. He also admitted that his Exhibit A-CE-20 was based on economic dispatch, not maximum output. 4 *T* 449. MCV output during 1997 was based on capacity factor of 99%. Output in Mr. Ernst's A-CE-20 assumptions of roughly 60% dispatch produces a Power Purchase Agreement capacity only cost of roughly $55-56/Mwh. MCV capacity in 1997 at 99% capacity factor was about $40 /Mwh total cost minus variable cost (see Brief Exhibit 5a).
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> This differential in the cost of capacity between 60% dispatch and almost 100% dispatch is almost completely explained by the fact that the total obligation to pay for MCV capacity under a year around contract does not vary markedly regardless of the Mwh dispatched since 100% of the capacity is always assumed to be available to and paid by the purchaser. Rather, it is the amount of energy that is taken which varies and causes the price per Mwh to vary because the same total capacity payment is spread over fewer Mwh. Consumers is, however, still required to pay for all MCV capacity on a year around basis since the QF project exclusively is dedicated to the need of Consumers.
>
> In essence, Mr. Ernst's exhibit asks us to assume that the market value of MCV capacity per Mwh from a partially dispatched MCV Power Purchase Agreement will be offered to market customers for only 60% of the year at the same price per Mwh as if the customer had been required to take the capacity 100% of the year. This is complete nonsense as demonstrated by the disparity in the capacity cost per Mwh between the actual 1997 output at 99% load and Mr. Ernst's assumptions for 19982007 at 60% load .
>
> As is shown in Exhibit 6 to this Brief, Mr. Ernst's Exhibit A-CE-20 should be revised by assuming output of at least 13 million Mwh of Power Purchases as was taken in

1997 times a value of .9 ¢ /Mwh or the .9 ¢/kWh assumed market rate should be increased to 1.5 ¢ per unit of economic dispatched output by dividing .9 ¢ by .6 to spread the total cost of capacity at 100% over only 60% levels assumed by Mr. Ernst. The impact of this adjustment is to produce an extra $40 million per year of income and reduce calculated stranded cost by .08 ¢ /kWh as shown in Exhibit 6 of this Brief. Total QF stranded costs as of 1998 are reduced from the $1.883 billion claimed by Mr. Ernst on line 65 of A-CE-20 to $1.754 billion. *See line 6.5 **of** Brief Exhibit 6 attached.*

2) Mr. Ernst also failed to assume that the value of Power Purchase Agreement capacity would escalate each year (see line 82, Exhibit A-CE-20) even though he concedes that the total price of energy and capacity would increase at the rate of over 3% (see line 80).

Witness Ernst admitted that if the capacity costs in his Exhibit A-CE-20 were escalated, stranded costs would be lower. 4 *T* 455. Mr. Ernst also admitted that all the escalation in his exhibit was applied to energy and not capacity. 4 *T 456.*

Mr. Ernst's treatment of this subject has the effect of depriving open access customers of an increasing value of marketed excess PPA capacity as a mitigation to stranded cost. If PPA capacity is assumed to escalate at the same 3% rate as used for capacity and energy, calculated transition charges are reduced by almost .04 ¢ /kWh or about $65 million net present value in 1998. *See Brief Exhibit 7 attached, lines 82 and* 71. The combined effect of these two adjustments is to reduce claimed stranded costs in 1998 from a net present value of $1.877 billion claimed by Mr. Ernst to $1.656 billion and transition charges are reduced from 1.2 ¢ to 1.06 ¢ . *See Brief Exhibit 8, line 65.*

For these reasons the MIPPA continues to recommend that the Commission utilize an objective measure of market price as found in known indices. The various controversies described above by Energy Michigan relate to just one transaction between Consumers and MCV. The Commission should consider how it will sort out dozens, if not hundreds, of such controversies in arriving at an average of wholesale transactions.

MIPPA RESPONDS TO THE ATTORNEY GENERAL

MIPPA agrees with the Attorney General when he categorizes "Any above-market PPA costs are contingent liabilities for each year." But so are virtually all other stranded costs in one form or another. The Attorney General has confused the fundamental issue by raising a question in which there is no basis in fact.

In the Attorney General's Initial Brief at page 48, she states:

K. Stranded Cost Recovery for Purchase Power Contracts vs. Plants

Mr. Johns testified on behalf of MIPPA that the true-up proposals in this case do not address purchased power agreement (PPA) prices above market prices after 2007, and Mr. Johns said that the MPSC should treat PPA prices the same way the MPSC has treated Fermi 2 (4 T 547). Mr. Johns analogy misses the point. The costs for Fermi 2 which have been treated as stranded costs are fixed costs already in rate base. Any above-market PPA costs are contingent liabilities for each year. If the qualifying facility fails to deliver the required capacity and energy in any given year, then the utility incurs no above-market cost. (Emphasis added)

On the other hand, if a qualifying facility does deliver the required capacity and energy in future years, then under PURPA CECo or DECo must take it and must pay the avoided cost determined under the applicable statutes and regulations, and if that happens, the utility will recover the mandated cost via its PSCR clause or base rates. PURPA costs will not be stranded after 2007.

Furthermore, they may not exceed market prices by then. In other words, there is no current basis for including such stranded costs in the true-up process.

The AG argues the contingency is that QFs may not perform. However the probability of that contingency occurring, i.e. that QFs will perform, is extremely high. More importantly, there is absolutely nothing to suggest otherwise on this record.

Furthermore, QFs cannot generate revenue to cover fixed and variable costs if they do not perform. There is no stronger incentive to keep performing in existence. MIPPA argues that these "contingent liabilities" should be calculated and provision for recovery established either over the transition period or the life of the contract in question. In U- 111 SO-R, Consumers' 97-PSCR Reconciliation, the Commission stated:

> In calculating the levelized base rate adjustment, the Commission must first decide whether to include capacity payments for the period 2002-2007. Consumers argues that it is necessary to do so in order to have the adjustment match the computation of stranded costs charged to customers leaving its system for retail open access. The MCAAA argues that Consumers is seeking to charge for speculative cost allowances and thereby avoid the notice and hearing requirements for a rate increase. The Attorney General concedes that future capacity rates are known, but contends that the calculation of total capacity charges requires the use of projections, such as projected plant outputs. (Emphasis added)
>
> The Commission agrees with Consumers that it is desirable to perform the calculation of the levelized base rate adjustment in a manner that best matches the computation of stranded costs. The Commission has established a true-up process for stranded costs. The "purpose underlying this true-up calculation is to ensure that Consumers' revenues and costs are accurately measured and that no over- or under

recovery occurs." Order dated August 3 1, 1999, Case No. U- 1194 1. Consumers' proposal to match the calculation of the levelized base rate adjustment with the stranded cost calculation is consistent with that objective and will avoid the potential over- or under recovery of costs that would be associated with a mismatch. The Attorney General is undoubtedlv correct that the calculation of total capacity charges involves the use of proiections, but that only leads to the conclusion that the proiections should be reasonable, not that the calculation should not be done.. . . (Order dated August 3 1, 1999, U-l 1180-R, page 23)

It is quite obvious that it is the AG that is missing the point. Any basis this Commission has for excluding PPA payments from stranded costs lies in whether market clearing prices will exceed payment obligations. This has nothing to do with whether QFs will meet their obligations.

MIPPA RESPONDS TO THE MPSC STAFF

MPSC Staff offers its recommendation relating to market clearing price discovery in their Initial Brief at page 15-l 6. The Staff states as follows:

> First, for future true-up cases Staff recommends that the Commission obtain from competitive power marketers ample, detailed data on their sales and billing determinants. The power supply agreements on file with the Commission can be used to show the prices customers will pay for their service, but they need to be matched up with actual billing determinants in order to accurately determine market price. Staff understands there will be concerns regarding confidentiality of competitively sensitive information, but firmly believes that aggregated data can be made public.
>
> Second, Staff recommends that the Commission continue to monitor the various indexes consulted by Mr. Carlson.. . .
>
> Third, Staff believes that the appropriate reference point for the Market Price of Power needs to be established as the full price of all generation services delivered to a representative mix of Michigan retail open access customers.. . .

MIPPA agrees that a laudable target and clear objective for this Commission should be for the Market Price of Power to be based upon the full price of all generation services delivered to a representative mix of Michigan retail open access customers as the appropriate reference point. MIPPA also agrees that a weighted average from a blend of indices might represent a reasonable means to derive such an estimate. However, Staff's recommendations do not work. Staffs weighted approach is severely flawed. Staffs proposed use of booked sales, Cinergy and NYMEX prices and a simple arithmetic weighting does not recognize that those measures relate to on peak sales. Use of on-peak price indices in this manner to derive an average will significantly over-state any levelized value. Nor is it practical or even feasible for this Commission to obtain and analyze detailed data from competitive power marketers on their sales and billing determinants in a timely let alone coherent and uniform manner as part of the process to develop a relatively weighted index. Again, the Staff is suggesting the Commission sort a huge number of apples and oranges and then specify exactly what is the correct recipe for making its version of fruit salad even if it could get the data.

MIPPA submits that it's suggested alternative market price estimators as proposed by MIPPA witness Mr. Johns, provides a far better means to measure and track changes in market value. Such indicators are more closely attuned to the market activity than the Commission is attempting to reassure than presented by Staff or other parties in this proceeding. (4 Trans at 559).

RELIEF REQUESTED

MIPPA respectfully requests the Commission to grant the Relief Requested in our Initial Brief and as clarified in this Reply-Brief.

Respectfully submitted,
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