

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)	
CONSUMERS ENERGY COMPANY for)	Case No. U-13720
determination of net stranded costs for the year 2002)	
and for approval of net stranded cost recovery charges.))	
_____)	

In the matter of the application of)	
CONSUMERS ENERGY COMPANY for)	Case No. U-14098
determination of net stranded costs for the year 2003)	
and for approval of net stranded cost recovery charges.))	
_____)	

At the November 23, 2004 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. J. Peter Lark, Chair
Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

OPINION AND ORDER

On March 4, 2003, Consumers Energy Company (Consumers) filed an application for determination and approval of its 2002 net stranded costs, the processing of which was delayed for seven months due to ongoing negotiations on behalf of the Commission, the Staff, Consumers, and other interested parties aimed at a collaborative solution to various stranded cost issues. After the collaborative process proved unsuccessful, on January 6, 2004, Administrative Law Judge Barbara A. Stump (ALJ) conducted a prehearing conference where she granted intervener status to the Association of Businesses Advocating Tariff Equity (ABATE), Cadillac Renewable Energy, L.L.C., Genesee Power Station Limited Partnership, Grayling Generating Station Limited

Partnership, Hillman Power Company, L.L.C., Viking Energy of Lincoln, Inc., Viking Energy of McBain, Inc., Dow Corning Corporation, Hemlock Semiconductor Corporation, Michigan Power Limited Partnership, Ada Cogeneration Limited Partnership (Ada), Enbridge Energy, Limited Partnership, MidAmerica Energy Company, National Energy Marketers Association, Constellation NewEnergy, Inc. (CNE), Midland Cogeneration Venture Limited Partnership (MCV), Energy Michigan, The Kroger Co., and Attorney General Michael A. Cox (Attorney General). The Commission Staff (Staff) also participated in this proceeding. The record consists of 324 pages of transcript and 20 exhibits that were admitted into evidence.

The stranded cost methodology compares the revenue requirement for the fixed generation costs of the utility with the recovery available through revenues actually collected. See, December 20, 2001 order in Case No. U-12639. In general, the Commission must determine if the utility collected enough revenues to cover its fixed generation costs. If not, it has stranded costs for that year. For 2002, Consumers used this methodology to calculate its stranded costs at \$37,965,000. The Staff and Energy Michigan presented their own calculations and came up with \$10,468,000 and \$24,000,000, respectively. The parties disagree on whether certain costs and discounts should be included in the calculation of Consumers' stranded costs.

Issues

1. Clean Air Act Compliance Costs

Consumers wanted to include Clear Air Act compliance costs (CAA costs) in the event that its efforts to securitize these costs failed.¹ Consumers argued that if CAA costs are not recovered in any other way, they are no different from other generation-related costs.

¹In an order issued on October 14, 2004 in Case No. U-13715, the Commission rejected Consumers' application for authority to securitize its CAA costs.

Energy Michigan, the Staff, ABATE, and the Attorney General do not want these costs included in the calculation of Consumers' stranded costs. The Attorney General asserted that the costs cannot be stranded because they were incurred after electric restructuring. Energy Michigan pointed out that the Commission already decided that CAA costs are not stranded costs.

The ALJ cited the Commission's December 20, 2002 order in Case No. U-13380, holding that CAA costs are not eligible for stranded cost recovery; therefore, they should be excluded from the calculation in this proceeding. Proposal for Decision (PFD) p. 5-6.

2. Post 2000 Capital Costs

Consumers proposed to include all generating plant capital costs through 2002. Consumers insisted that there is no evidence to support a claim that the costs were imprudent. Consumers argued that the new methodology requires consideration of all production plant investment in a revenue requirement calculation that is conducted on an annual basis.

The Staff agreed that all generating plant capital costs through 2002 should be included. The Staff stated that the methodology from Case No. U-12639 requires that each year's stranded cost calculation be performed using actual production fixed costs incurred during that year.

Energy Michigan, ABATE, and the Attorney General argued that because the Act 141 rate freeze prevents recovery of these generation costs, they are not stranded. Energy Michigan insisted that Consumers cannot recover costs from retail open access (ROA) customers that exceed the amounts recovered from retail customers in the 2002 frozen rates. Indeed, Energy Michigan stated that Consumers may only recover costs that would have been recovered under regulation but cannot be recovered under competition.

The Attorney General contended that the proper calculation should be comparing fixed costs with market prices, not calculating the revenue deficiency.

The ALJ determined that this old methodology was rejected and replaced with a new methodology in Case No. U-12639.² The ALJ found that the Commission should only include year 2000 costs in the calculation. The ALJ stated that the use of frozen year 2000 costs, with year 2002 revenues, is a mismatch that is not consistent with the current methodology. The ALJ concluded that post-2000 investments should be included in the calculation.

3. Costs to Purchase Power

Consumers and the Staff argued that the power purchases from external generating sources should be included in the calculation. Consumers asserted that even if a cost was not included in its frozen rates, it could still be included in the stranded cost methodology. Indeed, Consumers argued that the fact that a cost was not included in frozen rates cannot disqualify it from inclusion in the calculation because that would render Case No. U-12639's methodology meaningless. Consumers insisted that the Commission has already approved the costs, and they should be included in the calculation. The Staff agreed that it is only fair to compare current revenue to current production costs.

MCV, Ada, and MPLP argued that state and federal law require that the Commission allow full recovery of payments made to qualifying facilities (QFs). MCV argued that the Act 141 rate freeze is over, and the Commission can now approve recovery of QF charges. In fact, MCV stated that Act 141 established that the rights of the QFs to have charges recovered from Consumers' customers could not be "abrogated, increased, or diminished" by Act 141. MCV insisted that the

²The formula is "costs that would have been recovered under regulation that cannot be recovered under competition, offset by mitigation (such as market sales of capacity and energy that are freed up when customers choose alternative suppliers) and stranded benefits (such as generation assets with below-market costs)." December 20, 2001 order in Case No. U-12639, p. 10.

Commission explicitly stated in Case No. U-11180-R that Consumers could recover 2002 through 2007 capacity cost escalations for the MCV beginning in 2002.

Energy Michigan and ABATE argued that these costs should be excluded because they are not included in Consumers' 2002 frozen power supply cost recovery (PSCR) factor. Energy Michigan insisted that even though the Commission authorized Consumers to recover cost increases as ROA reached 150 megawatts of capacity, Act 141 froze all rates until December 31, 2003. Energy Michigan went on to say that Consumers cannot break Act 141's rate freeze by collecting purchased power costs from ROA customers when those costs cannot be legally collected from its retail customers. Energy Michigan argued that because Act 141 provides certain exceptions to the rate freeze, and increased QF costs are not mentioned, the collection of these costs from ROA customers is prohibited. Moreover, Energy Michigan stated that a growth in expenditures that has exceeded depreciation could be recovered from all customers by filing under Section 10d(4) of Act 141. Energy Michigan reasoned that if Consumers followed Section 10d(4) to increase retail rates, and some increases were not recovered from retail customers, only then should they be treated as stranded costs. The Attorney General agreed that Act 141 prevents recovery of these costs. The Attorney General cited the September 21, 2004 order in Case No. U-13935, where the Commission denied The Detroit Edison Company's request to recover blackout expenses that were incurred during the rate freeze.

The ALJ concluded that purchased power should be included in the analysis. She reasoned that the Commission already approved cost recovery for the QF purchases for 2002 and beyond. Because the Commission compares current revenue to current fixed costs, the ALJ concluded that the cost to purchase power should be included.

4. Special Contract Discounts

The Staff, CNE, Energy Michigan, ABATE, and the Attorney General argued that certain imputed revenues should be included in the stranded cost calculation. They want to include the difference between revenues collected from special contract customers and the revenues that would have been collected if these customers had paid standard tariff rates. Energy Michigan stressed that Consumers never introduced a full cost-of-service study demonstrating that special contract rates are enough to pay special contract service costs. Also, ABATE argued that permitting Consumers to offer special contract discounts and pass them on to ROA customers would impede competition. The Staff and ABATE contended that unless there is a compelling showing otherwise, the responsibility for any special contract deficiency should be assigned to the utility.

Consumers asserted that it has made a compelling showing that the amount of the special contract discounts should be recoverable as a stranded cost and should not be offset by imputed revenues. Consumers contended that the special contract prices are a resetting of rates to more closely reflect the actual cost of providing service to special contract customers. Consumers stated that if these customers switch to another provider, Consumers' revenues would decrease, and its stranded costs would increase. Further, Consumers stated that the additional revenue of over \$42 million is more than the discounts of almost \$20 million. Consumers maintained that the Commission has two criteria to evaluate whether revenue imputation is appropriate: (1) whether the contract terms are justified based on the cost of service; and (2) whether the benefits to other customers outweigh the costs that are not recovered from special contract customers. Consumers contended that both questions should be answered in the affirmative.

The ALJ pointed out that in dozens of proceedings, the Commission has required Consumers to report special contract revenues, as if they were billed at retail rates, when calculating money available for production costs. According to the ALJ, in order to reallocate the responsibility for the special contract discounts to ratepayers, Consumers had to show by clear and convincing evidence that:

- (1) the contract prices and terms are justified on the basis of cost of service, or
- (2) the benefits for other (non-participating) ratepayers are substantial and have a value that outweighs the costs that are not recovered from the contract customers.

March 23, 1995 order in Case No. U-10646, p. 21.

The ALJ found that Consumers has not met its burden. The ALJ decided that Consumers should have presented a cost-of-service study as required by the Commission. Therefore, the ALJ found that imputed revenues from special contract discounts should be included in the stranded cost calculation.

5. Options

Consumers argued for inclusion of the costs of short-term and long-term option purchases within the stranded cost calculation. Consumers stated that in order to provide reliable service to all customers, it commits to purchase options long before they are needed, and cannot just dissolve the options if requirements decline. Consumers argued that short- and long-term power purchase costs cannot be avoided unless it drops its reserve to unacceptably low levels. Consumers stated that to save money, even short-term contracts are negotiated and committed to years in advance. Consumers argued that short-term contracts avoid long-term commitments, and if short-term contracts are discouraged, power will not be acquired at all, or will be replaced with more rigid long-term contracts. Consumers contended that neither result is desirable. Finally, Consumers

maintained that the ALJ excluded the costs associated with single year purchases from the stranded costs calculation but left in the revenues from the sales of those contracts to third parties. Consumers asserts that costs and revenues from power purchase agreements should either both be excluded or both be included.

The Staff argued that long-term options are similar to fixed production costs and cannot be avoided when customers leave for choice. However, the Staff stated that short-term options (less than one year) should not be included because Consumers can avoid the purchase of an option when customers leave.

Energy Michigan, ABATE, and the Attorney General argued that, because the Commission has not approved recovery of these costs from retail customers, and due to Act 141's rate freeze, these costs should not be included. ABATE contended that these costs are avoidable because they are made seasonally. ABATE also asserted that these costs only benefit bundled sales customers.

ABATE argued that short-term options should be purchased at market prices; therefore, those market priced purchases would not translate into stranded costs. Further, Energy Michigan stated that any unused options can be sold in the marketplace. Energy Michigan also noted that even though the ALJ found that short-term options should not be included, she did not remove short-term transmission costs and management costs from her calculations. Energy Michigan contended that if options are removed from the stranded cost calculation, the transmission costs associated with them should be removed as well.

The ALJ found that short-term options can be avoided and, therefore, they should not be included in the calculation. Additionally, the ALJ found that long-term contracts could not be avoided when customers leave, so they should be included in the calculation. The ALJ also found that market price is no longer relevant in the stranded cost methodology.

6. Securitization Savings

In Case No. U-12505, the Commission ordered that securitization savings are first applied to offset the 5% residential rate reduction required by Act 141. The Commission ordered that half of any savings left after the 5% reduction (excess savings) shall be used to reduce the transition charge paid by ROA customers.

Consumers stated that ROA customers received \$3,160,000 of excess savings in 2002. Consumers believed that the actual amount they should have been credited was \$2,356,000. Therefore, Consumers contended that ROA customers have received more than their share of savings in 2002. Consumers sought a clarification from the Commission on how to make sure that ROA customers receive no more than the savings they are entitled to under MCL 460.10d(6).

The Staff recommended that ROA customers continue to get an offset, and that Consumers file a yearly accounting of the amount of excess savings available, and the amount allocated to ROA customers. The Staff concluded that the offset should be adjusted on an annual basis to reflect actual savings.

Energy Michigan insisted that Consumers is still required to provide ROA customers with an offset equal to 50% of excess savings. Energy Michigan proposed that the Commission calculate the offset by estimating the amount available in 2004 and 2005 and dividing it by the estimated 2004-2005 ROA load. Further, Energy Michigan stated that a true-up will be necessary to reconcile the credits.

The Attorney General recommended using a specific total and specific credit per megawatt-hour, and reminded the Commission that MCL 460.10d(6) does not require that exactly half of the savings go to reduce stranded costs.

ABATE stated that if the Commission ends the offset, it would decrease competition in Michigan.

The ALJ accepted the Staff's proposal to adjust the offset on an annual basis. The ALJ found that:

Consumers should be permitted to lower the offset to an amount that permits the excess savings to be fully used on an annual basis and based on the forecasted choice sales level. The Commission should require Consumers to provide an accounting of the amount used, annually, to verify the remaining balance of any excess savings allocated to choice customers.

PFD, p. 29.

7. Alternative Methodology

CNE proposed that the Commission change its stranded cost methodology to an approach based on the lost revenues approach used in Illinois.

Consumers argued that the Commission explicitly rejected the Case No. U-11290 methodology in Case No. U-12639.

Energy Michigan argued that the Illinois method is extremely complex and would produce excess transition charges.

ABATE agreed that the Illinois method is too complex and would cause confusion and uncertainty.

Alternatively, the Attorney General argued that the definition of stranded costs in Case No. U-11290 is still valid and was not rescinded by Case No. U-12639. Further, the Attorney General stated that adopting the approach used in Case No. U-12639 would nullify the definition of stranded costs codified by MCL 460.10a(5). Also, citing MCL 460.10a(5), the Attorney General insisted that stranded costs must be prudently incurred.

The ALJ rejected CNE's recommendation to adopt the Illinois approach and found that "the adoption of any alternative approach would require far more study, investigation, and discussion than was presented in this case." PFD, p. 31. The ALJ found that the methodology from Case No. U-12639 should be applied in this proceeding and that changing the method after three years would create confusion and uncertainty.

Discussion

The Commission finds that the PFD is well reasoned and should be accepted.

In the December 20, 2001 order in Case No. U-12639, the Commission used a current revenue requirements approach to stranded costs. To apply this calculation, post-2000 investments and costs to purchase power from QFs were to be included to properly match current revenues to current costs.

The Commission accepts the ALJ's and the Staff's recommendations that it include imputed sales revenue from special contract discounts. The Commission requires a "compelling showing" before any special contract deficiency is assigned to other customers. Consumers simply has not made this showing. These special contract discounts are \$19,868,677. This results in an increase of total revenue from sales from \$2,411,253,000 to \$2,431,121,000.

The Commission agrees with the Staff, ABATE, Energy Michigan, and the ALJ that short-term options are avoidable, within the control of Consumers, and are not stranded costs. Long-term options are similar to production costs because they are a fixed obligation on the company and cannot easily be avoided. Therefore, short-term options should be excluded and long-term options should be included.

The Commission finds that CAA costs are not eligible for stranded cost recovery; therefore, they should be excluded from the calculation in this proceeding. See, July 10, 2002 order in Case No. U-13380.

Consumers argues that an adjustment for seasonal capacity costs requires a countervailing adjustment to back out the revenues from related third-party sales. Consumers' exceptions, p. 9. This argument is unsupported because Consumers does not explain how, on this record, it would quantify such an adjustment.

In applying securitization savings, Consumers should change the offset to an amount that permits the excess savings to be fully used on an annual basis based on the forecasted choice sales level. The Commission accepts the ALJ's recommendation that a credit be applied to each rate class energy charge. Further, a true-up will be necessary to reconcile the credits.

The Commission rejects the suggestion to adopt the Illinois approach, which is currently being reevaluated in Illinois. The methodology from Case No. U-12639 should continue to be applied in calculating stranded costs. It has been used for two complete stranded cost filings and many of the issues with the method have already been raised and considered. The methodology is not in conflict with the rate freeze provisions of Act 141, as argued by the Attorney General, ABATE, and Energy Michigan. Such arguments ignore the fact that the Commission has approved stranded cost charges during the rate freeze period (e.g., Case No. U-13808), a result clearly anticipated by the Legislature. See, MCL 460.10a(1).

In applying the foregoing methodology, the Commission finds that Consumers incurred stranded costs of \$10,448,000 in 2002.³ With interest accrued at 7% through November 30, 2004, the total amount of 2002 stranded costs is \$12,310,844.

After the filing of exceptions and replies to exceptions in Case No. U-13720, Consumers' application for a determination of its 2003 stranded costs in Case No. U-14098 also became ripe for decision. In Case No. U-14098, the Commission had agreed to read the record, thus truncating somewhat the schedule. A review of the record in Case No. U-14098 indicates that both cases present nearly identical issues, so that the determinations in Case No. U-13720 will be outcome-determinative for 2003 as well. In the interest of administrative efficiency, the Commission has determined to adjudicate both cases in this order and consolidate the relief being granted to Consumers.

Applying the same methodology to compute 2003 stranded costs produces a finding that Consumers incurred stranded costs of \$46,225,000 in 2003.⁴ With interest accrued at 7% through November 30, 2004, the total amount of 2003 stranded costs is \$50,903,520.

The combined stranded costs for 2002 and 2003 of \$63,214,364 should be collected through a stranded cost charge of 1.2 mills per kilowatt-hour (kWh). In setting this stranded cost charge, the Commission considered retail open access forecasted volumes set forth in the five-year forecast

³The \$93,000 discrepancy with the amount shown on line 23 of Exhibit S-13 is due to a correction made by Consumers to line 9 of Exhibit A-10, as carried over to the stranded cost computation in Exhibit A-4.

⁴Inclusive of a last-minute correction made by Consumers on Exhibit A-17, which carried over to Consumers' stranded costs computation on Exhibit A-1. Consumers' brief, p. 4, n. 3. The amount computed by the Staff on Exhibit S-21 is \$594,000 less than the amount of stranded costs determined in this order.

presented by Consumers in its 2005 PSCR proceeding in Case No. U-14274.⁵ This stranded cost charge should be applied until Consumers 2002 and 2003 stranded costs plus interest at 7% are fully collected. The Commission is not persuaded by ABATE's suggestion that stranded cost recovery should be effected through class-specific surcharges, with charges billed on the basis of demand for those classes with a demand billing determinant. The record does not demonstrate that the complexity of adopting ABATE's proposed rate design is justified for recovery of stranded costs.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 et seq.
- b. Consumers should be authorized to collect its 2002 and 2003 stranded costs of \$63,214,364, plus interest through the surcharge period, through use of a stranded cost recovery charge of 1.2 mills per kWh until they are fully collected.
- c. Consumers should file a reconciliation of the surcharge within 30 days of the end of the recovery period.

THEREFORE, IT IS ORDERED that:

- A. Consumers Energy Company is authorized to collect its 2002 and 2003 stranded costs of \$63,214,364, plus interest through the recovery period, through use of a stranded cost recovery

⁵Consumers' projected choice volumes for 2005 (6,637,000 kWh), 2006 (10,404,000 kWh), 2007 (11,238,000 kWh), 2008 (11,788,000 kWh), and 2009 (12,201,000 kWh).

charge of 1.2 mills per kilowatt-hour commencing with the company's next billing period and running until the 2002 and 2003 stranded costs are fully collected.

B. Consumers Energy Company shall file a reconciliation of the surcharge within 30 days of the end of the recovery period. Consumers shall refund any over-collection to customers with interest.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ J. Peter Lark
Chair

(S E A L)

/s/ Robert B. Nelson
Commissioner

/s/ Laura Chappelle
Commissioner

By its action of November 23, 2004.

/s/ Mary Jo Kunkle
Its Executive Secretary

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MICHIGAN PUBLIC SERVICE COMMISSION

Chair

Commissioner

Commissioner

By its action of November 23, 2004.

Its Executive Secretary